**Ministry of Foreign Affairs - VBE**
F2 reference: 2017-443

**Meeting in the Council for Development Policy 28 March 2017**
**Agenda item 6**

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| **1. Overall purpose** | For discussion and recommendation to the Minister |
| **2. Title:** | The MFA's strategy for the Investment Fund for Developing Countries(IFU) |
| **3. Presentation for Programme Committee:** | 27 January 2017 |

# The MFA's strategy for the Investment Fund for Developing Countries(IFU)

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| **File No.** | 2017-443 | | | | | |
| **Country** | DAC countries | | | | | |
| **Responsible Unit** | VBE | | | | | |
| **Sector** | All sectors. | | | | | |
| | **2017** | **2018** | **2019** | **2020** | **2021** | Tot. |
| **Commitment** | 200 | | | | | |
| **Projected ann. Disb.** | 200 | | | | | |
| **Duration** | Ongoing | | | | | |
| **DK national budget account code** | §06.38.01 | | | | | |
| **Desk officer** | Niels Egerup | | | | | |
| **Financial officer** | Hans-Henrik Christensen | | | | | |

**Key SDGs for IFU: 1, 2, 7, 8, 9, 10, 12, 13 and 17**

| | | | | | |
|---|---|---|---|---|---|
| No Poverty | No Hunger | Good Health | Quality Education | Gender Equality | Clean Water, Sanitation |
| Clean Energy | Good Jobs, Economic Growth | Innovation, Infrastructure | Reduced Inequality | Sustainable Cities, Communities | Responsible Consumption |
| Protect Planet | Life below Water | Life on Land | Peace & Justice | Partnerships for Goals | |

| **Budget** | |
|---|---|
| **IFU** | |
| *Investment Capital* | *200* |
| **Programme Support** | **200** |
| **Total** | **200** |

## Key results:

- Investments that contribute to the realisation of the SDGs
- Creation of a large number of direct and indirect jobs
- Commitment of significant private capital to the SDG Fund
- Mobilisation of additional private capital by a factor 7
- Considerable annual tax contribution from investments
- Transfer of modern technology
- Compliance with international standards for responsible business conduct

## Justification for support.

- Mobilisation of private capital at scale is necessary to achieve the SDGs and an important part of the Danish strategy "The World 2030"
- IFU promotes public-private partnerships (PPP) that can mobilise significant private capital, knowhow and technology
- High effectiveness in capital mobilisation
- Significant development impact in terms employment generation, $CO_2$ reduction, food production, infrastructure availability, tax contribution etc.
- Application of international sustainability standards that will ensure high economic, social and environmental sustainability

## How will we ensure results and monitor progress

- IFU has a solid track record (50 years) on investment in developing countries in cooperation with Danish and international investors and companies.
- The MFA has established a structured and efficient monitoring of IFU
- IFU has a well-developed M&E system that ensures that the developments effects of the investments can be measured and reported in relation to the SDGs.

## Risk and challenges

- Investments in developing countries are associated with relatively high risks, not least for medium and long-term investments.
- IFU has a set of well-developed risk management procedures to minimise the overall risks.

| **Strat. objective(s)** | **Thematic Objectives** | **List of Engagement/Partners** |
|---|---|---|
| Contribute to the achievement of the SDGs in developing countries | Investment in key SDG sectors through mobilisation of private capital at scale. | – IFU<br>– Private institutional investors and companies |

MINISTRY OF FOREIGN AFFAIRS OF DENMARK

DANIDA | INTERNATIONAL DEVELOPMENT COOPERATION

# Strategy document

# The Ministry of Foreign Affairs' Strategy
## for
# The Investment Fund for Developing Countries (IFU)

## 2017-2021

**File no. : 2017-443** **Date: 14 March 2017**

# 1. Introduction

This document presents the Ministry of Foreign Affairs (MFA's) strategy for the Danish Investment Fund for Developing Countries (IFU). The strategy is aligned with Denmark's strategy for development policy and humanitarian action ("The World 2030"). Based on the strategy, it is recommended that the 2017 Finance Act allocation of DKK 200 million for general equity contribution to IFU be approved by the minister for development cooperation.

It has due to the existing monitoring structure for IFU been decided to waive a formal appraisal of the strategy. However, a "Peer Group" with relevant staff from various offices in MFA has contributed to the formulation of the final strategy document.

# 2. Context of IFU

## 2.1. Background

Private investments and expanding public-private cooperation in the form of blended finance are two of the most important ways the international community can support developing countries as they seek to generate the very large amount of domestic and foreign investment required to meet the SDGs by 2030. Trillions of dollars in public and private funds are to be directed towards the SDGs, creating huge opportunities for investors and companies.

Official development assistance (ODA) is crucial, especially in the poorest and most fragile countries. However, this is by far not enough to achieve the SDGs. There is a need to leverage ODA to bring in private investment and help countries mobilize domestic resources and attract private investments. Development finance institutions (DFIs) like IFU have a key role in the process.

DFIs that engage on commercial terms through investments can make a significant difference when it comes to mobilizing capital from the private sector. The DFIs provide "additionality" and they are "catalytic". They are additional in the sense that they invest in regions, sectors or segments that would not otherwise have had access to the required financial resources, technology and know-how – and DFIs bring sustainability and responsibility into the mindset of the private sector. This is their focus, their comparative advantage. They are catalytic by partnering with co-investors and enabling other private investors to follow in new areas that have proven to offer sustainable investment opportunities.

DFIs can also play a key role in addressing the market failure of lack of bankable projects in developing countries. There is capital available for investments in the developing countries, including from institutional investors. However, a sufficient pipeline of bankable projects is needed or the DFIs will lose the opportunity to bring in sufficient private sector capital from international and domestic sources. DFIs' can help improve the quality of projects through participatory processes with partners that de-risk projects and mature them to become bankable.

## 2.2. IFU's mandate and key experience

In 1967, the Danish government established IFU as a state-owned DFI with the purpose of promoting industrial development in developing countries by facilitating investments in these countries in cooperation with Danish companies and investors. The mandate and the scope for IFU's investments have been significantly broadened over the years, from a strictly tied fund in 1967 to an untied fund from 1 January 2017. See annex 1 for a description of IFU's activities.

IFU has over the years been an important executer of the private sector component in Denmark's strategy for development cooperation with demonstrated positive development impact and results for almost 50 years. Investments with IFU and IFU-managed funds have created an estimated 560,000 direct and indirect jobs, provided significant technology transfer, embedded leading sustainability practices and generated sizeable tax revenue locally. Furthermore, IFU and IFU-managed funds had at end of 2015:

- made over 1,200 investments with 800 Danish companies in more than 100 developing countries.
- invested close to DKK 18 billion in equity capital and loans, which in turn has generated investment projects totaling DKK 170 billion, corresponding to a leverage factor of 8-9.

IFU's historical strong ties to the Danish business community enable IFU to catalyse investments to developing countries in particular from Danish enterprises and institutional investors. The Danish business community, on the other hand, benefits from partnerships with IFU and other development finance institutions by becoming more international and able to operate in emerging markets.

See Annex 6 for Highlights. IFU was evaluated by the MFA in 2004. In 2006, Rigsrevisionen (The Office of the Auditor General) carried out a review of IFU. The climate fund (DCIF) was reviewed by MFA in 2015. It is planned to perform an evaluation of IFU in 2018.

## 3. Presentation of MFA's strategy for IFU

### 3.1. Objective and targets

The overall objective of MFA's strategy is that IFU shall promote investments that support sustainable development in developing countries and contribute to the realisation of the Sustainable Development Goals (SDGs). This objective supports Denmark's strategy for development policy and humanitarian action ("The World 2016"), which underline that IFU and its managed investment funds shall mobilize 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. the climate and environmental problems in difficult markets in the developing countries.

The investment projects of IFU are assessed and monitored in terms of both financial return and expected development outcomes, and the expected development outcomes is a key guiding principle for IFU's investment activities. IFU will contribute to the achievement of several of the SDGs through the implementation of substantial investments that would otherwise not take place or only at a much smaller scale and pace. The indicated outcomes of IFU, which are estimated on the basis of historic IFU records from a large number of investments, include: Total commitment of DKK 3 billion in private capital to the planned SDG Fund (see section 3.5), mobilization of private capital in portfolio investments by a factor 7 and the annual creation of about 16,000 direct jobs and an additional 16,000-32,000 indirect jobs.[1] Please refer to annex 2. IFU – Result framework. Furthermore, IFU's investments will contribute to reduction of greenhouse gas emission from sustainable energy investments, a considerable

[1] According to UN research, every direct job creates 1-2 additional jobs in for example local supply chains or service companies.

annual tax revenue (in 2015 companies in which IFU invested paid DKK 372 million in tax to the related tax authorities), transfer of modern technology and knowhow and compliance with international standards for responsible business conduct.

Responsible business conduct is an integrated condition of IFU's investments. IFU's contribution to sustainable development is carefully assessed, monitored and reported. IFU has adopted or is working to adopt a number of sustainability policies, procedures and standards including the UN Global Compact, the UN guiding principles for business and human rights (UNGP), and other relevant international standards for investments and business activities in developing countries. IFU reports work on sustainability as part of the financial annual report. IFU has a sustainability advisory board composed of external stakeholders within environment, human rights, development and company policies. IFU's focus on sustainability in investments covers all investments, both IFU Classic and through IFU managed investment funds.

Further details on the results framework, indicators, sustainability approach and IFU's Development Impact Model are provided in section 3.5 and in annex 2.

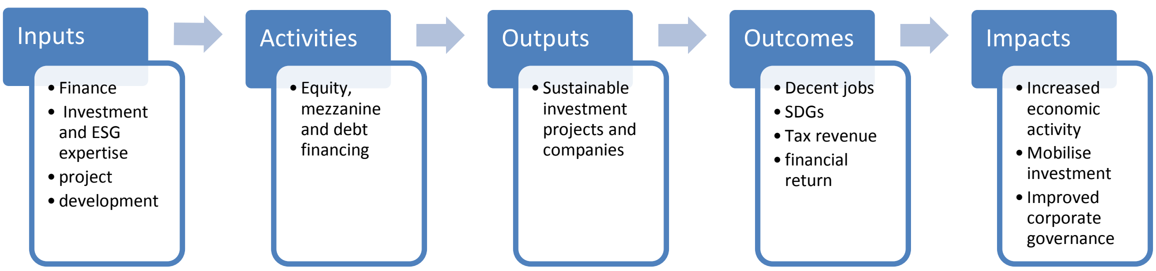
### 3.2 Theory of Change

IFU invests both directly and indirectly into companies in developing countries. When these investments are commercially and financially successful, this can:

- ensure the viability and the growth of companies, subsequently leading to direct creation of decent jobs, technology transfer and sustainable growth
- increase taxes paid by the companies (improving governments' ability to finance public services
- lead to sector specific outcomes (for example increased production of renewable energy or other goods underprovided by the market)
- have demonstration effects which lead to an increase in private investments in certain sectors
- lead to indirect outcomes, including the creation of indirect jobs in the supply chains of the project companies

IFU's main impact on the SDGs, including poverty reduction, will occur when recurrent capital investments are made in the developing countries and sustained at a high, long-term level. IFU's development impact comes from financially successful investments that grow sustainable companies, create decent employment, crowd in private investors and demonstrate to the market that investments in these countries and sectors can be commercially and financially viable. Therefore, IFU's financial return is an important feature in its investments.

**Diagram of Theory of Change**



### 3.3 Justification

*Relevance:* A massive increase in sustainable private sector investments is needed for developing countries to achieve the SDGs. DFIs can play a critical and bigger role in mobilisation of private capital, technology and knowhow for sustainable investments in SDG relevant sectors in developing countries. Therefore, IFU has a key role in promoting private sector led sustainable development in Denmark's new strategy "The World 2030" particularly with regards to the promotion of inclusive and sustainable growth (SDG 8).

IFU's activities are also in line with the development policies, needs and priorities of those countries that IFU is investing in, as most developing countries today have development of the private sector as a key agenda item.

*Efficiency:* The productivity of IFU's organisation (administration at head office, regional offices and operational investment teams) compares well with other DFIs. A restructuring of the organisation in 2015 has significantly enhanced IFU's efficiency and strategic focus. The increased size of IFU's activities, including fund management, has created organisational synergy and contributed to reduced transaction costs and thereby higher efficiency.

*Effectiveness:* The effectiveness of the IFU's investment activities is considered to be high as investments will mobilise considerable additional capital to the developing countries. Further the effectiveness is high in terms of achieving development impacts and financial returns.

*Impact:* IFU's investments will significantly contribute to the achievement of several of the SDGs. The most significant impacts are envisaged to include decent job creation, access to affordable and clean energy, reduction of greenhouse gas emission, food production, local tax contribution and promotion of responsible business conduct.

*Sustainability:* IFU has a strong focus on the sustainability of its investments. The application of sustainability standards, including UN Guiding Principles on Business and Human Rights (UNGP), as well as a number of other international sustainability standards during screening, design, implementation and management of investment projects is envisaged to ensure high social, environmental and financial sustainability.

### 3.4 Strategic considerations

*Rationale for selecting IFU as strategic partner:* In IFU, the MFA owns a DFI, which play a key role in the implementation of the "World 2030" strategy. IFU has a long and solid track record for investments in developing countries and is at the forefront of the international sustainability agenda. A <u>capital increase of DKK 200 million</u> will enable IFU to scale up its impact through mobilization of private sector finance and knowledge from Denmark and abroad invested in commercially viable SDG investments. IFU is thus MFA's principal mechanism for leveraging private sector capital for commercially sustainable investment projects in developing countries and emerging markets.

*Funding requirements*: It is estimated that the <u>funding of IFU's sustained growth to 2021</u> will require around DKK 1,000 million in additional capital (incl. the payment from IFU to the Danish State of an annual dividend of DKK 50 million) The financing could be funded by a combination of <u>capital contribution</u> from MFA and/or debt financing based on <u>state guarantees</u>.

*Capital contribution of the Danish state:* The capital invested by the Danish state should be considered as development capital assets that are envisaged to generate a return. IFU has been a profitable business for the Danish state: The state's aggregate capital infusion of DKK 3,607 million to IFU and IFU-managed funds have by the end of 2015 more than doubled in value to around DKK 8,358 million in the forms of accumulated dividends to the state of DKK 4,884 million and the remaining value of IFU's equity of DKK 3,474 million.

*Financial products, including a Development Bank-model:* The majority of IFU's capital is expected to be used for equity investments. Equity capital is strongly needed in most investment projects, and equity capital is fundamental for the mobilisation of additional capital, including loan capital, from other sources. However, there is also an increasing need for loans to finance infrastructure projects in developing countries. The Lake Turkana Wind-project in Kenya is one important example. It should therefore be considered to develop a Development Bank – model, which can strengthen IFUs role within development financing. The recent decision in principle to transfer the operative part of the Danida Business Finance (DBF) to IFU will be an important element in these considerations. IFU has decided to prioritize this area and will within the coming months establish a Vice President function for financial investments in the organisation, which should focus on developing a Development Bank model with focus on infrastructure loans.

*Project pipeline:* Access to a strong pipeline of bankable projects is fundamental for the success of the IFU. There is a general shortage of bankable investments in developing countries, and these challenges need to be addressed. IFU has generally been successful in maintaining a solid pipeline, but to accompany growth in investments, efforts will be made to strengthen internal project development capacity, strengthen cooperation with international and local project developers, and sharing lessons learned with other DFIs etc. The initial experience with the commercially based project development instrument, launched in the middle of 2016, is positive.

*Eligible investments:* IFU's mandate has become untied with effect from 1st January 2017. It is envisaged that also Danish investors and companies in general would benefit from the untied IFU mandate as it will open up for new international cooperation and investment opportunities. However, it is important that the untying of IFU is managed in a consequent manner and that potential risks relating to untying, e.g. in relation to social safeguards, are addressed. IFU will need to secure that its foreign partners have the same focus on sustainability issues as traditional Danish companies

*Eligible countries:* IFU can invest in countries that are registered on the OECD/DAC list of ODA recipients. However, at least 50% of IFU's investments must be made in countries with a GNI per capita below 80% of the upper limit of Lower Middle Income Countries (LMIC)[2] measured at a 3 year moving average. This means that 50% of the investments must be made in LMICs and the Least Developed Countries (LDCs).

*Leverage:* A key role for IFU is to mobilise private capital, technologies and knowhow. There is no clear defined target for the leverage factor which depends on the type of investments, country risks, commercial risk issues etc. However, the leverage factor will be measured, and it is expected to be around 7 based on IFU's historic observations.

*Additionality:* Additionality will be assessed in qualitative terms in order to ensure that the IFU generates SDG related investments and outcomes that would otherwise not have been achieved or achieved in a much less ambitious way, ref. section 3.5 and annex 2. The additionality

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[2] Countries with a GNI per capita of less than USD 3,300 (80% of the upper limit of LMIC

assessments will focus on[3]: a) financial additionality ensuring that public sector participation only is taking place when a market failure exists or an investment is too risky to obtain full financing from commercial investors; and b) value additionality which refers to the unique role of public sector stakeholders in e.g. improving the development impact of an investment by influencing the design, improving management performance through board participation, and/or through the incorporation of standards for responsible business conduct, environmental, social and governance sustainability etc.

*Investments with high impact: T*o achieve greater development impact, IFU will after establishment of the SDG fund still invest in investments that are less suitable for public-private partnerships. This includes investments in frontier markets contributing to sustainable growth, promote stability and prevent irregular migration. However, it should be recognized that the risks are higher in frontier markets, including unstable governments and policies, security risks etc..

*Strategic cooperation*: The potential for cooperation between IFU and MFA's departments for development and trade (i.e. Danida and Trade Council) at the head office-level and at the Danish Embassies – is not fully exploited. The cooperation will be strengthened with IFU employees at country level placed at Danish diplomatic missions. Furthermore, there will be increased focus on creating synergy between IFU's investment activity and MFA's development and export promotion activities.

*Organisational development*: It is required that all IFU's investments are based on a thorough due diligence-process, which also includes a comprehensive assessment of sustainability risks, environmental, social and governance risks, development impacts and risk mitigation measures related to the specific project. This requires that IFU has the right organisation in place in terms of capacity and competencies. It is important that IFU in line with its growth strategy make the necessary investment in institutional development and human resource development.

*Communication and results*: Several stakeholders have emphasized the need for IFU to strengthen its sustainability work, including the implementation of the UNGP in IFU's daily investment operations. Furthermore, there is call and request from stakeholders that IFU's openness and communication about projects (preparation, due diligence, development impact etc.) is enhanced. This disclosure must, however, respect the need not compromise the required confidentiality on commercial issues to IFU's investment partners.

### 3.5 MFA's strategy for IFU

Based on the above strategic considerations, MFA's strategy for IFU 2017-2021 consists of the following instruments:

- **SDG Investment Fund:**
  - MFA and IFU will develop a new SDG Investment Fund with significant contributions from institutional investors (DKK 2.5-3 billion)
- **IFU Classic:**
  - Going forward, IFU Classic investments shall focus on projects with high development impact, project development, SME investments, high risk projects and frontier markets.
- **Development Bank**

[3] OECD/DAC: Peer learning: Lessons from DAC members of effectively engaging the private sector in development cooperation. October 2016.

  - Develop a model for "Development Bank" lending – in particular larger scale infrastructure projects
- **Strategic Partnerships**
  - Build strategic partnerships with public and private partners, e.g. IFC
- **IFU's contribution to sustainable growth**
  - IFU's annual investment volume should almost double from approximately 1.1 billion to DKK 2 billion over the next five years, thereby supporting the SDGs and the development cooperation strategy
- **Framework agreement between MFA and IFU,** covering:
  - Specific goals for IFU's contribution to development impact as reflected in the current agreements on the IFU managed MFA facilities.
  - Strengthen cooperation and synergy between IFU, Trade Council and Danida
  - Establish a fact track procedure for IFU's co-location on relevant Danish Embassies
- **Openness and communication of development results**
  - IFU shall continue to seek to enhance its communication policy directed towards key stakeholders
- **Possible access of IFU to EU's blending facilities etc.**
  - The untying of IFU makes it now possible for the fund to be accredited to international financial institutions, which can provide financing and investment opportunities for IFU. This includes among others access to and participation in various facilities of the EIB
- **Executing agency for Danish strategic private sector initiatives (i.e. Ukraine)**
  - IFU is in a position to implement government initiatives within specific regions or sectors.

### 3.5 Results framework

In an effort to capture development effects of its investments better and improve its ability to report on the new SDGs, IFU has upgraded its monitoring framework and operates now a comprehensive Development Impact Model (DIM).

This new system for monitoring of development impact consists of a total number of 38 indicators, which are measured across the investment portfolio. The indicators are categorised into **general development indicators** and three types of more **strategic indicators**.
Some of the development indicators are general such as direct employees and tax contribution and some of them are sector specific related to climate change mitigation, renewable energy, agri-business and micro-finance. The indicator definitions used by the DIM are in general mainly standard indicator definitions used among the group of European Development Finance Institutions (EDFI).

The strategic indicators are divided into three groups related to additionality, catalytic effect and project sustainability. Additionality includes elements like training provided, technology transfer, board membership etc. Indicators for catalytic effect are related to leverage and 3rd party investors. Finally project sustainability is measured on environmental, social and governance scores as well as risk ratings and IRR. The Results Framework for the SDG fund and a complete overview of the DIM indicators are presented in annex 2.

A rating methodology will be applied in the DIM with three basic outcomes: **Exceed, Meet** and **Below**. The rating will be assigned according to predefined units and thresholds according to IFU's expectations. Each indicator group will also be assigned a group rating Exceed, Meet and Below and finally the project will be assigned an overall project headline rating going from **critical** over **poor, fair** and **good** to **excellent.** The database will enable compilation of project specific reports as well as data extraction across projects on specified indicators.

Expected results of a particular investment are used for the decision making in IFU's board. The ex-post results will be recorded in connection with the Final Evaluation Report (FER) to be filed at the end of the investment project. The Final Evaluation Report will make comparisons and analyse differences between the ex-ante and ex-post values.

The annual monitoring will capture selected actual numbers for a given year. As IFU gains more experience with its new Development Impact Model it will be possible to benchmark the individual investments against others and to gain specific sector knowledge about effectiveness and efficiency of each investment type in terms of development outcomes and impacts.

### 3.6 Risk assessment

Investments in developing countries are generally associated with a relatively high perceived and real risk, not least for medium- and long-term investments which constitute the majority of the portfolio under IFU. A risk management matrix is presented in Annex 3. The matrix presents the main contextual, programmatic and institutional risks in relation to IFU.

IFU has a set of well-developed risk policies and guidelines to minimise the overall risks in its project portfolio. These policies include guidelines for appraisal of commercial risk, for project, partner and country risk exposure, guidelines for managing direct financial risks and guidelines for sustainability risks.

## 4. Management set-up and MFA's monitoring of IFU

MFA is the parent ministry/"owner" of IFU. The Minister for Development Cooperation approves IFU's statutes ("rules and guidelines for running the business of IFU"). Furthermore, the Minister appoints the Board, including the chairman and deputy-chairman, the observer from MFA and the chief executive officer of IFU. Finally, the Minister has approved a dividend policy for IFU. IFU is considered to be a state-owned company, and MFA's monitoring is based on "Statens Ejerskabspolitik (April 2015)"/"Ownership Policy". This implies the following <u>monitoring structure</u>:

- "Annual General Assembly"-meeting between the Minister, IFU's chairman and CEO. The agenda focuses on the annual report of IFU and MFA's strategy for IFU.
- MFA's observer to the Board, who has access to all board documents, reports to the Minister concerning relevant issues.
- MFA-IFU High Level Coordination-meetings are held minimum 2 times a year. The agenda focuses on strategy, results, development impact, cooperation between IFU-MFA etc.
- On-going meetings between employees from MFA and IFU.
- Rigsrevisionen supervises IFU's activities. IFU's accounts are audited by a state authorized public accountant through an agreement between Rigsrevisor (the Auditor General) and the Minister.

## 5. Budget

The funding of IFU's sustained growth to 2021 is estimated to require around DKK 1,000 million in additional capital (incl. an annual dividend of DKK 50 million). The financing gap could be funded by a combination of capital contribution (equity) and debt financing based on state guarantees. The 2017 Finance Act allocates DKK 200 million for general equity contribution to IFU. These allocations are envisaged to be complemented with additional appropriations in 2018-2021.

## Annex 1: Description of IFU's activities

**Description of IFU's organization and activities**
IFU's present activities are based on three main business areas: 1) IFU Classic (the traditional DFI task), 2) IFU Fund Management, where IFU act as a fund manager for a number of investment funds based on public or public-private capital and 3) IFU Investment Program Management. Please refer to annex 4.

**IFU Classic**
IFU offers risk capital as a joint venture/minority investor and professional advice to companies wishing to do business in developing countries and emerging markets in Africa Asia, Latin America and parts of Europe. IFU can invest in all countries on the OECD's DAC list of development aid recipients. However, at least 50% of IFU's investments, measured over a rolling three year period, must be made in host countries with a GNI per capita income below 80% of the upper limit for LMIC (Lower Middle Income Countries), according to the World Bank's classification. In 2016 this limit was USD 3,300 (2014 level). In 2015, 81% of IFU's investments were below this limit.

IFU has a long-term investment horizon and invests typically directly in the company being set up in the host country. Exit is typically after 7-10 years. IFU's investments indicatively range from DKK 1m to DKK 100 million in a single project company. IFU participates in the establishment of new companies, primarily joint ventures between Danish and local partners, and in acquisitions of existing companies. IFU's investments are made on commercial terms based on the following key financing instruments: Share capital, Mezzanine financing (a hybrid of debt and equity financing), loans and guarantees. Annex 5 shows how a typical IFU investment is structured.

IFU offers professional advice from the first considerations regarding the investment, during the establishment and until the company is economically viable. IFU often participates as a board member in the project company, where IFU continually contribute with its knowhow and experience in running companies in developing countries. IFU's head office is located in Copenhagen. Furthermore, IFU has nine regional offices located in New Delhi, Shanghai, Singapore, Pretoria, Nairobi, Accra, Lagos, Bogota and Kiev. Three of these offices are located at a Danish Embassy.

IFU's Board has approved a sustainability policy that defines sustainability - in the context of sustainable development - as the framework for the environmental, social and governance (ESG) requirements in IFU's project companies and in the project companies of the IFU-managed funds. IFU's Board, management, employees and advisers must act in accordance with this policy. According to the policy, IFU is committed to the UNGP and is a signatory to UN Global Compact. IFU's sustainability policy covers IFU Classic and IFU Fund Management.

IFU is committed to ensuring that the project companies reduce sustainability risks, contribute to sustainable development and in general achieve high sustainability standards. IFU has thus established a process to identify and solve sustainability issues that need to be addressed by the project company. Assessing sustainability impacts is an integral part of IFU's investment process that consists of four phases: screening, due diligence, agreement and investment monitoring.  IFU reports work on sustainability as part of the annual financial report, and IFU has a Sustainability Advisory Board composed of external stakeholders within environment, human rights development and company policies.

**IFU Fund Management**

IFU acts as fund manager for a number of investment funds based on public or public-private capital, which target different regions or sectors like climate or agribusiness. The funds are based on political and strategic initiatives, which subsequently have been operationalized and designed by MFA and IFU.

The Arab investment Fund was set up in connection with the Arab spring in 2011 to contribute to economic development of countries in North Africa and the Middle East. AIF has committed capital of DKK 150 million, provided by MFA and IFU.

The Danish Climate Investment Fund (DCIF) was established in 2014 with a total committed capital of DKK 1.3 million. 60 per cent was committed by five Danish institutional and private investors, including PensionDanmark and PKA A/S. The remaining 40 per cent was committed by MFA and IFU. DCIF offers risk capital and advice for climate investments in climate-related projects in developing countries and emerging markets. Experience from similar investments in IFU Classic shows that for every DKK 100 that the fund invests; total investments will be leveraged up to about DKK 700. Therefore, total investments generated by DCIF are expected to be in the range of DKK 8-9 billion.

The Danish Agribusiness Fund (DAF)

Based on the DCIF-model, the MFA and IFU have in 2016 in collaboration with the three Danish pension funds PensionDanmark, PFA Pension and PKA A/S established a Danish Agribusiness Fund (DAF) with a total committed capital of DKK 800 million. DAF will invest in projects throughout the entire value chain from farm to fork. Because DAF only contributes with part of the investment in each project, IFU expects that the total investments will be leveraged up to around DKK 6 billion.

Ukraine Investment Facility (UFA)

MFA has provided UFA with a capital base of DKK 30 million with the overall objective to contribute to enhanced growth and employment in Ukraine.

Investment Fund for Eastern Europe (IØ)

IØ is on a continuous basis exiting all its investments. The final closing of IØ is expected to be in 2020.

In addition acts as fund manager for IFU Investment Partners (IIP) which is a DKK 500m co-financing fund financed equally by PKA and PBU with the purpose of co-financing larger IFU equity investments. IFU has also received an allocation of DKK 50m from Danida to create a programme, Project Development Programme (PDP) to promote the preparation of bankable investment projects in developing countries - cf. the section above about bankable projects.

**IFU Program Management**

Based on agreements with MFA, IFU is managing the following key grant-based programs: IFU SME Facility (funds for technical assistance and support to the preparation and implementation of investments by Danish SMEs together with IFU), IFU's Neighbourhood Energy Facility (NEF, finance feasibility studies of climate-related projects in EU neighbouring countries in Eastern Europe) and CSR Training Fund (help project companies to meet sustainability objectives and contribute to capacity building).

**Annex 2: IFU - Results Framework**

The Results Framework for MFA's strategy for IFU is fairly brief due to the fact that IFU's main activities comprise several MFA supported activities and each of these has their own results framework. Among these three should be mentioned: The establishment of an SDG fund, support for small and medium sized enterprises (SME facility) and the Project Development Programme (PDP).
Furthermore, IFU has developed a new ambitious Development Impact Model (DIM) covering its investment portfolio, which has been in operation from 1 January 2017. Please find more details below.

| | Overall indicators on IFU's capital mobilization and investment volume | Baseline / recent value | Target 2021 |
|---|---|---|---|
| 1 | Capitalization of SDG fund – private commitments | 1.275 million DKK (DAF/DCIF) | App. 3.000 million DKK |
| 2 | Mobilization of private capital in portfolio investments (IFU's portfolio) | 7X | 7X |
| 3 | Annual IFU investment volume (all IFU managed funds) | 1.100 Million DKK | 2.000 million DKK |
| 4 | Expected total number of jobs created: 8.000 direct jobs per one billion DKK invested by IFU, out of which at least 35% will be women and 10% will be youth. 12.000-16.000 indirect jobs. | 9.000 | 18.000 |

The above indicators should be understood as general indicators for IFU's performance linked to IFU's ability to attract new private capital for investments in developing countries and generate jobs. Attracting private capital is paramount for achieving the SDG goals which are a key objective for IFU and now directly reflected in IFU's purpose in the recently revised law on development assistance.

Within the individual funding mechanisms managed by IFU (DAF, DCIF, AIF, UFA) there are other detailed performance indicators as well. Finally, at the level of each investment a third level of indicators is being monitored through the DIM, IFU's Development Impact Model (see below).

The indicators at investment company level include indicators of development effects such as number of jobs and tax contribution etc. Monitoring of all indicators at investment company level takes place ex-ante and ex-post. However, some indicators are also monitored during operations.

In connection with MFA's strategy for IFU it should also be understood that IFU's Board is monitoring the effectiveness and efficiency of the IFU organisation compared to other

European Development Financing Institutions (EDFI) based on various indicators, e.g. IFU operating expense relative to capital under management (expense ratio), number of ongoing projects per staff member and number of new projects per staff member. It is noted that these indicators vary between the EDFI institutions; among other factors they depend on the investment process set up in each DFI and of the nature of projects in their portfolio. As such it is not meaningful to set up specific targets for these indicators.

From 2017 and onwards it is expected that IFU's contributions to the 17 Sustainable Development Goals are measured using the OECD principles for policy markers i.e. "Principal" or "Significant" contributions as well as measurements of direct contributions to several SDG's monitored as an integral part of IFU's Development Impact Model (DIM).

In addition to these results frameworks IFU is reporting results of its activities according to the requirements under the Danish Financial Statements Act (Årsregnskabsloven). This includes additional information on corporate social responsibility and gender in connection with the operations of the fund (Section 99a on Corporate Social Responsibility and section 99b on Gender).

As part of its annual report, IFU is preparing an annual progress report under the framework of the UN Global Compact.

**Methodology and standards for result measurement and reporting**
IFU's Development Impact Model has been developed taking the experience harnessed in the International Finance Institutions harmonized approach HIPSO into account:

**HIPSO** is a joint impact measurement system initiated by major International Finance Institutions (IFI's). In 2013, 25 IFIs signed a memorandum to ease the reporting burden on shared private sector clients and facilitate learning from each other. Together, these organizations created a harmonized set of 27 core indicators named Harmonized Indicators for Private Sector Operations (HIPSO) for 12 different sectors. The full memorandum and results indicators are available for download on the HIPSO website. Fifteen of the 27 core indicators are aligned to IRIS of the Global Impact Investing Network. The governance and evolution of the 27 indicators remains with the IFI Working Group.

As with other indicators, it is important to state that interpretation of these metrics must be complemented with an analysis of the context in which a company is evolving, and can change over time. Stand-alone numbers cannot by themselves indicate positive or negative social value, or necessarily be compared across companies or products.

**IFU's Development Impact Model methodology**
The DIM model will be operated by IFU's investment officers through IFU's project database. The DIM model will rely on manual entry of some data and automatically imported baseline information calculated on other indicators. The DIM model will also include automatic rating of indicators based on the empirical thresholds and automatic rating of indicator group and project based algorithms. The DIM will work in an integrated way so that key figures are sent into relevant templates for IFU decision making. The database will enable compilation of project specific reports as well as data extraction across projects on specified indicators. The DIM model will work through data collection at three distinct stages Ex-ante, Ex-post and annual monitoring:

**Ex-ante targets and Ex-post observations and comparisons**
The ex-ante targets are the expected outputs/outcomes of the investment project. In some cases the numbers reported here turns out to be either optimistic or underestimate what is really going on when the investment project set into motion. The ex-ante numbers are used for the decision making at Binding Commitment stage. The ex-post numbers will be recorded in connection with the Final Evaluation Report (FER) to be filed at the end of the investment project.

**Annual monitoring**
The annual monitoring will capture the actual numbers for a given year. The annual DIM monitoring sheet will be filled-in in connection with the annual sustainability reporting sheet. The annual monitoring will capture an initial high employment during construction and establishment followed by a lower number of staff in the operational phase of a given project.

The system is fully operational from January 2017 thus replacing the former Success Criteria Model (SCM) operated by IFU for the last twelve years.

**Indicator on climate**
The $CO_2$ emissions mitigated is an indicator of the positive climate-related outcomes of the investment. Reduction of $CO_2$-eq is measured as mitigated $CO_2$-eq emissions during a project lifetime per invested DKK one million by the fund. Savings in CO2-eq. emissions is defined in relation to a baseline scenario. The baseline scenario may either reflect the case without the project or the most likely alternative scenario. The mitigated $CO_2$ emissions is a measure of IFU's contribution to SDG 9: Industry, Innovation and Infrastructure and SDG 13: Climate Action. The source of information for this indicator is received from calculations by independent consultancy.

This indicator on climate is aligned to the joint IFI harmonized approach to GHG accounting, the GHG accounting protocol and the UNFCCC.

**Indicator on employment**
*Direct employment* is an indicator of the number of people that benefit directly from the project's activities. It is tracked to confirm that the expected direct employment after investment is realised. It is tracked as number of employees (as per local definition) working for the project company at the end of the reporting period. This includes directly hired individuals and individuals hired through third party agencies as long as those individuals provide on-site services related to the operations of the project company or the project. In addition, this includes work by seasonal, contractual and part time employees. Direct employment is a measure of IFU's contribution to SDG 1: No Poverty and SDG 8: Decent Work and Economic Growth. Documentation for employees is received once a year from the project company.

*Female employment* is an indicator of the number of women that benefit directly from the project's activities. It is tracked to confirm that the expected direct female employment after investment is realised. It is tracked as the number of female employees working for the project company at the end of the reporting period. Documentation for female employees is received once a year from the project company. Female direct employment is a measure of IFU's contribution to SDG 5: Gender Equality.

*Youth employment* is an indicator of the number of young people that benefit directly from the project's activities. It is tracked to confirm that the expected direct youth employment after investment is realised. Number of youth (defined as under 25 years) employees working for the project company at the end of the reporting period. Documentation for youth employees is received once a year from the project company.

*Unskilled employment* is an indicator of the number of unskilled people that benefit directly from the project's activities. It is tracked to confirm that the expected direct employment of unskilled labour after investment is realised. It is tracked as number of unskilled employees working for the project company at the end of the reporting period. Unskilled workers are defined as those carrying out work involving simple operation that requires little or no skill, experience or education level higher than primary education on the job. Unskilled employment is a measure of IFU's contribution to SDG 1: No Poverty, SDG 8: Decent Work and Economic Growth and SDG 10: Reduced Inequalities.

The employment indicator used is aligned with the HIPSO terminology.

**Indicator on additional financial resources mobilised**
Based on the historical leverage ratio a realistic estimate for future resource mobilisation can be calculated. Leverage is the ratio of the states and IFU's investment to total mobilised investment. It is tracked to confirm that the expected catalytic role after investment is realised. Total financial resources mobilised is a direct measure of IFU's contribution to SDG 17: Partnership for the Goals.

The financial resources mobilised indicator is aligned with HIPSO terminology.

**Annex 3: MFA Strategy for IFU - Risk Management Matrix**

**Contextual risks**

| **Risk Factor** | **Likelihood** | **Background to assessment of likelihood** | **Impact** | **Background to assessment to potential impact** | **Risk response** | **Combined residual risk** |
|---|---|---|---|---|---|---|
| Possible global financial instability and economic slow-down. | Possible | A certain financial turbulence and economic slow-down triggered by a global political or financial crises. | Major | A global economic slowdown may limit the companies' ability and willingness to invest in ventures in developing countries. This was also the case during the global financial crises. | IFU has extensive experience with assessment and mitigation of risk parameters when investing in developing countries. | Minor |
| Political and/or financial instability in individual countries limiting Foreign Direct Investments. | Likely | During recent years political and financial turbulence have taken place in many developing countries. | Major | Political or financial turbulence in a country could have a major negative impact on IFU's investments. | IFU has broad geographical coverage and is therefore not heavily exposed to any single county. IFU will try to mitigate consequences concerning ongoing projects, whereas new investments will only be made if sufficient risk mitigation is in place. | Minor |

**Programmatic risks**

| **Risk Factor** | **Likelihood** | **Background to assessment of likelihood** | **Impact** | **Background to assessment to potential impact** | **Risk response** | **Combined residual risk** |
|---|---|---|---|---|---|---|
| Lack of interest and/or capability by investors and enterprises to invest in developing countries. | Possible | Enterprises may be reluctant towards investing in developing countries, particularly in certain low-income and/or high-risk countries | Major | If investors and enterprises loose interest or capability to invest in developing countries it could be difficult for IFU to achieve the targets. | IFU's broad geographical and thematic approach will limit the risk. | Minor |
| Commercial failure of individual investments. | Likely | Unless investments are carefully appraised they can easily lead to | Major | Commercial failure of investments will mean that the concerned partner enterprise, investors and | IFU has established risk management procedures, comprehensive appraisal procedures | Minor |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | commercial failure. | | IFU will have high probability for losses. | and experience for mitigating the risks detected prior to investments. | |
| Shortage of bankable investment projects | Possible | It is broadly recognized by international development finance institutions, that there is a serious shortage of bankable investment projects in developing countries. | Major | A shortage of bankable projects could make it difficult for IFU to maintain an adequate project pipeline, which could reduce the quality of the portfolio of investment projects and/or delay investment activities. | IFU is aware of the importance of maintaining a solid pipeline of investment projects, and efforts are made to develop a solid project pipeline. IFU is further developing a network of project developers in relation to climate investment and other thematic areas. MFA funds have also been allocated to IFU to promote project development on a commercial basis-cf. PDP. | Minor |

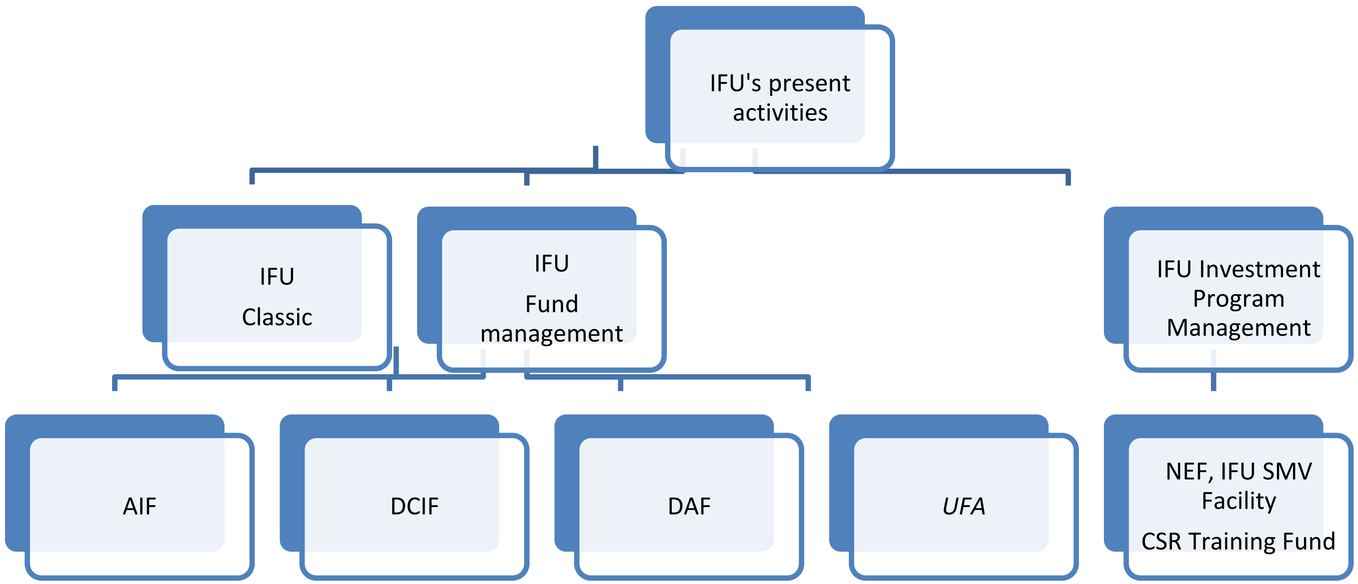
**Institutional Risks**

| Risk Factor | Likelihood | Background to assessment of likelihood | Impact | Background to assessment to potential impact | Risk response | Combined residual risk |
|---|---|---|---|---|---|---|
| Violation of human rights, OSH and environmental standards | Likely | Various studies indicate that international and not least local enterprises often violate human rights, OSH and environmental standards. | Major | Any possible violation of such standards in a specific investment project can have serious global consequences for IFU and its co-investors in the form of reputational damage that may be difficult to solve. | IFU has signed up to the UN Global Compact principles and IFU has comprehensive policies in place which commits the investments to responsible conduct in relation to labor rights, environment and anti-corruption in accordance with Global Compact principles and UN's Guiding Principles on Business and Human Rights (UNGP). | Minor |
| Misuse, corruption and fraud by participating partners | Likely | According to International Transparency Index, corruption is widespread in most developing countries | Major | Implementation of investment projects could be seriously damaged if funds are mismanaged, and it will undermine efforts by local authorities and donors to combat corruption. | Ref. above. | Minor |
| It may be difficult to attract investments | Possible | Investors may be reluctant to invest in | Major | Private investors may find that the design and performance of this | Experience from DCIF and DAF shows investors are willing to invest | Minor |

| | | | | | | |
|---|---|---|---|---|---|---|
| from institutional investors | | developing countries | | type of public-private-based funds are inadequately tested. | in developing countries. Feedback from the investors indicates that they seek larger funds and larger investment projects with documented development effects | |
| IFU stakeholder management could become critical to the growth strategy | Likely | With a significant investment volume the activities of IFU will draw more attention from both investors, partner companies and NGO's | Major | If not well managed stakeholders with negative attitude to the private sector can undermine existing broad support for IFU investments | Communication and dialogue with stakeholders will be intensified in order to maintain high level of public support. Documentation and communication of development effects will be strengthened | Minor |
| Increased investment volume and number of projects will put pressure on internal IFU resources | Possible | Expansion of investment portfolio and new investment partnerships will require more effort from IFU | Major | Investment projects with insufficient or incomplete due diligence and monitoring procedures may have an increased risk of failure or lower returns | Resources will be made available in step with the expansion to ensure sufficient due diligence and monitoring procedures (financial, legal and sustainability issues). In addition relevant training will be provided to IFU investment professionals and partner companies. External consultants will be used when relevant | Minor |

**Annex 4**

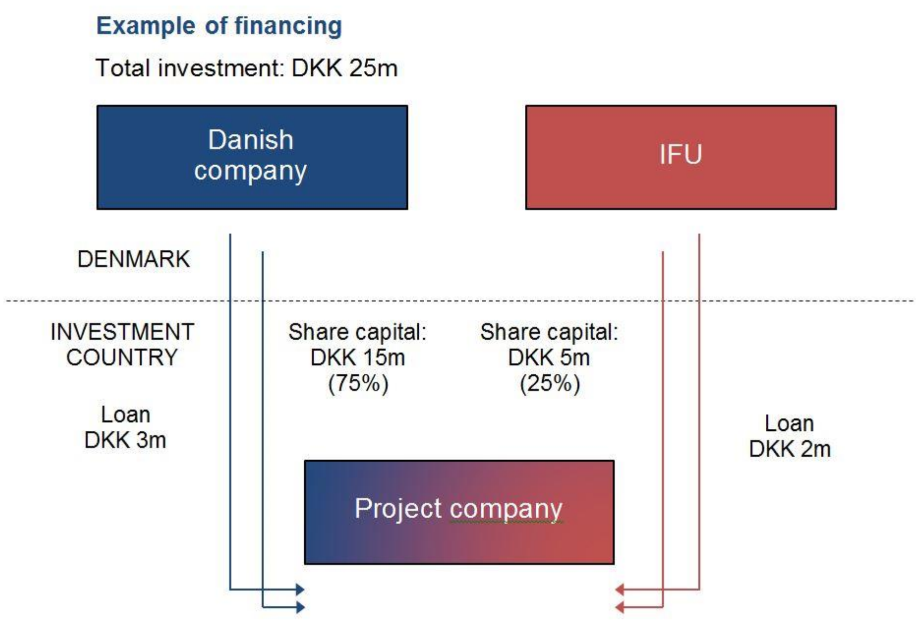
**IFU's activities:**




Note: Abbreviations: See page 12.

**Annex 5**

The figure below shows how a typical IFU investment is structured.



**Annex 6**

Please find below a table of highlights for IFU Classic and IFU managed funds

| Highlights for IFU Classic | **2015** | **2014** | **2013** | **2012** |
|---|---|---|---|---|
| Investments contracted DKKm | 660 | 681 | 566 | 524 |
| Net income for the year DKKm | 194 | 149 | 72 | 84 |
| Total balance DKKm | 2,892 | 2,667 | 2,500 | 2,517 |
| Highlights for IFU and IFU managed funds | | | | |
| Investments contracted DKKm | 906 | 634 | 637 | 578 |
| Actual direct jobs active portfolio (number) | 32,000 | 27,000 | 40,000 | 44,000 |
| Expected direct jobs new projects | 5,036 | 5,894 | 2,462 | 8,230 |
| Training (%) 1) | 100 | 95 | 95 | 90 |
| Green/brownfield (%) 2) | 86/14 | 70/30 | 65/35 | 75/25 |
| Use of technology (%) 3) | 45/50 | 75/25 | 70/30 | 90 |
| Taxes paid DKKm | 372 | 336 | n/a | n/a |

Notes:
1): Percentage of new project companies planning training for employees.
2): Percentage split based on greenfield/brownfield investments
3): Percentage split is for new projects and shows use of either world class technology or other type of well-known technology. Before 2013, the figure covers modern technology

## Checklist for appraisal of programmes and projects above DKK 10 million[1]

*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: 2017-443

Programme/Project name: The Ministry of Foreign Affairs' Strategy for the Investment Fund for Developing Countries (IFU)

Programme/Project period: 2017-2021

Budget: DKK 200 mio.

Presentation of quality assurance process:
The Ministry of Foreign Affairs' Strategy for IFU has been exempted from the normal appraisal procedures. The main reason is that the responsible department (Growth and Employment – VBE) has good technical capacity within the area of the support. Appraisal and quality assurance of the Strategy has been conducted by VBE with input from the Technical Quality Support department in the preparation process.

☒ The programme/project complies with Danida policies and Aid Management Guidelines.
*Comments:*

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

☒ Comments from the Danida Programme Committee have been addressed (if applicable).
*Comments:*

X 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:*

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

☒ The programme/project is found sound budget-wise.

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[1] 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).

*Comments:*

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

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

❑ The Danida guidelines on contracts and tender procedures have been followed.
*Comments: N/A*

X 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:*

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

☒ In conclusion, the programme/project can be recommended for approval: yes / no

- Issues related the HRBA/Gender have been considered adequately
- Issues related to Green Growth has been considered if applicable
- Environmental risks are addressed by adequate safeguards when relevant

Date and signature of desk officer: 16-03-2017 Niels Egerup

Date and signature of management: 16-03-2017 Morten Elkjær