MINISTRY OF FOREIGN AFFAIRS
OF DENMARK
Danida

MARCH 2019

EVALUATION
OF THE INVESTMENT FUND FOR DEVELOPING COUNTRIES (IFU) 2004-2017

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LIST OF ABBREVIATIONS

AIF	Arab Investment Fund
BC	Binding Commitment
BIO	Belgian Investment Company for Developing Countries
B2B	Business-to-Business
CSR	Corporate Social Responsibility
CiP	Clearance in Principle
DAC	Development Assistance Committee (of OECD)
DAF	Danish Agribusiness Fund
DBF	Danida Business Finance (former Mixed Credit Programme)
DCA	DanChurchAid
DCED	Donor Committee for Enterprise Development
DP	Danish Partner
DIHR	Danish Institute for Human Rights
DCIF	Danish Climate Investment Fund
DFI	Development Finance Institution
DIM	Development Impact Model
EKF	Danish Export Credit Agency
DMDP	Danida Market Development Partnerships Programme
ERG	Evaluation Reference Group
ESG	Environment, Social and Governance
EU	European Union
EVAL	Danida's Evaluation Department
FDI	Foreign Direct Investment
FMO	Dutch DFI
HIPSO	Harmonised Indicators for Private Sector Operations
IB	Investment Board
IC	Investment Committee
IFC	International Finance Corporation
IPP	Independent Power Producer
HIC	High Income Country
IFU	Investment Fund for Developing Countries
IIP	IFU Investment Partners
IØ	Investment Fund for Central and Eastern Europe
IT	Information Technology
KIF	Klimainvesteringsfonden (Danish Climate Investment Fund)
LDC	Least Developed Country
LIF	Landbrugsinvesteringsfaciliteten (Danish Agribusiness Fund)
LIC	Low Income Country
LMIC	Low Middle Income Country
MIC	Middle Income Country
MTR	Mid Term Review
NAO	National Audit Office
NEIF	Neigbourhood Energy Investment Facility
NEF	Neigbourhood Energy Facility
ODA	Official Development Aid

LIST OF ABBREVIATIONS

OECD	Organisation for Economic Co-operation and Development
OFC	Offshore Financial Centre
Opex	Operational expenditures
PPA	Power Purchase Agreement
PPM	Private Placement Memorandum
PPP	Public-Private Partnership
PDP	Project Development Programme
PSD	Private Sector Development
RE	Renewable Energy
ROE	Return on Equity
SCM	Success Criteria Model
SDGs	Sustainable Development Goals
SME	Small and Medium Sized Enterprises
SSA	Sub-Saharan Africa
ToR	Terms of Reference
UFA	Ukraine Investment Facility
UMIC	Upper Middle Income Country
UN	United Nations
UNGP	United Nations Guiding Principles on Business and Human Rights
VBE	Department for Growth and Employment
WB(G)	World Bank (Group)

EXECUTIVE SUMMARY

The Evaluation Department of the Ministry of Foreign Affairs has commissioned an evaluation of the Investment Fund for Developing Countries (IFU) over the period 2004-2017. The last independent evaluation of IFU was published in 2004. The consortium of the Nordic Consulting Group (NCG) and Carnegie Consult BV was selected to carry out the evaluation. There are two objectives for this evaluation:

1. To assess IFU's contribution to development and commercial outcomes through its investments in developing countries in line with its mandate;

2. To assess IFU's strategy and envisaged future role in Danish development cooperation policies, and whether the organisation is fit for purpose.

The evaluation was done at various levels: strategic (IFU as organisation), funds (IFU's statutory funds, IFU Classic and the Danish Climate Investment Fund in particular), partner country level (field visits to Kenya, China and Ukraine) and on the basis of a representative sample of 50 in-depth case studies.

CHANGING INTERNATIONAL CONTEXT FOR DEVELOPMENT FINANCE INSTITUTIONS

IFU is the Danish Development Finance Institution (DFI), which invests in commercially sustainable private sector projects in developing countries. In 2004, at the start of the evaluation period, DFIs were working in the international arena, but were relatively disconnected from the broader international policy agenda. However, this gradually changed. Globally, DFIs have shown rapid growth of more than 600% between 2002 and 2014 based on government and private sector capital injections and retained profits, compared to 50% growth of Official Development Assistance (ODA) during the same period. Governments now consider DFIs as key institutions to promote private sector development in order to achieve key development outcomes including the Sustainability Development Goals (SDGs) formulated in 2015. The main common challenge for DFIs is to act as a driver to maximise development outcomes and impact on the one hand and being commercially sustainable on the other.

MAIN CHANGES IN IFU DURING THE EVALUATION PERIOD

The 14-year evaluation period can be split in three sub-periods according to changes in the IFU mandate:

1. **2004-2010**: Fully tied mandate and limited country mandate (since 2005) with focus on poorer developing countries and Africa; substantial capital extractions by the State; stagnation in the portfolio (around DKK 600 million investments per year); limited number of instruments;

2. **2011-2014**: Fully tied mandate, but broader country mandate allowing investments in the lower segment of upper middle income countries; some capital extractions by the State; start of first Public Private Partnership (PPP) funds with private investors and also set-up of new government fund, but no growth (around DKK 600 million investments per year);

3. **2015-2017**: from a partially to a fully untied mandate and a broadened country focus allowing investments in all developing countries, rapid expansion both in terms of annual volumes of investments (more than DKK 1.2 billion investments in 2016 and 2017) and in number of funds (government and Public Private Partnership funds) and facilities (total of 11 funds and facilities end 2017), role for private sector investors in IFU governance, restructuring of the organisation, annual dividend payments to the State and new capital injections by the State.

Compared to the other 14 European DFIs, IFU is among the smaller DFIs, despite its recent growth, which started later than for most other DFIs. There is an enormous variation among DFIs, regarding their size, mandate, sector and regional focus, type of instruments, governance and involvement of private sector investors. Compared to other DFIs, IFU does stand out in the following areas:

- Its tied mandate until 2015, which allowed IFU to invest only in Danish partners and a continued focus on Danish interests even after the untying;

- Its recent growth through PPP funds with institutional investors;

- The relatively large number of both government and PPP funds and facilities;

- Traditionally a relatively strong focus on agribusiness and industry/manufacturing given the demand from Danish business, but recently more focus on renewable energy and the financial sector, where IFU for a long time was less active than other DFIs;

- Its nine regional and country offices with well-qualified on-the ground staff;

- Above average share of equity and quasi-equity (53% of new investments) in the portfolio.

KEY FINDINGS AND CONCLUSIONS

IFU's mandate consisted of a country mandate and regulations on tying to Danish business. This was the main government instrument to steer IFU. While the MFA defined eligible country categories, the operationalisation of the country mandate was left to IFU. In 2003, a number of exemption and phasing-out rules were defined, which are still applied today. As IFU had to stop its investments in a large number of countries from 2005 onwards, these rules allowed IFU at the time to manage the effects on its ongoing business. IFU did not report separately to the MFA regarding its compliance with the mandate but refers to its Annual Reports in which no systematic assessment of compliance with the mandate is presented.

A detailed portfolio analysis of all IFU Classic investments during the period 2005-2017 shows that it is very plausible that IFU complied with its mandate. In some years (i.e. 2011, 2013 and 2014) it is directly clear that IFU complied with its mandate, because even without considering the investments in regional funds a sufficient amount of investments was made in lower income countries. However, for the other years, assumptions had to be made regarding the country allocation of IFU's investments in regional funds.

Since 2011, the portfolio shows a rapid shift towards more investments in middle income countries, varying between 20% and 45% of the annual investment volume. This is logical given the broadening of mandate and the preference of the PPP funds to invest in countries where risks are perceived to be relatively low. The portfolio also shows a steady increase in investments in Africa from 3% of total annual investments in 2004 to 35% on average during the period 2015- 2017, which is in line with the ambitions of the MFA and IFU.

The relations between the MFA and IFU, which were rather tense at the beginning of the evaluation period, gradually improved over time. The continued capital extractions by the Danish State (net total DKK 4.4 billion) during the evaluation period were one important source of tension. By the end of the evaluation period, the State provided some new capital injections to IFU. Despite formal arrangements and frequent informal meetings, government oversight and supervision of IFU has been rather limited throughout the evaluation period. The MFA depended mainly on IFU's Annual Reports and did not ask for additional reporting on key issues. The government did also not commission any external evaluation during the period 2004-2017.

IFU has been very pro-active in mobilising private sector capital to set up PPP funds, which can be considered as an important innovation in line

with international priorities for DFIs. From 2011 to 2017, IFU raised DKK 1.8 billion private capital for its PPP funds. From January 2018 to January 2019, IFU raised additional private capital – DKK 2.9 billion – for the new SDG Equity Fund, adding up to a combined total of DKK 4.7 billion raised from the private sector. The set-up of these PPP funds such as the Danish Climate Investment Fund (DCIF) has been the main driving force for change in IFU, which led to better risk assessment and also drove further professionalisation of the investment process.

The portfolio of IFU has been primarily demand-driven by the Danish business community. Initially, the focus was on both large Danish companies and SMEs. However, especially from 2014 the number of investments in Danish SMEs decreased as these investments were considered to be quite time-consuming and showed an inadequate risk-return balance. Demand from large Danish companies also decreased over time as some of them can now find the money on the capital market. The untying of the mandate provided IFU with the opportunity to invest also in non-Danish actors. Nevertheless, IFU will keep a focus on Danish interests.

When the mandate was tied, the prime focus of IFU was on internationalisation of Danish business while realising development impacts at the same time. This evaluation found that IFU's investments did address relevant development needs of developing countries. However, the focus has so far not been on maximising development outcomes. In practice, IFU and the investee companies were, in addition to the financial returns, mainly focused on Corporate Social Responsibility (CSR) or sustainability performance. IFU developed a good system to check on compliance with human rights, environmental, social and governance standards. At company level evidence on some good achievements such as good labour conditions and environmental measures was found to which IFU contributed.

In contrast with the attention to CSR performance, there is still insufficient attention to measuring and reporting on development outcomes in all stages of investment, i.e. screening, appraisal, implementation and exit with the exception of one indicator namely the number of jobs. Although CSR and sustainability overlap to some extent with development outcomes, they are centred around the company and do not deal with broader development outcomes at sector and host country level. If outcomes are measured such as job creation, IFU still has to overcome various measurement problems, which are common according to international literature. The monitoring system is still too much a 'one-size-fits-all' model based on self-reporting by the investee companies.

Despite the measurement problems, in more than half of the case studies evidence was found on primarily positive development outcomes. Main positive development outcomes were job creation, transfer of

(Danish) technology and knowhow, climate effects and sector effects such as better access to energy. It is estimated that IFU contributed to the creation of 80,000-100,000 jobs from 2004 to 2017. The positive development effects are most noticeable in the energy sector and to some extent in agribusiness. However, in one third of the case studies development outcomes were negligible or below expectations or the positive outcomes were offset by negative development outcomes. There is a clear correlation between negative or poor financial outcomes and a low score on development outcomes. In other cases with limited or negative development outcomes production facilities had very little integration in local supply chains and/or distribution or hardly any new jobs were generated.

During the evaluation period, IFU has communicated more and better on its CSR performance and on some development outcomes, in particular in its Annual Reports. However, despite the fact that IFU opened up to a certain extent, communication on sensitive issues remains challenging. IFU still tends to be rather defensive in its communication. More and better learning can and should take place on the basis of complete and more credible stories, including some negative results.

IFU has generally been financially additional to the market during the evaluation period especially for Danish SMEs. IFU managed to invest either at the right time or in the right type of countries: particularly during the financial crisis when credit was scarce and/or in countries where risk oriented capital credit was difficult to obtain. IFU's role as service provider providing non-financial value to investments is less pronounced. The non-financial value provided by IFU is reflected in the form of bringing 'the Crown & Flag' as government institution, but there is little concrete evidence on how and when this advantage is used.

In general, IFU has made good financial returns on its equity investments, often in double digit figures, which is higher than its returns on loans with interest margins usually in the 5-7% range.

The recommendations are based on the key evaluation findings and conclusions, while at the same time the challenges regarding the way forward, in particular the challenges related to the SDG Equity Fund such as the preference to operate in relatively risk-averse environments are taken into account.

RECOMMENDATIONS TO MFA (IN CONSULTATION WITH IFU):

1. Develop an overarching long-term supervision agreement for IFU with several attachments on specific issues for specific periods. In addition to the Act on International Development Cooperation, which forms the legal basis for IFU, there is no long-term supervision agreement that specifies the details of the governance system, reporting requirements for IFU, IFU Board composition and profiles of Board members.

   The following elements can be added as attachments to the overall long-term agreement:

2. Define a new clear mandate for IFU Classic for 4-5 years (2019-2022/23) with specific development outcomes, clear and transparent investment criteria, focus on poor (and fragile) countries and with a variety of financial instruments. Given the new broad mandate for the SDG fund and its first right of refusal, it is urgent to define a new mandate in clear and operational terms for IFU Classic. It should be avoided that all rejected investment proposals by the SDG Fund will easily get funded by IFU Classic in the absence of own specific investment criteria. IFU Classic should have a strong development focus aiming to maximise development outcomes.

3. Prepare a M&E protocol for 4-5 years: with responsibilities for the MFA such as the preparation of an evaluation plan including independent external evaluations at fund, sector and thematic level that should contribute to further learning.

4. Develop and revise agreements/programme documents regarding specific funds and facilities to be managed by IFU, keeping the number of funds and facilities to a strict minimum while paying due attention to consistency of objectives, clear and well-defined targets.

5. Agree on additional expenditures for strengthening IFU's development expertise at all levels of the organisation.

SPECIFIC RECOMMENDATIONS TO IFU (TO BE ALIGNED WITH MFA RECOMMENDATIONS):

6. Strengthen the development expertise within the organisation at all levels, including the Board.

7. Focus on expansion in sectors where IFU has already built up (some) good expertise such as agribusiness, industry and more recently in renewable energy and finance, in principle, no expansion in the coming years to new sectors where IFU has hardly any expertise.

8. Improve M&E (see the M&E protocol above): from the present focus on compliance with CSR standards to more pro-actively monitoring and evaluation (at exit) of actual CSR performance and development outcomes with a clear focus on learning.

9. Improve the transparency of IFU, its learning culture and communication further.
   IFU should further improve its communication of development results and be more transparent and open in the dialogue on sensitive issues such as investments in Offshore Financial Centres/ tax havens and issues raised by civil society and in the media.

10. Set clear criteria for Board membership in investee companies to help increase the non-financial value that IFU can deliver to investee companies.

11. Further strengthen and/or expand the role of the country/regional offices in order to procure increasingly scarce bankable projects.

1 INTRODUCTION AND BACKGROUND

1.1 Introduction

This is the report of the Evaluation of the Investment Fund for Developing Countries (IFU) over the period 2004-2017 that has been commissioned by the Evaluation Department of the Ministry of Foreign Affairs (MFA), (see Terms of Reference (ToR), Annex 1). After a tender phase the consortium of the Nordic Consulting Group (NCG) and Carnegie Consult BV (hereafter referred to as 'the Evaluation Team') was selected to carry out the evaluation.

The ToR mention two objectives for this evaluation:

1. To assess IFU's contribution to development and commercial outcomes through its investments in developing countries in line with its mandate;

2. To assess IFU's strategy and envisaged future role in Danish development cooperation policies, and whether the organisation is fit for purpose.

The first objective is backward looking and serves accountability purposes, while the second objective is forward looking and meant for learning. A main challenge was to strike a balance between sound and robust findings for accountability on the one hand, and a dynamic, forward looking and inspiring evaluation on the other. The independent Evaluation Team would like to express its appreciation for the availability and openness of IFU towards this evaluation, in particular the availability for interviews, the continuous uploading of documents in the virtual data room, and the assistance in organising the field visits. The information on individual companies was only used for analytical purposes and all information is aggregated in such a way that no traces can lead to individual companies.

An Evaluation Reference Group (ERG) was set up to guide and supervise the evaluation. The ERG was chaired by the Evaluation Department of the MFA and included key stakeholders such as the responsible department of the MFA, IFU and external stakeholders and advisors. The ERG met five times at key moments of the evaluation process: kick-off, inception report, desk study report, presentation of findings of the field phase and draft final report. A first draft final report was submitted 21st December 2018 and discussed with the ERG on 23rd January 2019. The

Evaluation Team addressed comments on the first and second draft final report and provided explanations whether and how comments were addressed in separate response sheets. The second round of comments focused on factual errors and clarity of formulations. The analysis in the report and the formulation of key findings, conclusions and recommendations are solely the responsibility of the independent and impartial Evaluation Team.

1.2 Background IFU

In 1967, the Danish Government established IFU as self-governing and independent institution governed by a Board of Directors appointed by the Minister for Development Cooperation[1]. IFU's objective was reformulated in 2016 as follows: "to promote investments which support sustainable development in developing countries and contribute to the realisation of the Sustainable Development Goals (SDGs)"[2]. During the evaluation period, two main strategic directions can be identified:

1. **Strategic directions initiated by the MFA.**
   The MFA defines the mandate of IFU, which was changed various times during the evaluation period. The most significant change was that IFU's mandate and scope of investments have broadened from a strictly tied fund in 1967 to an untied fund as from 1st January 2017. Other mandate changes refer to the countries in which IFU is allowed to invest: during the period 2004-2011 the mandate focused primarily on poorer developing countries and Africa in general; after 2011 the country focus was gradually broadened (see Chapter 2 for mandate discussion). In addition, from 2011 onwards the MFA established three investment facilities with a specific geographical focus, one Project Development Programme, and four grant facilities[3], while the operational part of the concessional financing programme Danida Business Finance was transferred from the MFA to IFU.

2. **Strategic directions initiated by IFU.**
   IFU has formulated various strategies during the evaluation period. A very significant change initiated by IFU was the set-up of three Public Private Partnership (PPP) funds with institutional investors such as Danish Pension Funds. In 2018, this resulted in the set-up of the new SDG Equity Fund. Figure 1-1 shows the

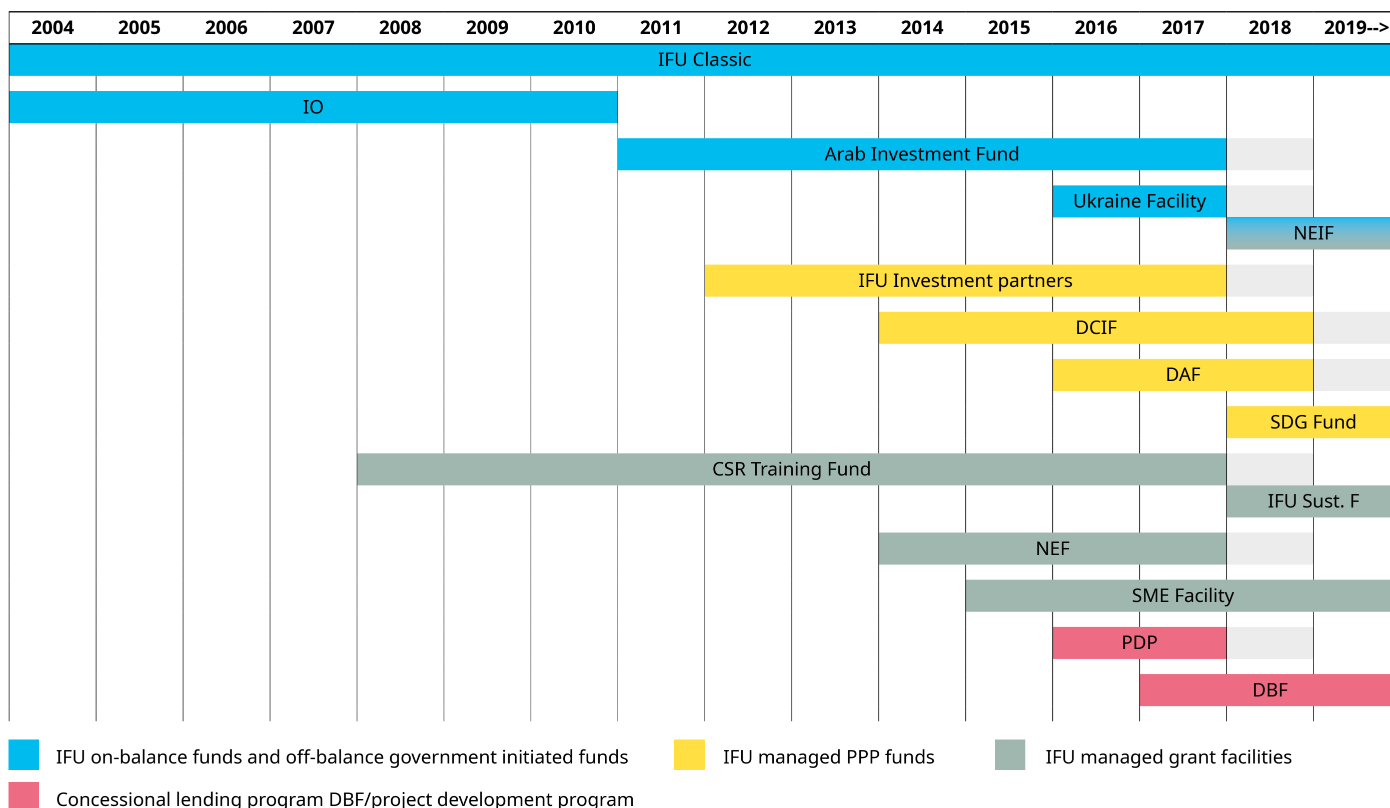
1 Act on International Development Cooperation, 1967 amended various times in which the purpose is defined as "promoting investments in developing countries with Danish trade and industry, with the aim of promoting business development".

2 New Act on International Development Cooperation 2012, amendment 2016.

3 The CSR Training Fund was set up in 2008.

various IFU funds and facilities active during the evaluation period (see Annex 4 for a complete overview and commitments).

FIGURE 1-1 OVERVIEW OF ACTIVE IFU FUNDS AND FACILITIES, 2004-2019



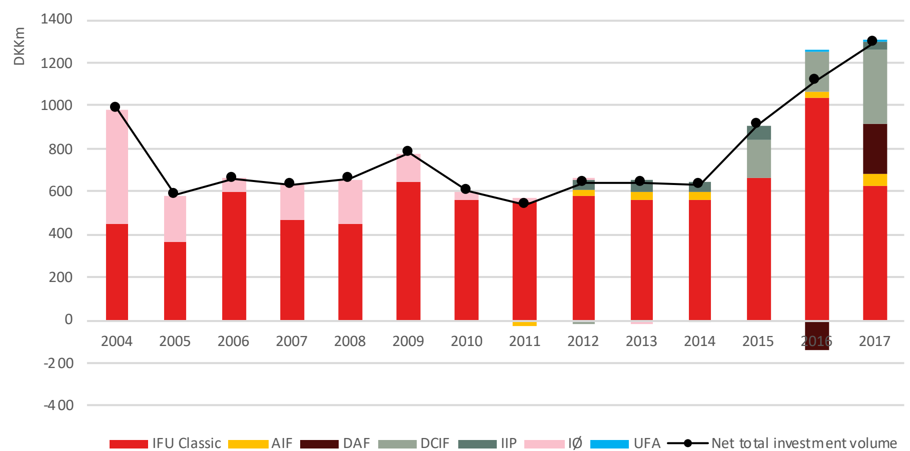
Note: DAF: Danish Agribusiness Fund; DBF: Danida Business Finance; DCIF: Danish Climate Investment Fund; IØ: Investment Fund for Central and Eastern Europe; NEF: Neighbourhood Energy Facility; NEIF: Neighbourhood Energy Investment Facility; PDP: Project Development Programme.

Through the establishment of new PPP and government investment funds, IFU had more capital available to invest, which is reflected in an increase of annual investments, from 2014 onwards, as shown in Figure 1-2.[4] Total net investments made by IFU on its own balance sheet amounted to DKK 7.6 billion in the period from 2004 to 2017. In 2017, IFU contracted close to DKK 1.3 billion in investments (consolidated figure). IFU Classic has remained the most important investment vehicle during the evaluation period corresponding to 71% of all investments made, compared to 13% of investments made by IØ and 9% by DCIF. With the start of investments via the SDG Equity Fund from 2018

4 Transfers of investments between IFU Classic and IFU-managed funds (and vice versa) are included in this graph by subtracting the investment volume in the one fund and adding them in the annual investment volume of the other.

onwards, the SDG Fund will be the most important IFU investment fund with an expected annual investment volume of about 1 DKK billion per year, which is slightly above the total average annual volume of investments during the evaluation period of DKK 800 million. This means that from 2019 onwards, the majority of IFU investments will be realised by the SDG Fund.

FIGURE 1-2 TOTAL ANNUAL INVESTMENTS, DKK MILLION, 2004-2017, NET OF TRANSFER INVESTMENTS, INCLUDING INVESTMENTS INTO IFU-MANAGED FUNDS



Source: IFU portfolio data.

On the basis of the two strategic directions and the portfolio analysis, the evaluation period is divided in:

1. **The period 2004-2010**, which is characterised by a relatively strong poverty and Africa-focus in IFU's investments, at the initiative of the MFA. Through capital extractions by the Government IFU's capital for investments was reduced. Fully tied mandate.

2. **The period 2011-2014**, which is characterised by some more room to manoeuvre for IFU and start of three new investment vehicles: One government-initiated fund (Arab Investment Fund (AIF)) and two PPP funds (IFU Investment Partners (IIP) and the Danish Climate Investment Fund (DCIF)). Continuation of the tied mandate, but broader focus on emerging markets in particular Eastern Europe (related to the closing of the Investment Fund for Central and Eastern Europe (IØ)[5]) and the Arab region (set-up of AIF).

5 The IØ fund still has nine active investments, i.e. IØ is not fully divested and there is still outstanding capital.

3. **The period 2015-2017**, characterised by rapid expansion in terms of volume of investments and number of IFU managed funds and facilities based on capital provided by institutional investors and the government capital injections. From gradual untying in 2015 to a fully untied mandate in 2017. Further expansion of the investment mandate to all developing countries leading to an expansion in Latin America. New overall IFU objective with focus on SDGs (see above). In 2017, the MFA formulated for the first time a strategy for IFU[6], including preparations for the establishment of the SDG Equity Fund.

1.3 Methodology

The ToR (Annex 1) provide general guidance regarding the development of the evaluation approach and methodology. The evaluation was structured in four phases: an inception phase, desk study phase, field phase and an analysis and reporting phase.[7] A general overview of the approach and methodology is presented in this chapter, while details are presented in Annex 2. The list of case studies, the list of documents and the list of people interviewed are presented respectively in Annexes 6, 7 and 8. Additional portfolio, tables and figures are presented in Annex 3, an overview of IFU funds and facilities in Annex 4 and details on CSR performance can be found in Annex 5A. The ToR identified nine evaluation issues that were regrouped by the evaluation into five evaluation issues (see Table 1-1). For each evaluation issue, evaluation questions were formulated and specific indicators and information sources to answer the questions. This is laid down in an evaluation matrix, developed and approved in the inception phase, and further refined in the desk study and field phases (see Annex 2).

6 Ministry of Foreign Affairs, Strategy for IFU 2017-2021, 2017.

7 As the amount of information to be analysed far exceeded the initial expectations, the desk study phase took one month longer than planned and was interrupted by the summer break, therefore the draft final evaluation report is submitted one month later than foreseen in the ToR.

TABLE 1-1 REGROUPING OF EVALUATION ISSUES TOR IN FINAL EVALUATION ISSUES

Evaluation issues ToR	Final evaluation issues	Chapter
Relevance of IFU instruments	Relevance and complementarity	2
Balance between a demand driven and a policy-driven investment portfolio		
Effectiveness in terms of the desired outputs		
Efficiency of the organisation	Efficiency and risk assessment	3
Risk management		
Effectiveness of IFU in leveraging other funds	Financial and value additionality	4
Results measurement and communication	Development outcomes, CSR/ESG performance and communication	5
Effectiveness of IFU in promoting development outcomes		
Sustainability of IFU investments	Financial outcomes	6

The sampling was done in various stages and at various levels (see Annex 2 for detailed selection criteria):

- **Strategic level**: the IFU mandate, relevant MFA policies, all IFU strategies, all funds and facilities, the full portfolio 2004-2017 were analysed;
- **Fund level**: IFU Classic (the statutory funds) and DCIF were analysed in more detail;
- **Country level**: on the basis of the top-10 of countries with the highest number and volume of investments taking into account regional variation, Kenya, China and Ukraine were selected.
- **Case study/Investment level:** A representative sample of 50 companies across various countries and of various profiles was selected for in-depth analysis. The selection of these companies in which IFU invested covered a total of 119 new and follow-on investments of IFU and its managed funds, representing 21% of the total value of the portfolio. The list of case studies is included in Annex 5B. All investments in Kenya (12) were included in the sample and for Ukraine 10 and China 16. In additional, five funds were selected, four case studies in Least Developed Countries

(LDCs), two additional DCIF and one additional case in Latin America. The 50 case studies included 33 active investments and 17 exited investments as well as a representative balance between loans end equity investments: 57%/43% of the total value of investments covered in the sample were equity/debt investments, whereas this ratio for the overall IFU portfolio is 53%/47% for 2004-2017. The sample was chosen to be representative for the entire IFU portfolio in terms of geographic spread of investments, type of funds invested and older/newer investments (see more details in Annex 2). Figures 1-3 and 1-4 show the geographic and fund representativeness of the sample versus the overall IFU portfolio. The country context in the three selected countries for field visits can never be fully representative for all countries that IFU invested in, but this is compensated for by adding case studies in Low Income Countries (LICs) and Latin America.

The 50 case studies were analysed and recorded in case study assessment sheets regarding their performance related to seven key evaluation issues (relevance and complementarity, risk assessment, financial additionality, value additionality, Corporate Social Responsibility (CSR) performance, development outcomes and financial outcomes) based on underlying indicators presented in the evaluation matrix. A traffic light scoring system using the red-amber-green traffic lights was developed to analyse the 50 case studies to respect the confidentiality of investee companies. This system is based on an assessment of each of the indicators related to a specific evaluation issue and subsequent weighing of these indicators leading to a red-amber-green score for each evaluation issue per case study. For very recent investments not all issues could be scored as for these cases insufficient information was available. In each chapter and in Annex 2 the scoring system is further explained in detail. At the end of the field phase, overall scores on the basis of case study assessment sheets were aggregated and a consistency check was done by the evaluation (see Annex 2 for more details).

FIGURE 1-3 GEOGRAPHIC REPRESENTATIVENESS OF THE SAMPLE

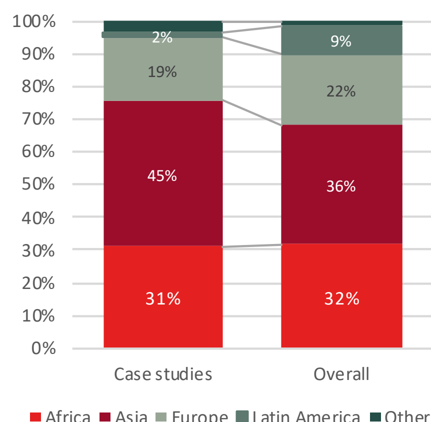
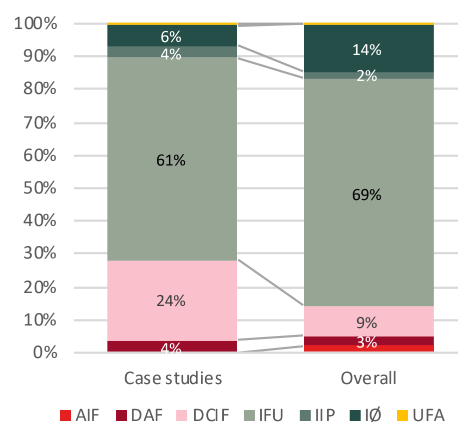


FIGURE 1-4 FUNDS REPRESENTATIVENESS OF THE SAMPLE



Note: Based on total value of investments of IFU classic and IFU managed funds for new and follow-on investments 2004-2017, net of transfers.

Source: Evaluation's calculations based on IFU portfolio data.

The following evaluation challenges and limitations were identified and addressed by the evaluation:

- Challenge to strike the right balance between depth and breadth given the complexity of the evaluation (773 investments, 15 IFU instruments, 14 years, many countries and stakeholders, changing policies, strategies and mandate). This challenge was addressed through an analysis at overall and portfolio level on the one hand, and sampling at various levels on the other hand.

- Difficulties to formulate specific indicators for key evaluation criteria such as relevance, additionality, and development outcomes as the definitions should be based on government policies and guidelines. The government has defined the mandate and on that basis and as part of the relevance assessment the evaluation has assessed whether IFU complied with the mandate. However, beyond the mandate the government did not define specific development or financial objectives that can be used as yardsticks in the evaluation. The evaluation has identified indicators based on the available IFU documents, general Danida policies and action plans and international literature.

- Evaluations of Development Finance Institutions (DFIs) and blended finance face common challenges to measure develop-

ment results.[8] The precise contribution of DFIs to specific development results is another step still to be taken. Therefore, in this evaluation no sound contribution analysis based on a Theory of Change has been conducted as the basic information is not available for such an analysis. However, some proxy indicators are used to assess the specific contribution of IFU to the achieved development results. No attribution analysis could be done in the absence of a counterfactual.[9]

- In the desk study phase some benchmarking with other DFIs was done based on publicly available information and some of this information is included in this final report.

- The evaluation has been conducted mainly from a development cooperation perspective (see ToR). Therefore, internationalisation of Danish industry has not been a key area of focus.

- A very strict limit for the maximum number of pages for the evaluation report was set for good accessibility. This means that methodological explanations cannot be provided in the main text but are presented in Annex 2. Also, the findings had to be kept to a strict limit. Some readers may be interested in more information on concepts, methodology and additional figures and tables presenting underlying evidence (Annex 3) and they have to check these annexes.

8 See e.g. OECD/DAC workshop 22 October 2018, Copenhagen, the next step in blended finance: addressing the evidence gap in development performance and results.

9 Development additionality has also not been assessed, which refers to the development impacts that arise as a result of investment that otherwise would not have occurred. The analysis of additionality in this report is limited to financial and value additionality (see Chapter 4).

2 RELEVANCE AND DEMAND-DRIVEN VERSUS POLICY-DRIVEN PORTFOLIO

In this chapter the relevance and complementarity of IFU instruments and the issue of demand-driven vs. a policy-driven portfolio are discussed, including compliance with the mandate. In Annex 2, indicators and the scoring of the case studies are explained.

KEY FINDINGS

- The portfolio of IFU is primarily been demand-driven by Danish business. The main explanation is that IFU's investments were tied to Danish companies (until 2015) or Danish interests (until 2017).
- The portfolio is to a limited extent policy-driven by the MFA. The main instrument for the MFA to steer IFU was the country mandate, which was limited to investments in poorer countries from 2005 to 2010 but was gradually broadened to various groups of upper middle income countries from 2011 onwards.
- While the MFA defined a maximum income threshold for eligible countries based on the World Bank classification for developing countries, the operationalisation of the country mandate was entirely left to IFU. This resulted in a number of exemption and phasing-out rules defined in 2003, which allowed IFU to help minimise the impact on its regular business with the tight mandate in 2005.
- IFU did not report separately to the MFA regarding its compliance with the mandate in the three sub-periods. There is also hardly any public information on the operationalisation of the mandate.
- A detailed portfolio analysis of compliance with the mandate of all IFU Classic investments during the period 2005-2017 shows that it is very plausible that IFU did comply with its mandate. IFU aimed to live up to its mandate, but a number of issues such as how investments in regional funds should be allocated, are difficult to assess in terms of compliance with its mandate. However, it is likely that these funds also operated in the lower income category countries as defined in the mandate.
- The portfolio analysis also shows that since 2010, there is a rapid shift towards more investments in upper middle income countries, which is logical given the broadening of mandate and the preference of the PPP funds to invest in more risk-averse countries.
- The portfolio also shows a steady increase in investments in Africa from 3% of total annual investments in 2004 to 35% on average during the period 2015-2017, which is in line with the ambitions of the MFA and IFU.
- IFU invested mainly in large Danish companies (more than half of the value of investments) and in Danish SMEs: (more than half of the total number of investments). Despite the SME Facility, investments in Danish SMEs have decreased over time. SME-investments are reported to be quite time-intensive and SME scores on all evaluation issues – with the exception of additionality – are lower than for larger companies.
- Most investments were done in relevant sectors from a host country development perspective, which explains to a large extent the three quarter positive scores of the 50 case studies on relevance and complementarity. Nevertheless, IFU has not pursued a proactive strategy to maximise development outcomes.
- There is in general good complementarity between IFU's main investment vehicles given the differences in sector and geographical focus. In theory, the additional government initiated grant and project development funds should be complementary to the investments, but with the exception of the CSR Training Fund they lack traction.
- The MFA specifically aimed for synergies among its business instruments, but only limited scattered evidence was found. Recently, IFU has been given a more central role to create synergies among Danish business instruments.
- Some evidence of increased synergies with other DFIs is found, which is partly due to the untying of IFU's mandate. However, competition among DFIs also increases especially in the middle range of developing countries with an improved investment climate. In these countries more DFI and private sector capital has become available, while there are insufficient bankable projects.

2.1 Relation between the government and IFU

The Act on International Development Cooperation specifies IFU's main objective, its name[10], how IFU should be governed as an independent institution, issues on dividend payments and capital extractions, limited applicability of the Public Information Act and the untying of the mandate in 2016 (effective in 2017). MFA/Danida policies specify strategic directions on the way forward. IFU also prepares strategies. In Table 2.1 the main MFA policy documents and guidelines for IFU as well as the IFU strategies during the three sub-periods are summarised.

TABLE 2-1 MAIN MFA POLICIES AND IFU STRATEGIES FOR THE THREE SUB-PERIODS

Sub-period	MFA policies	IFU Strategies
2004-2010	Focus on poverty reduction, in particular in poorest countries of Africa[11] Despite some business development programmes, relatively limited attention to business development[12]	"Facing New Challenges" (2008) with focus on how to work within the tighter government mandate and ideas for partial untying and set-up of a climate fund, that did not materialise during this sub-period
2011-2014	Growth and employment became a priority in Danish development cooperation, in particular Green Growth[13], and set-up of new business instruments including new IFU funds and facilities	Start of public-private partnership with two Danish pension funds: set-up of IIP and DCIF
2015-2017	More central role of private sector development[14] in Danish development cooperation. Set-up of more IFU funds and facilities 2017, Strategy for IFU in relation to new capital injection with a focus on mobilizing private capital	"Shifting Gears for Higher Impact" (2014) focussing on a broader and untied mandate "IFU Strategic Direction" (2017) with focus on strong returns and high development impact through the set-up of the SDG Equity Fund

10 In the new 2012 Act, the name of IFU changed from 'The Industrialization Fund for Developing Countries' to 'The Investment Fund for Developing Countries'.

11 A World of Difference: The Danish Government's Vision for New Priorities in Danish Development Assistance 2004-2008 (2003). Globalisation – Progress through partnerships. Priorities of the Danish Government for Danish Development Assistance 2006-2010 (2005). A World for All: Priorities of the Danish Government for Danish Development Assistance 2008-2012 (2007). Freedom from Poverty – Freedom to Change: Strategy for Denmark's Development Cooperation (2010).

12 Business Growth and Development: Action Programme for Danish Support to Private Sector Development in the Developing Countries (2006).

13 The Right to a Better Life: Strategy for Denmark's Development Cooperation (2012). Strategic Framework for Priority Area: Growth and Employment 2011-2015 (2011).

14 The World 2030: Denmark's strategy for development cooperation and humanitarian action (2017). The Ministry of Foreign Affairs' Strategy for The Investment Fund for Developing Countries (IFU) 2017-2021 (2017).

This overview shows that IFU strategies are in line with the changes in MFA/Danida policies, which are also reflected in the mandate changes (see Section 2.2). During the evaluation period, the priority for business development increased in the MFA policies. This went hand in hand with a more central role of IFU in MFA's development policies, including the set-up of new government-initiated funds and facilities, and the transfer of DBF. The table also shows that IFU did take several initiatives to broaden its mandate and over time the MFA responded positively to IFU's suggestions. The table does not show the capital extractions by the Danish State for IFU and IØ with a total amount of DKK 4.4 billion, which affected IFU's performance (see Section 6.2). Annex 3, Table A3.1 shows an overview of the DKK 1.8 billion commitments of institutional investors in the various PPP funds as well as government and IFU contributions to both PPPs and other IFU managed funds.

2.2 Changes in mandate

FROM A TIED TO AN UNTIED MANDATE

The previous IFU evaluation (2004)[15] recommended that "IFU's objective should be modified so that the tying to Danish companies is abolished. This would facilitate cooperation with other DFIs, particularly the EDFIs and with venture capital funds in developing countries." IFU was of the opinion that untying could increase investments in Africa and contribute to the aim of poverty reduction in Africa.[16] Around 2008, preparations at government level started for a legislative amendment on the issue of untying. In 2010, however, the MFA indicated that after internal inter-ministerial discussions, it was decided not to proceed with legislative changes. The reason was that there was at the time no political backing for the untying of IFU from investments in Danish companies.[17]

IFU remained in favour of untying. IFU argued that with a continuation of the tied mandate it would move too far away from poorer countries as Danish companies considered poorer countries as rather risky. In response, the MFA argued in discussions with the business community that IFU could play a role as first-mover in risky markets, not being tied to Danish interest. This would allow IFU to pave the way for other Danish companies who could follow with own investments in these countries. In 2015, after a long debate, IFU was allowed to invest in projects having a

15 Ministry of Foreign Affairs, Danida (2004). Evaluation of The Industrialization Fund for Developing Countries, p. 73.

16 IFU, Facing New Challenges, 2008.

17 Minutes from MFA-IFU Coordination meeting on 4th of June 2010; Rigsrevisionen (2010). Notat til Statsrevisorerne om beretning om Udenrigsministeriets investeringsfonde, IFU og IØ. October 2010.

Danish economic interest.[18][19] In December 2016, The Danish Parliament agreed on fully untying.[20]

The untying has gradually led to identifying and engaging with some more non-Danish investment partners in 2017, but the overall volume of investments without any Danish interest remained still very low and is not substantially higher than in some previous years, in which IFU also sporadically engaged with non-Danish partners. This may be understandable since the law only came into force 1st January 2017. The consequence of the tied mandate was that IFU investments were mainly driven by the demand from Danish companies. This meant that – compared to other DFIs – IFU did for a long time not need to develop specific sectors of focus (see Figure A3-1). Agribusiness has been an important sector throughout the whole evaluation period, while industry/manufacturing declined in importance. This were sectors where Danish demand was quite well developed. The implication is that IFU was relatively absent in sectors where other DFIs have been very active, such as finance, but where there was limited Danish demand. Recently with the untying of the mandate more investments were made in the financial sector – in particular fund investments in microfinance – and also in forms of renewable energy such as solar energy (via DCIF) and infrastructure where Danish business is not very active. However, as full untying became only effective in 2017, the portfolio analysis does not show clear changes in sector focus, with the exception of renewable energy, which has become more important since 2012 (see Figure A3-1).

FROM A NARROW TO A BROAD COUNTRY MANDATE

The MFA changed IFU's mandate three times during the evaluation period as presented in Annex 3 – Table A3-2.[21] As explained in Section 1.2, the changes applied meant an initial tightening of the mandate but after that an increasingly flexible mandate for IFU in terms of countries they could invest in over time (with the first period 2005-2010 most strongly focused on investments in lower income countries). Documents

18 In an amendment to the Act on International Development Cooperation.

19 IFU (2009). Annual Report, page 14: This could be a Danish company supplying goods, knowhow, technology, management or services to the project; a Danish company having an operating and maintenance agreement with or off-taking products from the project; a project using state of the art Danish technology or a project that directly or indirectly generates jobs in Denmark.

20 The Danish Parliament amended the Act on International Development Cooperation again and IFU became legally untied from only making investments with a Danish partner or a Danish interest https://www.retsinformation.dk/pdfPrint.aspx?id=142451.

21 The first two mandates were based entirely on the World Bank country classification, while the last country mandate from 2015 is partly based on the OECD-DAC classification (reference is made to LDCs and investments are allowed in all countries classified as developing countries according to the DAC list), while for the 50% investments in LMICs up to the 80% income limit, the WB classification is still used.

and interviews made clear that IFU was never in favour of a narrow mandate as it felt it would become irrelevant in the international DFI landscape. Therefore, IFU argued for broadening the country mandate. IFU's arguments[22] are clearly reflected in MFA's justification for broadening the mandate in 2011 when it stated: "*The consequence of maintaining the current national income limit will be that an increased number of developing countries, including in Africa, will come above the country income limit. Since the 2005 change, the overall growth in the countries has meant that 23 developing countries have ceased to be IFU countries. In addition, it is noted that IFU is expected to be able to increase its return if it is possible to invest in countries with a higher income limit*."[23]

The three mandates that were given to IFU during the evaluation period focused primarily on defining the geographic scope of activities of IFU in terms of eligible countries IFU could invest in. While the mandates formulated by the MFA to IFU in 2005, 2011 and 2015 contained a clear measurable reference to the maximum threshold for IFU's eligible countries, a number of operational aspects were not defined sufficiently and had to be operationalised by IFU. IFU and the MFA agreed on certain exemptions to the country limits posed[24] and agreed on some further operational rules in letters and Board meetings. The Board agreed in November 2003, prior to the 2005-mandate change, that investments in countries that had exceeded the eligible country limit could be approved in case preparations for the investment had begun in the year in which the country was still eligible for investments.[25] In the same note, IFU and the MFA also agreed that follow-on investments in countries that had exceed the eligible limit could be made to safeguard investment positions. In general terms, these additional rules were also included in the mandate letter from 2005. The broad description of IFU's mandate by the MFA, in combination with the various exceptions and operational rules, makes IFU's mandate complex, somewhat intransparent, difficult to measure and not always sufficiently clear:

- The exemptions and operational rules put in place by IFU to further operationalise the mandate have hardly been publicly

22 IFU argued that it expected to be able to increase its returns on investments if it would be made possible for IFU to invest in countries with a higher income limit. Another argument was that given the economic growth in Africa and other continents an increasing number of countries was expected to graduate to UMIC level. This would mean that IFU would have too limited investment opportunities.

23 Folketinget (2011): Aktstykke 84, page 1.

24 Investments in graduating countries, for which a Clearance in Principle (CiP) were approved when the country was still eligible, could be completed. Also, exceptions for follow-up investments were agreed upon, in addition to exemptions for South Africa, Botswana and Namibia.

25 November 2003, Extraordinary Board meeting.

communicated[26] and internally only documented as minutes of board minutes or bilateral letters. There has also not been a direct follow-up after 2003 between IFU and the MFA on how IFU specifically operationalised the mandate, such that certain rules could explicitly be approved by the MFA or adjusted when needed.[27]

- In absence of follow-up meetings between MFA and IFU on the operationalisation of the mandate, IFU continued to apply the earlier agreed exemptions and rules between IFU and MFA, without explicit approval by the MFA
- Neither the mandate nor the operationalisation of it by IFU contain(ed) clear rules on how investments in third-party funds should be dealt with when checking compliance with the mandate. Many of IFU's investments in third-party funds have a multi-country or regional character. In order to be compliant with the mandate, all countries in which the third-party fund could invest should be below the 80% LMIC income level for the period 2005-2010. For the years thereafter, an accurate mandate analysis of the fund should involve a check of how many investments are made in which type of countries (UMIC or LMIC). Neither IFU's operational rules nor the mandate are clear about how to check the compliance of such fund investments with the mandate.

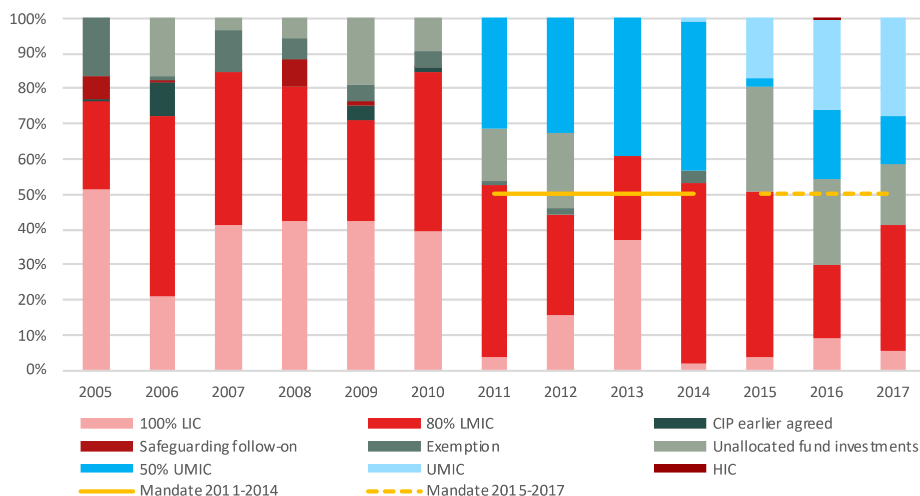
The MFA also never specified how IFU should report on its compliance with its complex mandates. IFU refers for evidence on compliance with its mandate to the investment data in its annual reports, but those annual reports do not contain sufficient detail to be able to draw conclusive findings on IFU's compliance with the mandate.

A rigorous objective analysis has been conducted of IFU's investment activities against the mandate criteria and rules as operationalised by IFU and is presented in. Figure 2-1. The analysis is based on new and follow-on investments made by IFU Classic (more methodological details on the analysis of IFU's mandate are presented in Annex 2).

26 Exempted countries and the phase out rule were mentioned in selected annual reports, but not in a systematic way.

27 In 2010, in a letter to Rigsrevisor and MFA IFU explained the principles which were accepted without further enquiries.

FIGURE 2-1 IFU COMPLIANCE WITH ITS COUNTRY MANDATE, NEW AND FOLLOW-ON IFU CLASSIC INVESTMENTS, 2004-2017



Source: Author's analysis based on IFU portfolio data.

As a result of the various exceptions and rules visible in the graph[28], it is not directly obvious whether IFU complied with its mandate. Most of the uncertainty is caused by the difficulty to allocate IFU's investments in regional funds in one specific category. However, based on the documentation received, it is likely that these funds indeed invested to most extent in the poorer country category, it is very plausible that IFU has operated within its mandate.

In the period 2005-2010, IFU directly complied with its mandate in 2005 with a number of investments that were either initiated or concluded before the mandate became active in June 2005 (labelled exemption together with investments in exempted South Africa, Botswana or Namibia) or for which Clearance in Principle (CIPs) were agreed when countries were still eligible (grey area). In the period 2006-2010, IFU invested in some regional funds that cannot conclusively be allocated to country categories as defined in the mandate, as explained earlier (brown area). The broadening of the mandate in 2011-2014 is clearly visible in Figure 2-1 and IFU complied with its mandate directly in 2011, 2013 and 2014 and most likely in 2012 too since the country focus of the unallocated funds in that year included various countries below the 80% LMIC limit. The further broadening of the mandate in 2015-2017 is also clearly visible with a significant share of investments also going to UMIC countries in these years. Compliance of IFU with its mandate for 2015 is directly visible, while for 2016 and 2017 it is less obvious, but also likely given the fact that a rolling average of the last three years of

28 Labelled in the figure as 'CIP earlier agreed', 'Safeguarding follow-on', 'exemption' and 'unallocated fund investments'.

investments needs to be computed and a share of the unallocated funds will be countries below the 80% LMIC limit.

Yet a fully conclusive objective conclusion on IFU's compliance with its three mandates cannot be formulated in the absence of clear criteria on how to treat investments in regional funds that focus on making investments in a variety of countries (both LMIC and UMIC) as these funds cannot be allocated to one particular country income category. In the years 2012, 2016 and 2017, it is assumed that the majority of the third-party funds that could not be allocated ('unallocated fund investments') operated in countries below the 80% LMIC limit, which allow IFU to comply with its mandate in those years. It is however also clear that IFU's investment focus is increasingly shifting towards higher income countries over time (in line with its broadened mandate).

From 2005 onwards, IFU was expected to focus in particular on Africa. Therefore, in 2005 IFU prepared a strategy how to refocus its investments on poorer countries, and in particular on Africa. This note was discussed in an extraordinary Board meeting in 2005. One year later a follow-up note was presented in another Board meeting. From 2005 to 2014, IFU's annual reports also contained specific sections on its Africa focus. The portfolio analysis indeed also shows increasing investments in Africa with an increase from 3% of the value of annual investments in 2004 to on 40 % in 2017 (see Figure A3-2).

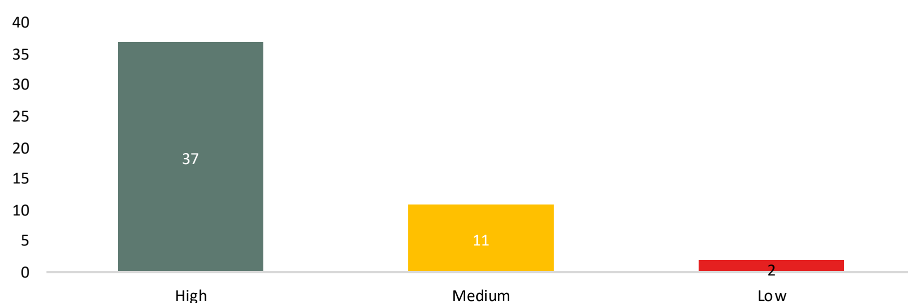
In 2005 it was also agreed that China's share of investments should be limited to around 15%, but maximum 20% of the entire IFU portfolio. The limit to investments in China was based on the 53% share of annual investments in 2004 of IFU Classic. Figure A3-3 shows that after 2004 the annual share of investments in China showed variations but decreased on average. From 2015 onwards, a rapid decrease in investments in China is visible both due changes in demand and some edging out of DFIs, and also to some IFU staff shortages in China during that period. An analysis on IFU's compliance with the specific China limit could not be performed since the portfolio data received did not allow for an analysis of outstanding investment amounts compared with the net IFU investment portfolio. However, IFU's annual reports since 2005 includes explicit information on the China exposure. The percentage is below 20 for all years and stands at 8.4% in 2017.

2.3 Assessment of relevance and complementarity

The assessment of relevance and complementarity of the 50 case studies should be based primarily on the policy guidelines and the government mandate. The analysis above made clear that all case studies are in line with the mandate and the broad policy guidelines provided. The evaluation made an assessment of relevance and complementarity based

on six indicators: (1) the extent to which relevant country and sector development needs are addressed; 2) the extent to which Danish private sector development (PSD) needs are addressed; 3) the extent to which PSD needs of developing countries are addressed; 4) complementarity of IFU instruments; 5) synergies with other Danish activities/instruments; and 6) synergies with other DFIs (see Annex 2, Table A2-7 for more details). The first indicator regarding relevance had the highest weight in the scoring, followed by a medium weight for the two other relevance indicators, while the last three scores regarding complementarity had the lowest weight. This leads to the following scores for the 50 case studies:

FIGURE 2-2 CASE STUDY SCORES FOR RELEVANCE AND COMPLEMENTARITY



The relatively high scores for relevance and complementarity (approximately three quarters of the case studies show a high score) illustrate that most investments are done in relevant sectors in developing countries and that, in particular Danish PSD needs are addressed. The assessment of the extent to which developing countries needs are addressed is more complicated (see Section 2.4). The 13 cases with a medium or low score are cases where no clear private sector development needs at country or sector level are addressed and where there is no evidence of complementarity. The scoring also takes into account that development needs are changing over time in line with the evolving country context. This has been the case for some cases in Kenya (recent and often not well-designed investments in a flower farm, a four- to five-star hotel, online beauty industry), one case in China and five out of 15 SME cases (see Section 2.4). In China there were only a very limited number of investments in West-China, which is relatively poor, and which was indicated by the MFA as priority region. Nevertheless, based on the applied criteria most investments in China still took place in relevant sectors at the time and addressed relevant development needs. This was also the case in Ukraine. The scores for relevance and complementarity do not significantly vary across the various IFU funds. There were a few cases with problematic outsourcing of production activities to developing countries, which negatively affected the relevance score.

Examples are Danish companies that already faced market problems, but in an ultimate attempt to reduce the production costs they decided to outsource production activities assisted by IFU. In these cases, broader development needs of developing countries were hardly taken into account.

Investments made in the renewable energy sector have generally been scored as relevant since they contribute to positive environmental development effects. Therefore, the DCIF case studies also scored on average (very) well on the relevance criterion. Nevertheless, it is not the case that by definition investments in score high on relevance, because the investment context needs to be still considered (there should be no negative side-effects or obvious trade-offs). For example, new renewable energy projects need to be able to be incorporated in the capacity and structure of the national grid in order for the positive effects to materialise. One of the DCIF cases had also flagged this as genuine risk to the business model (curtailment risk) and had mitigation measures in place for it. The DCIF programme document and the DCIF MTR also indicated that DCIF should not only focus on climate mitigation, but also on climate adaptation projects. However, in practice no climate adaptation projects were realised as these are not yet commercially viable. This issue also points at a difference between what is highlighted in MFA programme documents on the one hand and in the Private Placement Memoranda (PPM) and in the actual management of PPP funds on the other.

The field visits and also literature show that the investment climate is rapidly changing in many countries. In most developing countries with a relatively good business climate more FDI capital has recently become available[29], as donors are now more focused on blended finance and capital contributions to DFIs, while also more private equity funds are active. Due attention is needed to the development of demand as there is a lack of bankable projects in many countries. There are some exceptions though: in Ukraine the investment climate has not improved substantially since the 2014 crisis and also the LDCs and fragile countries are confronted with limitations regarding the availability of capital.

In 2004, at the start of the evaluation period, DFIs were working in the international arena, but were relatively disconnected from the broader international policy agenda. However, this gradually changed. DFIs have shown rapid growth of more than 600% between 2002 and 2014 based on government and private sector capital injections and retained profits, compared to 50% growth of Official Development Assistance (ODA) during the same period. Governments now consider DFIs as key institutions to promote private sector development in order to achieve

29 OECD (2016), Development Co-operation Report 2016, Chapter 'Trends in foreign direct investments and their implications for development'.

key development outcomes including the Sustainability Development Goals (SDGs) formulated in 2015. The main common challenge for DFIs is to act as a driver to maximise development outcomes and impact on the one hand and being commercially sustainable on the other.

2.4 Danish and developing country private sector development needs

DANISH PRIVATE SECTOR DEVELOPMENT NEEDS

The tying of IFU investments was meant to serve the needs of the Danish private sector and this led to specific focal sectors for IFU for a long time (see Section 2.2). The Danish business community was also very much interested in the broader mandate discussion, i.e. the countries that IFU was allowed to invest in. IFU, Dansk Industri (DI) and Danish companies encouraged MFA at various occasions to increase the income limit that was set in 2005. They stressed that with the very tight limit, IFU would risk losing its customer base and relevance to Danish business' globalisation into emerging markets in developing countries. Furthermore, it was stressed that many Danish companies saw Africa as a continent with high financial and political risks.[30][31]

It is often argued that IFU addressed the internationalisation needs of the Danish business community, and IFU may have facilitated as first-mover the way into new emerging markets, where without IFU Danish business would not have gone. However, as indicated in Chapter 1, this aspect of internationalisation is beyond the scope of this evaluation. The evaluation found that the investments needs of Danish business, in particular, larger companies changed considerably over time. Large Danish companies can now more easily find money on the capital market for investments in developing countries, which explains why the IFU partners change over time.

LARGER COMPANIES VS. SMES

For a long time IFU aimed to serve both the larger Danish companies as well as Danish SMEs.[32] IFU made quite some large investments in various large Danish companies[33] that wanted to expand abroad (both

30 IFU (2008). Annual report, page 15.

31 IFU (2009). Annual Report, page 3.

32 The definition of a SME is a company with less than 250 employees, turnover below EUR 50 million or balance below EUR 43 million.

33 Regarding the terminology to be used: either IFU invests directly in a project company (for example, IFU invests in parallel with a parent/holding company in a subsidiary) or IFU's investment is routed via a parent or holding company, in which case it would be appropriate to say that IFU invests with a (large) Danish company. However, in order to use uniform terminology, the term 'invest in' is used throughout the report.

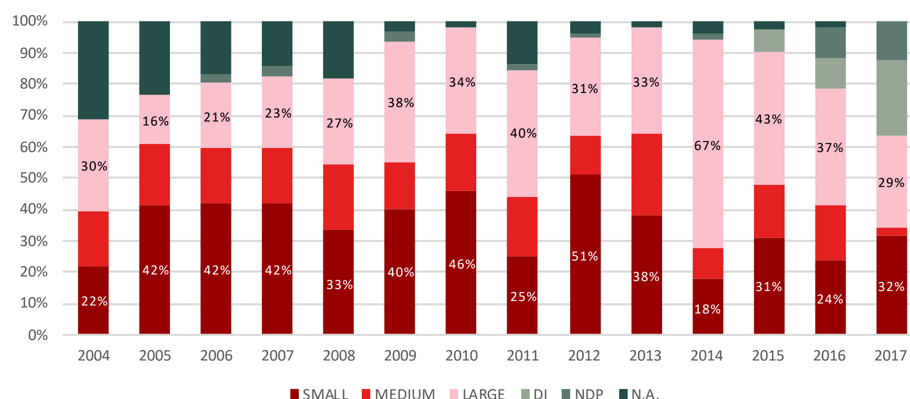
new and follow-on investments). The top-10 companies in which IFU invested received 27% of the contracted portfolio over the entire evaluation period. Figure 2-3 shows the number of investments per type of partner (Danish partners: small, medium and large, Danish interest and non-Danish partner or interest):[34]

The figure shows that for the period 2005-2013, most investments were made in SMEs, with the exception of the year 2011. However, from 2014 the number of investments in SMEs declined. This can be directly related to the 2014 IFU strategy, which was rather critical of IFUs investments in SMEs indicating that "*a substantial proportion of minor investments with small investment partners fail and therefore places a heavy burden on IFU's organisational resources whilst generating a net financial loss for IFU and a questionable development impact*".[35] It was estimated that Danish SMEs took up approx. 50% of IFU's organisational resources, accounted for only 15% of disbursed funds and were loss-making to a large extent. The 15 SME case studies in the sample point at less than average performance on most evaluation issues (see below). Although in terms of numbers most investments were made with Danish SMEs, in terms of volume of investments with large Danish companies were always most important (52% of the total value of investments, 2004-2017). Since 2015 when the mandate was partially untied, more investments in partners with Danish interest and non-Danish partners were realised. This included investments in funds and in the financial sector, where IFU was necessarily less active before, compared to other DFIs.

34 The classification of Danish partners was provided by IFU and the following criteria were applied: Small: turnover <= DKK 74.5 million and employees <=49 employees; large: employees >=249 employees or: turnover >= DKK 373 million and balance >= DKK 320 million.

35 IFU Strategy (2014) – Shifting Gears for Higher Impact (2014-2018), p. 14.

FIGURE 2-3 NUMBER OF INVESTMENTS (NEW AND FOLLOW-ON) BY SIZE OF DANISH PARTNER AND NON DANISH PARTNERS, IFU AND IFU MANAGED FUNDS, 2004-2017



Source: Portfolio data.
DI is Danish interest, NDP is No Danish Partner and N.A. is not available.

The 2014 IFU strategy aimed at a new focus on Danish SMEs, with an emphasis on fewer SMEs which are better prepared and of better quality. In response, in 2016, a SME Investment Facility funded by the MFA was set-up and an investment team for Danish SME partners was established within IFU. The SME facility aims to help Danish SMEs having access to better advisory support and hand-held guidance during the preparation and the initial critical years of the project's life cycle with the goal of securing higher chances of successful projects and long-term survival.[36] A recent review (2018) of the SME Facility concluded that "*IFU is far from achieving the target mentioned in the project document*[37] *of 40-50% new projects with SMEs*". The SME Facility overview (2015-2017) shows that 21 SMEs received grants for investments mainly in UMICs. IFU realised investments in the business plans of 10 of these 21 SMEs. The SME Facility does so far not meet its quantitative targets. In the evaluation sample, three case studies were included of SMEs that received SME grants. The SMEs were happy with the additional support received, but they were also somewhat critical indicating that the support could have been more tailor-made and complained about the heavy IFU requirements. The SME Facility aimed to improve the quality of investments in Danish SMEs and their outcomes, but the small evaluation sample did not find evidence on such an improvement. Also, the Ukraine Investment Facility (UFA) was specifically focused on Danish SMEs but was quite far from realising its targets end 2017 and it has recently been merged into the new NEIF facility.

36 IFU (2016). Annual Report, page 25.

37 Project Document, IFU SME Investment Facility, 25 July 2014, Annex 1.

IFU acknowledges that the expectations regarding Danish SMEs were probably too optimistic when the SME Facility started, and that traction is slower than expected. IFU wants to continue its investments in Danish and other SMEs. Following the 2018 SME Facility Review IFU introduced an adjusted SME definition to allow for the inclusion of a broader range of SMEs. In addition, IFU has recently taken measures to address needs of local SMEs especially through investments in the financial sector and microfinance, i.e. sectors in which IFU traditionally was less active.

PRIVATE SECTOR DEVELOPMENT NEEDS OF DEVELOPING COUNTRIES

As this evaluation covers a 14-year time period from 2004 to 2017, the development challenges that IFU and other DFIs are facing have changed enormously. DFIs address a broad range of PSD needs of developing countries ranging from an enabling business environment and regulatory framework to capacity development, growing companies and sectors to making markets work for the poor. DFIs offer a range of different services and products, but all DFIs have in common that they invest in companies in developing countries aiming to contribute to capacity development through the transfer of knowledge and technology, creation of jobs, economic growth and poverty reduction. While in the past, DFIs focused mainly on the financial/investment side of business, recently they have become more firmly focused on contributing to the broad development gaols i.e. the SDGs.[38]

For most of the evaluation period, IFU worked with a tied mandate and invested in and with Danish companies in developing countries. Within this tied mandate, IFU could address relevant PSD needs of developing countries especially through investments in relevant sectors with the potential of job creation and capacity strengthening. The 74% green scores of the case studies on relevance and complementarity indeed show that important development needs were addressed. The main development focus was on job creation and capacity strengthening of the staff working in the investee companies. The case studies showed that the focus of IFU on addressing broader development needs, e.g. related to business reform and overcoming market obstacles was more limited, which was in line with most bilateral DFIs during the evaluation period.

A complicated analysis is to assess to what extent the tied IFU mandate hindered or not the development focus, i.e. the optimisation of development outcomes. From a development perspective it was often argued that the tying to Danish companies was not in the interest of developing

38 CSIS and ODI (2016), Daniel F. Runde and Dirk Willem te Velde, Development Finance Institutions Come of Age, Policy Engagement, Impact, and New Directions, p. vi.

countries.[39] Given the tied mandate, no direct private sector needs in developing countries in terms of investments in national companies could be addressed. However, IFU argues that for many investments the Danish partner worked with a local partner and in this indirect way private sector needs in developing countries such as strengthening of local ownership and management were addressed. Figure 2-3 above shows an increase in the portfolio of non-Danish partners in 2017, but these are not necessarily host country partners in the sample, only in 14 out of the 50 case studies a local partner was engaged. Danish SMEs in most cases do not have a local partner, but also larger Danish companies in which IFU invested often did not have local partners, as this was is often considered to be quite risky. In general, both the investee companies and IFU show in their risk assessment some reluctance to have local partners. The presence of a local partner and contributing to strengthened local entrepreneurship is only one of the possible indicators to assess to what extent IFU has addressed PSD needs of developing countries. As has been indicated above, investments in relevant sectors and contributing to job creation and to transfer of knowledge and technology also have been taken into account, which explains the overall positive scores.

In addition, IFU perceives investments in greenfield projects (i.e. new set-ups) as having potentially the highest development impacts, while brownfield projects (i.e. investments in already existing companies) are assumed to have less development impact. IFU indicates in its annual reports that the majority of investments have taken place in greenfield projects, i.e. establishment of new companies. The sample shows that 40 of the case studies were greenfield projects and only 10 were brownfield projects. Indeed, in greenfield projects all jobs created are additional and the potential development impact might indeed be higher (see Chapter 5).

For IFU the point of departure has for a long time been the demand from Danish companies that wanted to be active in developing countries. With the untied mandate this focus has recently broadened primarily to Danish interests and some other actors. An important underlying assumption is that IFU expects that investments in private sector companies will, in principle, generate positive development outcomes. In its risk assessment IFU carefully analyses whether this is the case and that no negative development outcomes are expected or whether negative effects can be mitigated (see Chapter 3). However, there is no real focus on maximising development outcomes, i.e. weighing off investment proposals on their expected development impact or discussing ways during the investment process how to increase development impact for a certain project.

39 E.g. see the 2004 Evaluation of IFU.

Finally, an analysis of the type of countries and regions in which DFIs are active is often considered as an indication of the development focus of DFIs. Therefore, benchmark figures on DFIs often show the share of investments in different regions such as Sub-Saharan Africa and type of countries such as Least Developed Countries (LDCs) and or fragile countries. Governments that provide capital to DFIs often formulate country mandates, as was discussed for IFU in Section 2.2. The changes in investment climate in various regions are also reflected in changes in mandates and the composition of DFI portfolios, e.g. DFIs are hardly present anymore in Eastern Europe as they are edged out by private investors, while DFIs have also become significantly less active in China during the evaluation period. Benchmark figures for DFIs show considerable differences in their focus on poorer and/or fragile countries and on Sub-Sharan Africa (SSA). IFU as one of the smaller European DFIs attains average figures for its investments in SSA (34% for IFU[40] and 31% for 15 European DFIs in 2017, with the highest share of >70% for Swedfund and near 50% for Norfund and BIO). The 15 European DFIs invested approximately 17% of their portfolio in LDCs. While this percentage for IFU is also exactly 17% (IFU Classic and IFU managed funds) over the entire evaluation period (2004-2017), in relative and absolute terms the IFU investments in LDCs have declined over time in each new mandate period (average of 30% in 2005-2010, 12% in 2011-2014 and 6% in 2015-2017). Figure 2-1 shows that this is also the case for only IFU Classic investments.

2.5 Internal and external complementarity of IFU

Complementarity is assessed through the indicators related to synergies with other IFU instruments (internal complementarity) or synergies with Danish government business instruments or other DFIs (external complementarity). In approximately one third of the cases the combined scores on the two complementarity indicators are positive.

INTERNAL – COMPLEMENTARITY AMONG IFU FUNDS AND FACILITIES

In terms of complementarity three groups of IFU investment vehicles can be distinguished (PPP and IFU managed funds included): 1) General funds such as IFU Classic and IIP; 2) Funds with a geographical focus: such as AIF, IØ and UFA; and 3) Funds with a sector focus: DCIF and DAF (see Figure 1-1 and Annex 4 for a complete overview).

In principle, the investment funds are complementary to each other as either the focus is different, or the funding source is different. In

40 The portfolio data shows 26% in SSA including investments in funds with a regional African focus. It goes up to 32% if all funds which are classified as ‘DAC developing countries’ in the portfolio are included in the SSA category.)

China, complementarity in terms of funding source was important given the ceiling of max 20% of annual investments. In 2013, in one of the case studies half of a huge investment was funded by IFU Classic and the other half by IIP for various reasons including the China ceiling. In Ukraine, good complementarity between IØ and IFU Classic was found with transfers of investments from IØ to IFU Classic when IØ was phased out. Complementarity of UFA was more problematic as the rationale for UFA was not very clear (see Section 2.4), which negatively affects complementarity. DCIF and DAF are in principle complementary to IFU Classic, but also show overlap. One investment has been transferred from IFU Classic to DAF at market value. Another project was transferred from IFU Classic to DCIF before the financial close. These transfers allowed IFU to build up a pipeline for the PPP funds. DCIF and DAF had the right of first refusal, which meant that more risky investments went to IFU Classic. For the SDG Equity Fund the same challenge exists.

The MFA has set up various grant facilities to be managed by IFU to assist in particular the Danish private sector in its investments abroad both during the preparation phase as well as during implementation (see Figure 1-1 and Annex 4). An overview of the MFA commitments to the various grant facilities is presented in Annex 3 (Table A3-3) as well as the main features of these grant and other facilities (see Table A3-4). While the SME Facility, NEF, and the PDP were all meant to contribute to better prepared bankable projects, and therefore they should be very complementary to the investment vehicles. In practice, NEF and the SME Facility suffer from a certain lack of traction, and limited evidence on synergies was found. The CSR Training fund (to be replaced by the Sustainability Facility) provides grants for CSR activities (see Section 5.2 and Annex 4) and is complementary to the investments. The additionality of the grant facilities will be discussed in Chapter 4. The transfer of DBF to IFU in 2017 is expected to lead to improved synergies in infrastructure projects, but this falls outside the scope of this evaluation.

EXTERNAL – GOVERNMENT/MFA/DANIDA BUSINESS INSTRUMENTS AND DFIS

During the evaluation period, there have been various attempts to increase the synergies with other Danida/MFA business instruments such as the Business-to-Business (B2B) programme and its successor the Danida Business Partnership that provided grant support to Danish companies and their partners. The case studies showed that some IFU investments were an offspring of B2B projects, but in general very limited evidence of synergies was found. The new Danida Market Development Partnerships Programme (DMDP- 2017-2020) is centralized and therefore synergy options with IFU appear to be even more limited than in the past.

Another initiative to promote information exchange and collaboration was the GoGlobal initiative that aimed to bring together all main actors

active in PSD in developing countries including the MFA, IFU, the Export Credit Agency (EKF) and the Trade Council. Other evaluation studies and reports have shown that synergies have remained rather limited so far: the GoGlobal initiative did not go further than some information exchange, and the studies did not show evidence for real synergies between IFU and other actors such as EKF. While EKF has provided guarantees to banks providing loans to IFU investee companies, no signs of direct collaboration between IFU and EKF were found.

The co-location of IFU country/regional offices with an embassy/consulate was a specific measure to increase synergies. In practice, this has indeed led to frequent contacts and more collaboration with the Trade Council and other diplomatic staff to organise joint events, etc. There are some indications for increased collaboration between IFU and the Trade Council also as a result of the framework agreement signed by the two parties in 2017 and related to the co-location, but this is primarily at the input level. If the IFU office is located in an embassy at a distance from the business centre with tight security, the co-location has also specific disadvantages for IFU as it complicates their daily operations. For a few case studies, some evidence on synergies was found where embassy staff assisted with tax issues or through policy dialogue to create an enabling environment for the investments.

In view of the recently untied mandate, IFU is expected to work more closely together with other DFIs especially in poorer less developed countries where the IFU track record is more limited. An example is the joint funding together with Finnfund and Swedfund of a small equity fund in Somalia. On the other hand, as there is a relative scarcity of bankable projects, DFIs are also increasingly competing with each other. Therefore, DFIs including IFU invest in specific funds/companies focusing on project development in particular for Renewable Energy.[41] In emerging markets DFI's importance decreases as more private sector funding sources become available. In the past DFIs were edged out from Eastern Europe, but some DFIs have also withdrawn from other emerging markets. The consequence is that with increasing availability of DFI capital, DFIs tend on the one hand to concentrate on specific countries with a relatively favourable investment climate, while (some DFIs) also gradually move towards LDCs and fragile states in order to live up to their development mandate.

41 Three RE project development/investment funds have been included in the sample: one funded via IFU Classic and two via DCIF.

3 EFFICIENCY OF THE ORGANISATION AND RISK ASSESSMENT

In this chapter two evaluation issues are merged: 'Efficiency of the organisation' including an analysis of governance, the organisational structure, operational efficiency and efficiency of the investment process, and 'Risk assessment' (See Annex 2 for sub-questions and indicators in the evaluation matrix).

3.1 Governance and organisational structure

SUPERVISION AND OVERSIGHT

IFU is a state-owned institution for which the Danish governance policy for state-owned institutions applies.[42] In a 2007 report on IFU, the National Audit Office (NAO) concluded[43] that *"The MFA has not provided sufficient, concrete information about the funds' investments".* [44] The NAO criticised the MFA in particular for not having ensured sufficient and concrete information on IFU's investments in poorer countries. Although this NAO report did refer to a previous mandate, it is indicative for the MFA oversight at the time. The NAO report led to a restructuring of the oversight regulations. Main oversight functions are that the MFA should collect and follow-up on relevant information and evaluate the activities of IFU in addition to effective coordination and ensuring that Parliaments decisions are followed. In 2010, in a follow-up to the 2006-2007 NAO investigation, it is mentioned that the MFA concluded a supervisory

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42 Finansministeriet (2015). Statens ejerskabspolitik. The Act on International Development Cooperation stipulates how IFU should be governed as an independent institution. The Danish National Audit Office (NAO or Rigsrevisionen) supervises IFU's activities.

43 Rigsrevisionen, Beretning til Statsrevisorerne om Udenrigsministeriets investeringsfonde, IFU og IØ, Maj 2007, RB A503/07.

44 The Act 382 26/6 1996 is related to a capital contribution of DKK 750m to IFU to be invested in poorer more risk-prone countries, particularly in Africa. While the purpose was that IFU should be more focused on risky investments in poor countries, this did only happen to a limited extent with the consent of MFA, according to the NAO. In 2012, the two MFA representatives on the Board of IFU were replaced by one MFA observer in the Board. According to all stakeholders interviewed, this did not affect the Board's work.

agreement with IFU and IØ.[45] Since 2008 the following mechanisms are in place:

- Annual meetings between the Minister for Development Cooperation, the Chairman of the IFU Board and the CEO of IFU;
- MFA-IFU bi-annual High-Level Coordination meetings at senior management level;
- Regular informal meetings and exchange of information between MFA and IFU staff.

The minutes of meetings indicate that important topics such as the tied mandate and the country limits for investment were discussed. The minutes and interviews show clearly that the relations between the MFA and IFU were strained during the first sub-period, but gradually improved since 2011. The two parties now agree that *"the relationship has never been better".* An important governance question is whether MFA's oversight is still given sufficient attention given the improved and close working relations. This question can only be answered when the various issues on which oversight is based such as financial and value additionality, development outcomes and financial returns have been analysed as part of this evaluation.

IFU BOARD

The Minister for Development Cooperation appoints all members of the Board of Directors[46] for three-year terms. During the evaluation period, the number of Board members has varied between 10 and seven. The Board has become relatively smaller after 2010. The Chairman and Deputy Chairman have served for a long period of time albeit in different roles, since 2000 and 1994 respectively.[47] The other Board members are more recently appointed (2009 and later). Most Board members have a financial background. The Board of Directors convened six to 10 times a year during the evaluation period, and recently the number of meetings has gradually reduced somewhat. The Board served as an investment

45 Several parties have referred to this agreement, but neither the MFA nor the IFU have been able to find this supervision agreement after multiple requests.

46 Including the chairman, the deputy chairman, other members of the board of directors and an MFA observer. Each appointment is personal. A Board member can be re-appointed and there are no limits to the number of terms for Board Members. In 2012, the two MFA representatives on the Board of IFU were replaced by one MFA observer in the Board. According to all stakeholders interviewed, this did not affect the Board's work.

47 Both the Chairman and Deputy Chairman are Board Members for more than 20 years.

committee for IFU Classic and IØ to make decisions about investments,[48] while also strategic issues were discussed.[49] The case study analysis of case studies showed that the Board did almost always approve the proposals of the IFU management and discussions focused on financial issues (see Section 3.5).

During the evaluation period, IFU has managed to raise DKK 1.8 billion private capital for its PPP funds IIP, DCIF, DAF (see Annex 4, Table A4-1). In addition, in 2018 and 2019 IFU raised total amount of DKK 2.9 billion from private investors for the SDG Equity Fund (see Section 7.2).[50] The new PPP funds have their own investment committees with an independent chair and representatives of institutional investors and two members from the IFU Board. Therefore, the work of the Board has changed in recent years and is expected to change even further the coming years with the establishment of the SDG Fund.[51] As from 2019, the majority of IFU investments will be realised by the SDG Fund. All the large investors, including the government, are represented on the Investment Board (IB) of the SDG Fund, but the influence of the government in this IB is much less than in the IFU Board. This new set-up from 2018 onwards[52] will mean in practice that the influence of the MFA on IFU will decrease further. The government appointed IFU Board will remain responsible for investment decisions regarding IFU Classic and other government funds, but the large majority of investments will be

48 The Board discusses all CiPs and BCs, which include detailed recommendations.

49 Interviewees indicated that from 2013 onwards, when a new CEO was appointed, more strategic discussions have taken place in the Board.

50 In 2018, in the first close the total capital for the SDG Equity Fund was DKK 4.13 billion, of which DKK 2.48 billion from private investors and DKK 1.65 billion from IFU and the State. In the second close, capital was raised from three new investors, which raised the total and final amount for the SDG Fund to DKK 4.85 billion with DKK 2.92 billion from private investors (60%) and DKK 1.94 billion from IFU (DKK 1.04 billion) and the State (DKK 0.9 billion, consisting of DKK 0.1 billion as equity contribution to IFU earmarked for the SDG Fund, and DKK 0.8 billion as debt/guarantee contribution through the Danish National Bank's on-lending scheme). For the SDG Fund it was agreed that IFU would always provide 40% of the total capital corresponding to two thirds of mobilised private capital.

51 The DCIF and DAF investment committees have the same independent Chairman, who will also be the Chairman of the new SDG investment committee. To build up good working relations, the CEOs of the two pension funds have taken a seat on the new investment committees, and that has worked quite well according to the different parties. These good working relations have benefitted the set-up of the new SDG Fund, in which more institutional investors participate and who will have a seat on the new investment committee.

52 For the SDG-Fund, an Investor Board (IB) has been set up, which has appointed an Investment Committee that can take investment decisions for investments up to DKK 100 million. The IB will consist of a chairman, representatives of the investors and two representatives from IFU's board of directors.

realised by the SDG Fund over which the IFU Board has a more limited say.

In 2007, a CSR Advisory Board was established, which was renamed the Sustainability Advisory Board in 2014. This Board consists of academic experts, members of civil society, and CSR experts of companies. Each member is appointed on a personal basis. This Advisory Board provides advice on the Sustainability Policy, the Development Impact Model (DIM) and other related issues. There is no clear relation to the Board of Directors.

3.2 IFU organisation and efficiency of the investment process

ORGANISATIONAL STRUCTURE

The Executive Management consists of a CEO, appointed by the Minister for Development Cooperation, and a Executive Vice President (EVP).[53] Before 2015, IFU was structured around the main stages in investment: investment preparation on the one hand and implementation on the other. In July 2015, a major reorganisation was implemented, and a new middle layer management was created[54] (see organigram in Annex 3, Figure A3-4). Compared to other DFIs, IFU stands out by working with country/regional offices. During the evaluation period the number of these offices increased from four to nine.[55]

The interviews at HQ and country office levels pointed at increasing pressure on IFU staff given the many changes and new requirements. Nevertheless, IFU job satisfaction surveys (in 2015 and 2018) with a very high response rate indicate high job satisfaction and do not show clear indications of increased work pressure. IFU is very much aware of the important organisational challenges and recognises the risks that it will not have sufficient staff and competences to fulfil its new role and mandate. Given the challenges, two tracks for staff development can be distinguished: 1) further improvement of financial capabilities

53 During the evaluation period, there have been two Managing Directors (new appointment in 2006) and one CEO, appointed in 2013. While the Managing Director appointed in 2006 had a government profile, for the appointment in 2013 a business profile was agreed upon and a professional recruitment agency was assisting in the recruitment. The Managing Director resigned in 2018 and at the moment of writing this report, a new recruitment procedure is ongoing.

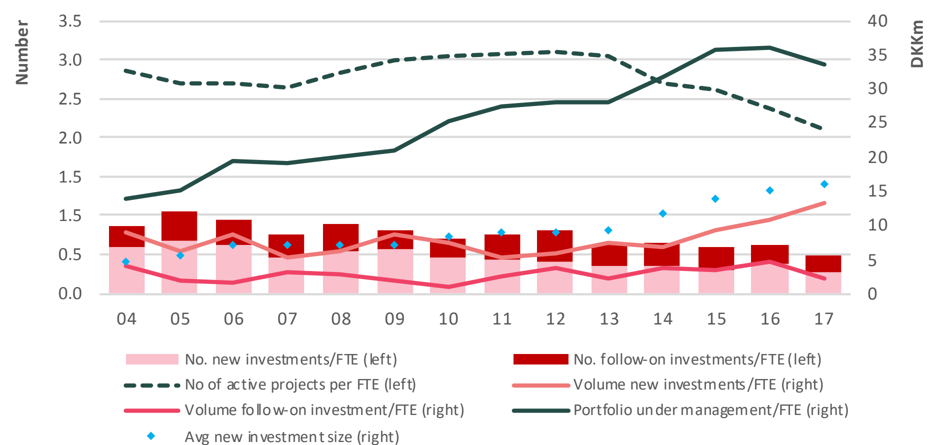
54 Eight Vice-Presidents are heading five geographic teams (North Asia, South Asia, Sub-Saharan Africa, Europe &MENA, Latin America) and three sector teams (climate, agribusiness, finance). A Sustainability team and SME team provide support in their respective areas to all investments staff.

55 Shanghai, Singapore, New Delhi, Accra, Nairobi, Lagos, Johannesburg, Kiev and Bogotá. Closed offices (2004-2017): Moscow, Cairo, Beijing.

and capacity for investment professionals, to deal adequately with the larger and complex SDG fund investments in emerging markets, and 2) further professionalisation of the development side to deal with investments in poorer, fragile and risky countries in Africa and elsewhere given the untying of investments. External stakeholders have noticed positive changes, but are of the opinion that further professionalisation is needed in specific financial fields such as quasi-equity instruments, but also development expertise (the latter in relation to measuring and achieving development outcomes, see Chapter 5).

In 2017, IFU launched a 'Fit-for Purpose' project to address the challenges regarding professionalisation brought forward by the external stakeholders. This project aims at delivering organisational insight into the competences needed for investment professionals on the one hand and sustainability unit staff on the other. A detailed tailor-made competences model was made based on the IFU Strategy for the future, but also making use of insights and lessons from other DFIs. 'Sustainability and corporate governance' is one of the core competences for investment professionals for which the sustainability unit provides training. Also, legal training is provided regularly. In addition, the sustainability staff has to deal with 16 specific sustainability competences. These competences deal with international development policies, SDGs and the DIM model, various Environment Social Governance (ESG) standards and corporate governance standards, but development monitoring and evaluation methods is not among the core sustainability competences.

FIGURE 3-1 NUMBER OF IFU STAFF IN RELATION TO NUMBER AND VALUE OF NEW INVESTMENTS AND PORTFOLIO UNDER MANAGEMENT



Source: Portfolio data, IFU annual reports.

MANAGEMENT OF INVESTMENT PORTFOLIO BY IFU STAFF

The number of staff employed by IFU in terms of Full-Time-Equivalents (FTEs) has stayed relatively stable during the evaluation period and hovered between 67 and 78 FTEs in the years between 2004 and 2016[56], while the number of new and active investments changed significantly over time, as depicted in Figure 3-1. While the number of new investments has gradually declined, the volume of new investments has steadily increased, which can also be seen by the increasing average size of new investments (which increased on average by 19% year-on-year, see blue markers in Figure 3-1). Thus, while IFU staff have contracted less new investments per person over time (less efficient), the average size of a new investment per person has steadily increased (more efficient). IFU staff also has to manage active projects and the volume of investments under active management from DKK 14 million per FTE in 2014 to DKK 34 million per FTE in 2017. Compared with other European DFIs, IFU staff closes the same number of deals, but the volume per staff is substantially lower than for other DFIs. The differences can (partially) be explained by the fact that IFU makes relatively more direct investments in projects, compared to the other DFIs that also invest strongly in funds and financial institutions (see Annex 3, Table A3-5).

Another indicator for the efficiency of the investment process is the average time that it takes to develop a lead from first contact, to a Clearance in Principle (CiP), a Binding Commitment (BC) and eventually an agreement (see Figure A3-5 for the five steps of the investment process). Between 2005 and 2014, on average 86% of BCs made it to an agreement (see Annex 3, Figure A3-6). The share of CiPs that make it to an eventual agreement is naturally lower (approximately 50% between 2005 and 2014), but it is remarkable that the rate declined sharply from 2011 to 2014, from approximately 60% to 34%, despite the fact that the country mandate was broadened during that period.[57] Possible reasons for this change are the introduction of a new risk management system in 2011. More rejections of SME proposals may also have played a role. While the overall number of new and follow-on investments per FTE declined slightly during the period, the average value of new investments per FTE increased proportionally, so it cannot directly be concluded that the investment process became less efficient.

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56 In 2017, five FTE staff and one student-assistant were transferred from MFA to IFU in relation to the transfer of DBF, which drove the increase from 78 to 84 FTE in 2017, but which does not alter the conclusion that the number of staff has stayed relatively stable over the years.

57 Some 508 CiPs were approved in the period 2005-2014, and preparing a CiP cost on average seven man-days, which implies that a loss in efficiency from 60% to 34% over the entire period is equivalent to a loss of 4,511 man-days of time (451 man-days per year).

INVESTMENT PROPOSAL LEAD TIMES

The in-depth review of the 50 case studies shows that the average time required in months from the moment a CiP is brought to the Board until the date of signing of an agreement can vary strongly across projects (see Annex 3, Table A3-6). The case study average of eight months from CiP to agreement in the 50 case studies is in line with the overall average for IFU as a whole.[58] Investments in funds (8.4 months) and large companies (9.2 months) take longer than the lead time for SME investments, but possibly more SME proposals do not make it to an agreement. The long average lead time for DCIF investments is driven by three large cornerstone renewable energy projects that each have taken 15 months or more to arrange due to the involvement of (many) other investors and careful due diligence processes due to the risk nature of the projects. There is also a positive relation between investment size and lead time required (see Annex 3, Figure A3-7). Nearly 60% of the case studies were smaller than DKK 50 million and took on average 5.5 months to complete. This is in line with the above analysis: IFU did relatively many small investments in a short time in the past and in more recent years IFU started to focus on fewer and larger investments that also take longer to prepare.

3.3 Operational efficiency

The main portion of IFU's operating expenses (opex) is made up of HQ staff costs, followed by expenses for the regional offices.[59] In addition to its own investments ("IFU Classic"), IFU manages the investments as well as the administration and accounting of other funds that are off IFU's balance sheet. IFU receives compensation for the latter costs through three different methods:[60]

1. Debiting of actual costs after they have been incurred (this is the case for IØ and IFV)[61];

2. Levy of management fees based on a percentage on invested funds under management or commitments from investors (i.e. the PPP funds IIP, DCIF and DAF and the new SDG fund);

58 Based on an IFU analysis of all proposals prepared in the time between 2005-2014 (IFU internal note).

59 Throughout the period, IFU operated three to four regional offices plus a number of adviser offices in the countries of investment.

60 This account of opex and fees does not encompass grant-funded facilities such as the SME Facility, NEF, NEIF, PDP and the Danida CSR Training Fund. (The funding of IFU's Sustainability Facility is done out of IFU's retained earnings, as decided annually by IFU's Board.)

61 As for the first method, IFU's total operating expenses are divided at year-end between IFU, IØ (and IFV until 2011) in proportion to the average total project commitments for each fund during the year in question.

3. Levy of management fees on government investment vehicles (KIF, LIF, UFA and AIF varying between 2%-4% of contributed capital, but last fees were charged in 2017, given the consolidation in 2018). In the past, IFU has charged administration fees or received a cost cover on the grant facilities according to the administration agreements. This has changed in January 2018 when the new arrangements became operational, but the cost cover for the SME facility is continued. The MTRs of UFA and the SME Facility questioned whether there was sufficient clarity regarding these administration fees when facilities operate in overlapping geographic and/or thematic areas.[62] This may have led to overlapping administration fees between the UFA and SME facilities. In 2018, with the merging of facilities this issue has been addressed.

An analysis of the distribution of opex on IFU and IØ/IFV and the share that is covered by IFU's management fees (see Table A3-6) shows that IFU's part of overall opex rose from 56% in 2004 to a peak of 82% in 2011 and then declined again to 56% in 2017. For the major part of the evaluation period, IØ was still the most important off-balance sheet fund under IFU's management. This is reflected in IØ's large share of opex, reaching 43% in the beginning of the period (2004-2005). A trend of decreasing opex attributable to IØ began in 2008 and accelerated as from 2010, when this fund entered into its divestment phase and the Danish State made continuous capital extractions.[63]

The decline of IFU's relative share of overall opex towards the end of the evaluation period corresponds with the growth of the PPP funds managed by IFU. The trend of exponentially increasing management fees – escalating from DKK 0.2 million in 2009 to DKK 43.5 million in 2017 – is illustrated in Table A3-7. IFU's fee income is expected to continue to grow in pace with its increasing fund management role. The growing volume of capital under IFU's management corresponds to the growing share of management fees over the evaluation period, as a source of meeting IFU's operating expenses. An analysis of the coverage of IFU's total opex by management fees shows a coverage of more than 40% of total opex in 2016 and 2017.

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62 It is beyond the scope of this evaluation to check all IFU's accounts on charging of administration fees in the past. The MTRs of UFA and the SME Investment Facility (February 2018) point at issues regarding administration fees and it is not clear to the evaluation whether all these issues have been addressed. The overview of activities funded by the CSR training fund shows that also IFU networking activities have been funded through this fund. IFU explained that this were IFU focus seminars with project companies aimed at learning on ESG and HR issues and creating networks among these.

63 The Danish State has systematically been extracting capital from IØ since 2004, and IØ's equity balance had been reduced to about DKK 250 million by the end of 2016. It is expected that the remaining IØ projects will be exited within the next few years.

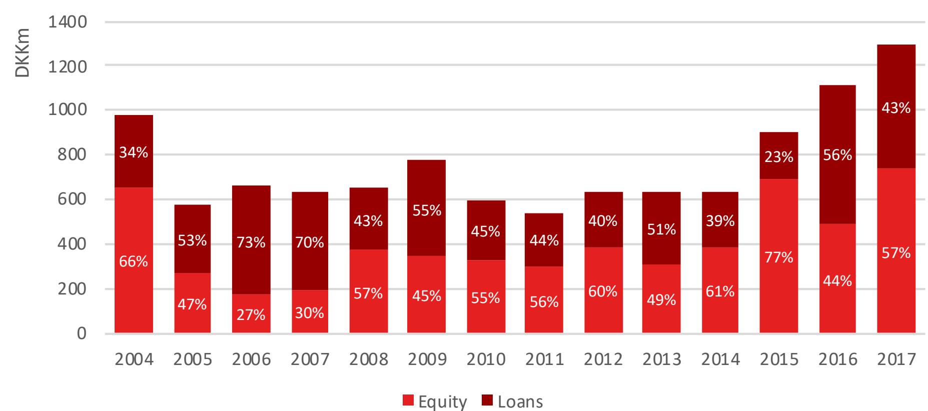
IFU's operating efficiency can be assessed using opex per amount invested as the measure. IFU's opex in relation to incremental investments has been fairly constant throughout the period, hovering around 10%[64] (the smaller the ratio, the higher the efficiency) (see Table A3-8). This is a satisfactory performance for a national DFI of IFU's size. DFIs bigger than IFU (such as FMO) tend to show a higher operational efficiency than 10%, and DFIs similar to or smaller than IFU (such as Swedfund) a lower efficiency.

3.4 IFU's role as lender and investor

EQUITY VERSUS LOANS

IFU's stated preference is to prioritise equity investments over loans. Equity holds out the promise of sizeable capital gains ('upside') and has often a higher degree of additionality as compared to loans. A DFI also needs to have a dependable recurrent source of income to cover operating expenses such as staff costs; this can be provided by a sizeable loan portfolio generating a steady income stream in the form of interest payments. Nevertheless, Figure 3-2 shows that IFU's equity share only intermittently exceeded 50% of the portfolio in value terms over the evaluation period, culminating in 57% at the end of 2017, which can be explained by the focus of the PPP funds on equity. For all European DFIs the equity-debt ratio stood at 49%/49% end 2017 on a total portfolio basis. IFU reports a 64% share for its active portfolio, which means that it provides relatively more equity than most other European DFIs, with the exception of Norfund, CDC, BIO and some small DFIs.

FIGURE 3-2 VALUE OF INVESTMENTS BY IFU AND IFU-MANAGED FUNDS, NET OF TRANSFERS, BY EQUITY AND DEBT



Source: Portfolio data, IFU annual reports.

64 The earlier years are 2011 and 2016, with a ratio of respectively 14% and 4%.

INSTRUMENTS

IFU makes equity investments with the intention of becoming an influential minority shareholder. IFU is often able to structure the investment with put and call options that are designed to offer pre-agreed exit opportunities; sometimes this is combined with a 'floor' (i.e. a pre-determined minimum return). Such financing structures may be referred to as quasi-equity, as they combine the potential upside of an investment in shares with repayment terms that are similar to loans (see Section 6.3). IFU's lending instruments are usually secured or unsecured[65] senior loans that are denominated in DKK (approx. 20%), EUR (approx. 30%) or USD (approx. 50%). IFU also manages to obtain parent company guarantees to back-up the loans that IFU has made to project companies. IFU has to be receptive as to what their partners demand; investee companies can be reluctant to share profits and strategic influence with a new equity investor. Equity is also, from the investee companies' horizon, more expensive than debt. IFU has to be responsive to the market and strike a reasonable balance.

IFU also has the possibility to use mezzanine loans and guarantees. As for the former, the Evaluation is aware of a few cases of mezzanine loans in the BCs, of which one was extended by DCIF and the others via IFU Classic, which were not all realised. Mezzanine instruments may become more frequent in coming years through the PPP funds, but this is not yet reflected in the overall portfolio. As for guarantees, the Evaluation do not have insight into IFU's use of such unfunded instruments, but we are aware of IFU's recent engagement in the African Guarantee Fund (AGF) where IFU blends its capital with capital from the MFA. Through AGF, IFU can reach the SME segment across the African continent by supporting AGF's offer of guarantees to credit-enhance bank loans to African SMEs.

FUND INVESTMENTS

Figure A3-8 shows the share of IFU's investments in funds, indicating gradually increasing investments in other funds (including private equity and other third party funds), with occasional spikes in individual years emanating from large single transactions (for example in 2010 and 2015).[66] A general motive for investing in third party funds is to widen the reach of IFU, leveraging on specialised fund managers to provide growth capital and managerial assistance to a multitude of mid-sized companies in various regions/countries/sectors (as prioritised by IFU). Another main reason is the possibility to make co-investments with such funds, which happened occasionally. There are some general drawbacks of investing in third party funds: IFU will generally have less control over the choice of individual investee companies, as compared to direct

65 IFU's experience is that that credit losses for unsecured loans are not substantially different from loans with pledge on assets.

66 IFU indicated in its 2018 Strategic Directions a moratorium on its investments in funds to decrease the share in the overall portfolio.

investments, and IFU's share in a fund may not be large enough to warrant a seat on the investment committee (so the non-financial value addition will be limited or non-existent). IFU would also be exposed to the risks of unsatisfactory management, governance, financial health and fiducial responsibility of the fund manager (who normally is the General Partner of the fund). In the five case studies on funds, evidence on all these possible advantages as well as on the drawbacks was found.

3.5 Risk assessment

RISK ASSESSMENT SYSTEM

IFU applies an internal risk model to assess investment risks at project level before making investments, while also risks at strategic level are managed.[67] The risk model in its current form was introduced in 2011 and is more sophisticated and dynamic than the previous version.[68] It derives at an overall risk score (A, BBB, BB or B from low to high risk) for projects based on the scoring of 20 questions in five risk groups.[69], The model covers various risk categories and with weightings for the overall risk score.[70] The expected loan losses according to IFU analysis equal 0%, 2.5%, 13.3% and 41.1% for risk classes A to B respectively.[71] On the basis of a portfolio and case study analysis, Figure 3-3 shows that IFU mainly selects projects of medium risk profile (BBB or BB). IFU only very selectively goes for high risk projects and still does a relatively significant number of low risk investments. Low risk investments may imply lower financial additionality and therefore should also be assessed carefully for

67 Beyond risk assessments at investment level, IFU manages its equity and credit risk by investing in a variety of countries and by limiting the concentration of risks per partner. Moreover, it manages currency risk by hedging foreign exchange exposures originating from project loans in other currencies than Euro, but it does not hedge exposures in share capital investments due to the costs involved, nor does it hedge commitments to disburse as timing and amounts are often difficult to foresee. Liquidity risk is managed by maintaining a positive cash position in a five-year forecast period and the standby overdraft facility. Lastly interest rate risk is largely managed by using variable interbank interest rates (e.g. LIBOR or CIBOR) in its project loan offerings so that changes mainly affect future cash flows.

68 Before 2011, there was a more simplified model that would calculate a score (high, medium and low) on the basis of a high, medium and low score for 13 indicators in the categories 'country risk', 'partner risk' and 'project risk'.

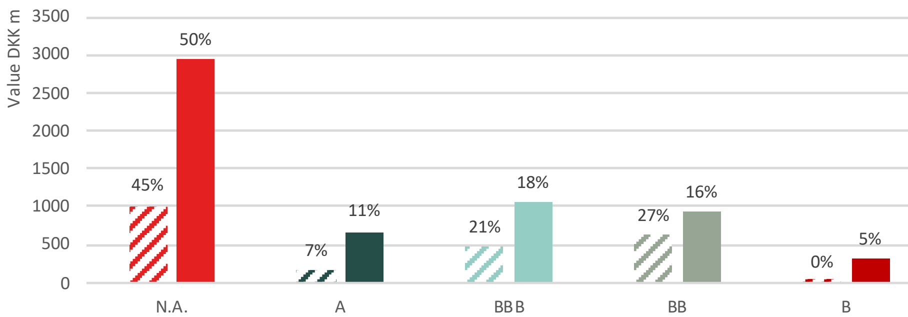
69 The five risk groups are derived from 1) a correlation analysis between different factors and actual IFU defaults, 2) IFU experience and 3) the credit rating approach described in Standard & Poor's Corporate Ratings Criteria. The five risk groups are: partner risk (25% of weight), country risk (20% of weight), management risk (25% of weight), financial risk (10% of weight) and business risk (20% of weight).

70 Weightings are derived from an analysis of IFU's own final evaluation reports.

71 The risk rating categories are calculated differently than the similar looking ratings from external credit rating agencies, but an internal IFU loss analysis has shown that the credit quality can still be adequately compared to them.

their fit with the DFI investment model. With the increased importance of PPP funds for IFU, it could be expected that the overall risk profile of IFU's portfolio may move further in the direction of safer, more risk-averse investments given the PPP funds' focus on financial returns and less on additionality.

FIGURE 3-3 RISK CATEGORIES FOR CASE STUDIES (SHADED) AND TOTAL LOAN PORTFOLIO IFU 2003-2017 (SOLID COLOURS)



Note: For the category N/A there is no risk rating available (investments before 2012) and the percentages in the figure represent the value of the investments in a risk category in relation to the total value of the case studies and the total loan portfolio.

In practice, based on the case study analysis, substantial changes over time in the application of the risk models are noticed. In the first sub-period, 2004-2011, when another risk model was in use, there was relatively little attention to identifying and describing key financial risks in the investment proposal documents. There was a section on risk mitigation and sensitivity analyses on the budgeted growth and IRR, but there was little reference to the risk score included in an annex. There were no clear implications highlighted for the conducted basic risk checks. Investment conditions were there mainly to ensure adequate risk sharing to cover unforeseen losses and making sure non-financial goals were achieved (CSR, board seat, etc.). After the financial crisis and the introduction of the more sophisticated risk model in 2011, attention to risk assessment increased. The templates for CiPs and BCs were updated to more strongly highlight an extended risk analysis at the investment appraisal stage. The risk analysis from the new risk model served as basis for a more elaborate discussion around key risks in the investment documentation. However, the increased attention to the risk analysis came at the cost of a broader analysis of the project's business plan, sensitivity analysis and reflections on ESG issues and development impact. To illustrate, a risk analysis and mitigation overview featured prominently on the second page of BCs at the time, while often a short paragraph on development impact was included only at the very end and quantitative sensitivity analyses on the business model did not feature in the BC anymore (as before).

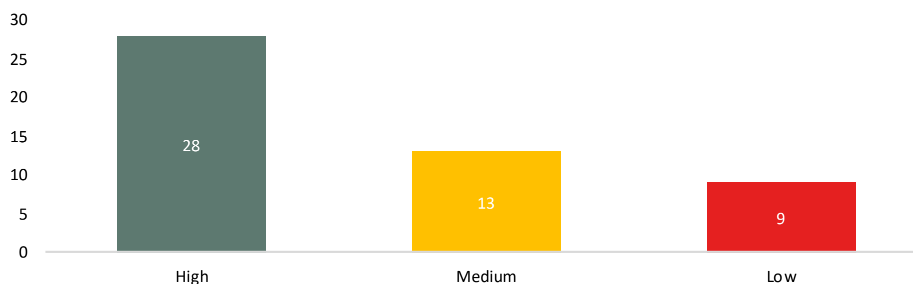
Since the setup of DCIF in 2015, the 'best of both worlds' were combined in the current version of the investment proposal templates, in which the attention was placed on the investment case (business plan), financial returns, fund structure, ownership analysis and key risks. The influence of the cooperation with private investors in DCIF is clearly reflected in the type and depth of analyses conducted, with a focus on the financial aspects of projects, bringing the quality of investment documentation in this respect in line with international best practice. Analyses of CSR/ sustainability dimensions have, however, moved more towards the background, and receive relatively less attention (see also Chapter 5). This is illustrated by the fact that the executive summary and investment recommendation (first three pages of the BC) mainly contain information regarding financial and market considerations and risks. Of the typically 15 pages information in the BC, only one (the last page) contains a minimum amount of information on development impacts and ESG considerations. Other than the mention of the SCM or DIM score, there is no elaborate attention to the rationale behind the scoring in the proposals itself.

One of IFU's measures to manage reputational risk is to place strong emphasis on the identification and management of ESG-CSR issues. The identification and assessment of these issues have never been reflected as indicators in IFU's risk management models but are separately assessed in investment proposals. That has happened consistently throughout the evaluation period, despite the changes in the templates over time and the changed focus.

ASSESSMENT OF RISK ASSESSMENT IN CASE STUDIES

Case studies were independently rated for the extent to which they deal with risk assessment adequately, based on the criteria and indicators presented in Annex 2, Table A2-8. The overall score is based on four indicators (1) Adequacy of assessment of financial risks; 2) Adequacy of assessment of contextual risks, reputational and governance risks; 3) Adequate interpretation and follow-up of risk mitigation measures; and 4) Formulation of a clear exit strategy (equity only), where the first indicator weighs double due to its importance in the overall risk assessment for banks.

FIGURE 3-4 ASSESSMENT OF CASE STUDY SCORES FOR RISK ASSESSMENT



Despite the fact that risk assessment was not dealt with consistently in investment documentation until 2015, the slim majority of cases (55%) were assessed positively to the extent they dealt with risk assessment. Two key drivers for the positive risk assessments are:

1. The improvement of the investment documentation and the use of the new risk model. The DCIF (and DAF) cases illustrate the improvement in risk assessment as it became active in 2015 and this fund scored the best from all funds with 60% of DCIF cases received a good score and the other 40% a medium score. Many of the more recent investments also score well on risk assessment.

2. There has often been a good use of risk assessments or due diligence information from reputable partners that were investing at the same time as IFU or where already an investor. IFU made in those cases clever use of that material by still critically reviewing the information themselves. When IFU invested together with others, there is also evidence that other co-investors, in particular DFIs, helped to push IFU's standard of risk assessment. In specific cases IFU made smart use of the expertise of others and were deliberately 'piggybacking', which is a wise strategy when resources are scarce.

Also, the focus on obtaining financial security of the investee company received considerable attention. In general, the financial risk assessment receives high scores, which based on the relatively large amount of 'medium' (26%) and 'low' (18%) scores of the quality of IFU's risk assessment in the remainder of cases, implies that the overall level or risk assessment was not entirely satisfactory. Risk assessments for SME investments scored below average. A likely driver of this result is the shorter lead times for SME investments and their generally lower investment size, which may not always justify a more rigorous due diligence process. In general, an (over)reliance on the self-assessments of the Danish companies on the success of their business plans is noticed, which meant that not in all cases a rigorous analysis on potential market and organisational risks was done.

In the nine cases of weak ('low') risk assessments, two findings stand out:

1. The identification and analysis of obvious risk factors given the rationale and market of the investment were inadequately dealt with or ignored in either CiP and BC stage. There was also little follow-up between CiP and BC stage on getting more clarity regarding some key risks. For instance, when a project promoter offers an idea but is unwilling to invest itself, it should warrant a very sharp due diligence. Another example includes financing of yet unproven technology in new countries, which should warrant an in-depth analysis of the (economic) feasibility of the technology which was insufficiently done in those cases.

2. Sometimes there were follow-on investments made at a time that some key risks started to materialise and IFU was faced with the issue to support the struggling company or not. In those cases, a critical and rigorous risk assessment on how the risks could be managed better in the future is needed but did not always get sufficient attention.

4 FINANCIAL AND VALUE ADDITIONALITY

In this chapter, financial and value additionality of IFU are assessed. International best practice according to OECD/DAC standards require that DFI investments are 'additional' to the activities from the commer-

KEY FINDINGS

- In general, assessing and proving financial additionality and value additionality is challenging both for outsiders and for DFIs themselves, who often fail to show good evidence for their additionality. Additionality means making an investment happen that would not have happened otherwise. Both *ex- ante* and *ex-post* assessments are difficult as ex-ante not all information is available and ex-post because stakeholders may not remember, while information on market conditions at the time cannot be validated with actual 'live' information.
- IFU has aimed to pay attention to the 'additionality' of its investment activities (i.e. whether it has provided financing and/or services beyond what could have been expected to be provided by the private sector) during the evaluation period. In 2017, the MFA included additionality as a requirement for IFU's operation for the first time in official documentation. IFU generally paid more attention to assessing value additionality than financial additionality. IFU's tied mandate (until 2017) has certainly played a role in reducing the importance of assessing additionality.
- The case study analysis shows that IFU was financially additional to the market in the majority of cases (62%) by investing either at the right time (when credit was scarce in the country or globally) or in the right type of countries (in countries where risk-oriented capital credit was difficult to obtain). This was especially the case for some SMEs that otherwise would not easily have obtained financing or where IFU succeeded to attract other investors (leverage factor). Still, there were a significant number of cases (38%) where IFU was not or only partially financially additional either because there was clear evidence that companies could have (easily) obtained private finance or where IFU's role was limited to a signal or safeguard function by bringing the 'Crown & Flag'.
- Beyond its financial role, IFU is generally perceived as respected investment partner in developing countries with presence on the ground, local knowledge and the governmental stamp (Crown & Flag) to assist business in developing countries. In most case studies (46%), value additionality was assessed to be medium as there was little concrete evidence on whether IFU also through other advice and/or use of its board seat actually assisted companies to improve their performance. In cases where IFU played a relatively minor role such as when only debt is provided or or in case of big investments with multiple investors, value additionality is difficult to realise and cannot always be expected. Nevertheless, IFU's reputation and network with public institutions as government institution (bringing the Crown & Flag) is by most investee companies mentioned as value added compared to commercial investors, but there was no concrete evidence or impacts found in the case studies that would proof this value additionality.
- Value additionality could be further improved by defining clearer criteria for the selection of Board members that fit the needs of the investee companies and represent IFU interest. Driven by the experience with more complex investments via the PPP funds, IFU now appoints in some cases very experienced and skilled IFU board representatives or separates the responsibilities for active management from the board seat.
- Grant funding provided by IFU was not always additional, as in quite some cases funding was provided to large(r) companies that had the capacity and the funding to fully fund CSR actions themselves.

cial market. Even though there is general consensus that additionality means providing support that would not have been provided by the private sector otherwise, there is no internationally agreed definition on how to precisely measure additionality. A study by the UK Aid Network found that in nine reports that evaluated DFIs additionality, the definitions used varied strongly and also the results were mixed.[72] As a result, this chapter starts with a short introduction on how additionality is assessed in this evaluation (see also Annex 2 that includes the detailed sub-questions and indicators in the evaluation matrix).

4.1 Introduction

The concept of additionality has been mentioned in several documents prepared by IFU, the MFA and other stakeholders. IFU integrated the concept of additionality in its risk assessment systems throughout the evaluation period, but the MFA only first explicitly referenced to IFU's additionality in its MFA strategy for IFU in 2017.[73] It defines additionality as a key principle for IFU's investments that should be assessed qualitatively for each investment decision from two perspectives: financial additionality and value additionality. The MFA follows an OECD/DAC working definition[74] for financial additionality and value additionality that are defined as:

- **Financially additional –** when the private sector could not have done the same, or otherwise could not provide financing on an adequate scale or on reasonable terms to IFU's investee companies, or when IFU investment catalyses private investment that would not have occurred otherwise. IFU should not crowd-out the private sector by providing funding that the private sector would also have provided.

- **Additional in value –** if IFU offers or mobilises, alongside its investment, non-financial value that the private sector is not offering, leading to better development outcomes.

Despite this working definition, establishing additionality remains very challenging both *ex-ante* (for IFU) and *ex-post* (for this evaluation): *ex-ante* since not all information needed is available before investments are made. For financial additionality due to asymmetric information on

72 Idem.

73 Ministry of Foreign Affairs (2017). The Ministry of Foreign Affairs Strategy for The Investment Fund for Developing Countries (IFU) 2017-2021.

74 OECD. (2016). Understanding Key Terms and Modalities for Private Sector Engagement in Development Cooperation. Retrieved from http://www.oecd.org/dac/peer-reviews/Inventory-1-Private-Sector-Engagement-Terminology-and-Typology.pdf.

the side of investment partners about their actual available financing options and for value additionality because it is also created *after* an investment is done. *Ex-post* because stakeholders may not remember and/or are biased (e.g. investment officers get rewarded for deal flow) and information on market conditions at the time cannot be validated with actual 'live' information. Rigorous objective *ex-post* analyses would however require a quantifiable counterfactual or valid instrumental variables, both of which are not available for DFIs.[75] This reflects a long debate among development evaluators on the one hand and DFIs on the other on how to assess additionality, which is considered to be the thorn in the side of DFIs. In the absence of an internationally agreed rigorous methodology, this evaluation analyses IFU's financial and value additionality on the basis of (1) an in-depth review of 50 case studies, involving document review and a range of interviews per case actively taking into account the potential bias from stakeholders; and (2) an analysis of the manner in which IFU itself assesses and reports on additionality.

4.2 Assessment of additionality in IFU

As mentioned, IFU paid attention to the need for additionality throughout the evaluation period. The operationalisation of the concept within IFU's activities has however evolved over time. IFU has assessed its additionality during the investment process (*ex-ante*) by integrating both financial and value additionality elements in (the different versions of) the Success Criteria Model (SCM – from 2005-2017) and its Development Impact Model (DIM – since 2017). See Table A3-9 for an overview of the indicators used and how the measurement of additionality in the system evolved over time.

In both the SCM and the DIM, the focus is on measuring the leveraging/catalyst impact part of the financial additionality definition. Both systems include specific indicators for that. In the DIM, financial additionality is attempted to be assessed via the indirect practical indicators of whether an investment is greenfield and in which income group the host country falls, both of which are only slightly indicative for a conclusion about IFU's role versus private investors. The tied mandate of IFU may have affected the extent to which IFU could be financially additional. Recently, since the untying, the MFA gives it more explicit attention, as indicated above. Since the mandate is officially untied, financial additionality explicitly appears in the IFU Strategy for the period 2017-2021.

75 Carter, P., 2017, *Wanted: Mechanism for additionality*, in: OECD Development Matters 10-2017, available on: https://oecd-development-matters.org/2017/05/10/wanted-mechanism-for-additionality/.

In recent years, IFU s focus on financial additionality in its result measurement system decreased somewhat. This may be due to the increased importance of the public-private funds in IFU's portfolio (DAF, DCIF, SDG), as explained in more detail in Box 4-1. Conversely, there have been more indicators capturing value additionality elements, such as contribution to project preparation, project development and employee training increased over time. Currently, IFU defines its value additionality role along three dimensions: 1) advice, 2) network and local presence and 3) as a strategic partner. While it is internationally acknowledged that measuring financial additionality is hard ex-ante, the international best practice shows that more proxy indicators exist and could have been used by IFU more systematically, such as the financing structure offered (grace period, extended tenor or local currency finance) or whether it includes innovative forms of financing instruments not yet (cheaply) available on the market[76].

BOX 4-1 ADDITIONALITY IN IFU MANAGED FUNDS (DAF, DCIF AND SDG)

The concept of (financial) additionality is even more complex in the PPP funds where IFU acts as investment manager, because by definition every investment will include public and private funding and thus the private sector is already 'crowded in' instead of 'crowded out'. MFA project documentation on DAF, DCIF and the SDG Fund show that the additionality of the funds is approached from a leverage point of view for the overall fund level (the participation of IFU and the government in the funds helped leverage private participation) and at investment level focuses on assessing whether the investments and outcomes would otherwise not have been achieved (or in a lesser way). DAF's success criteria regarding additionality, however, do not explicitly include an indicator (qualitative or quantitative) on IFU's role versus commercial investors. In the SDG Fund this aspect is assessed only qualitatively. Investment professionals that work with DCIF also believe that by definition DCIF investments are additional because they have already leveraged private finance as part of the funding structure and therefore acknowledge that the qualitative assessment of financial additionality receives relatively little attention during the investment preparation phase. The latest investment documentation templates for managed funds do include a separate section with a qualitative substantiation of DIM additionality scores and additional information regarding IFU's contribution to the project, but the application of this template could not be tested with actual cases from the case study sample. During the evaluation period, additionality has not been a key criterion at the investment documentation, nor did additionality often explicitly feature in Investment Committee (IC) considerations when approving investments, but the new investment templates may change that.

76 Based on the latest best practice guidance document from various international MDBs (October 2018, available at: https://idbinvest.org/en/download/6204).

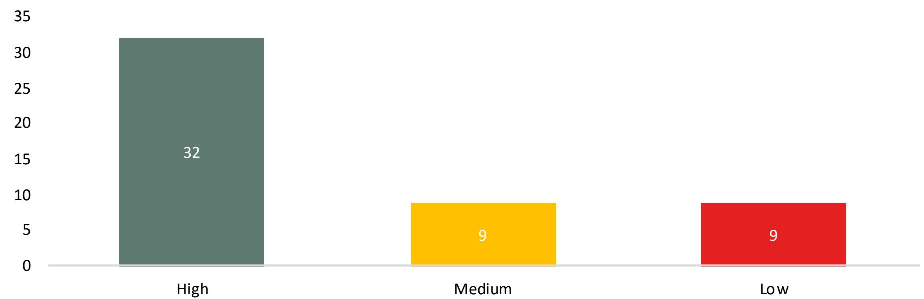
The in-depth review of investment documentation for the case studies revealed that the assessment of additionality during the investment preparation process has often been limited to the generated scores for additionality in the SCM and DIM, without further qualitative substantiation or elaboration in the documentation itself. Especially during the time IFU's mandate was tied, there is, next to the SCM or DIM scores, little qualitative attention to the assessment of additionality in investment documentation. In the latest CiP and BC templates, there is a separate small section on 'additionality' in the 'development impacts' section with room for a short qualitative description of either value or financial additionality. In communicating their decisions on specific investment proposals, the Board/Investment Committee (IC) does not generally mention additionality arguments in the rationale of approving the investment, but rather focuses on the conditions that need to be met before an investment can be made. While value additionality is given more attention through the quantitative scores of the DIM (and SCM), the lack of indicators on financial additionality, lack of qualitative substantiation of overall additionality in the investment documentation and lack of reference to additionality in IC decisions give the impression that the assessment of additionality is not a key factor in IFU's investment decisions.

Moreover, IFU has not used the SCM or DIM data to systematically report on its financial additionality. A review of its annual reports shows that IFU reports on its additionality of its investments *ex-post* irregularly and on the basis of different definitions: in 2004 from the perspective of partner mobilisation, in 2009 amongst others on IFU's relative financial participation and more recently in 2010 and 2016 from a more value additionality perspective by mentioning elements like board work and employee training provided.

4.3 Evidence on financial additionality

Figure 4-1 shows the scores based on the 50 case studies. The scoring of financial additionality is based on four indicators (1) Main reason for the company to have IFU as investor; 2) Role of that IFU funds played in the overall funding of the company; 3) Type of other funders/investors involved and their timing of involvement; and 4) IFU's role in leveraging additional funding). For each aspect, a high, medium or low score was given, and the overall score is derived from the average across all four indicators (all indicators have an equal weight in the scoring). The indicators used for the scoring of the case studies on financial additionality is presented in Annex 2, Table A2-9. Overall, more than half of IFU's investments (62% of cases) scored high.

FIGURE 4-1 ASSESSMENT OF CASE STUDY SCORES FOR FINANCIAL ADDITIONALITY



This overall outcome is driven by three main factors:

1. **IFU was additional by often investing 'at the right time and place'**
   IFU was additional by providing funds in countries with little capital available (in LDCs, China in the early 2000s and Ukraine generally in the entire evaluation period) or during the financial crisis years (2008-2010). Most of the IØ/UFA cases in Ukraine were for example rated positive for this reason. In the 16 investments reviewed in China, on the other hand, IFU was less often financially additional as the amount of capital in China increased rapidly over time along with the country's economic development. However, long-term credit is still particularly scarce in China and combined with long payback periods in some industries, some investments are still risky in China. In these cases, IFU's finance is additional. Also, in six concrete cases, IFU took an additional role by financing a company that experienced set-backs during project development and private financiers dropped out or had earlier gone through restructuring or bankruptcy.

2. **IFU is typically financially additional when it finances SMEs (80% of SME investments scored high versus 7% low)**
   IFU played a highly additional role for some Danish SMEs, which would not easily have found another funding partner. In some of these cases, though, the business plans for expansion abroad of the SMEs might have been too weak to obtain commercial funding even if it were available (see financial outcomes). In these cases, financial additionality is by definition high, but not necessarily for the right reasons. In China, IFU also played an additional role by providing finance to (Danish) SMEs that could not access Chinese funding. For the large company investments, IFU was not or moderately financially additional in 15 out of 35 large company cases (43%), because there was significant evidence that the company would have been able to find commercial funding or provided a corporate guarantee to IFU's finance.

3. **Leveraging positively contributes to financial additionality**
   To a lesser extent, IFU played a financial additional role by levering other (DFI or private) finance into projects. For six positive cases, a significant leverage effect with other DFIs or private investors was the main reason for a positive assessment. In these cases, there was concrete evidence that other financiers made their finance conditional upon IFU to join or there was evidence that the company was able to attract private finance after IFU invested.

Despite a generally positive assessment of financial additionality, there are a number of cases in which IFU's role was likely only partially or not additional to the private sector. In about half of these cases the explanation is linked to the tied mandate and the historical relations that existed between IFU and large Danish companies with investments abroad. There were cases in the sample where these companies still preferred IFU's investments, mainly because IFU can provide the backing of a state institution (bringing 'the Crown and the Flag'). This is, however, considered part of the value additionality. These large companies could have obtained funding at comparable terms elsewhere. Quite a few of these large companies decided over time, sometimes after an earlier than planned IFU exit, to find new investment money on the capital market. Therefore, in some cases with a 'red' score, the companies either already had significant commercial funding available or could clearly have received it. The highest number of doubtful or negative cases were in DCIF, in China and for large(r) companies. In the case of DCIF, investment sometimes followed after commercial investments and the overall strategic considerations for the investment outweighed the negative additionality assessment. This result combined with the fact that an increasing share of IFU's capital is committed to PPP funds like DCIF, could indicate that there will be mounting pressure on IFU's financial additionality in the market in the future as PPP funds will by definition look for more commercial market type of investments than fully government funds.

Lastly, the use of the IFU grant facilities has also not been very additional, despite satisfactory results of the CSR Training Fund, the recipients were in 62% of cases large(r) companies that could have provided for good CSR implementation themselves. It would have been in their own interest to independently finance CSR implementation.

4.4 Evidence on value additionality

IFU's assessment of value additionality is based on various dimensions in the SCM and DIM assessments as explained in Section 4.1 above. IFU distinguishes three elements in its value creation in addition to financing: 1) Being a strategic partner (e.g. board work); 2) Providing advice, and 3) its network and local presence. The latter element also includes

its function as government institution (bringing the Crown & Flag). There is, however, little portfolio-wide evidence on the non-financial role that IFU actually played in the preparation, during or after an investment. As a result, the case studies have been used to independently evaluate the non-financial role that IFU played for its investment partners. The scoring of value additionality is based on four indicators (1) Appreciation of IFU's non-financial role by the company or other stakeholders; 2) Evidence on use of IFU board seat; 3) Evidence on useful IFU advice before investment or at exit; and 4) Evidence on useful IFU advice throughout investment. All indicators have an equal weight in the scoring. Table A2-10 presents the indicators and scoring criteria applied to generate an overall assessment.

FIGURE 4-2 ASSESSMENT OF CASE STUDY SCORES FOR VALUE ADDITIONALITY

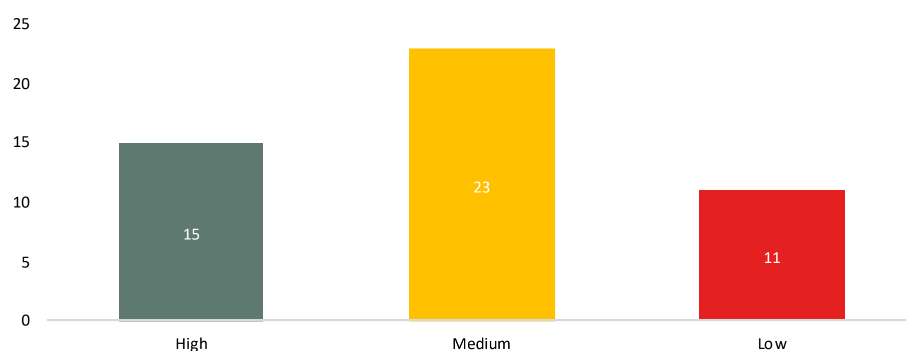


Figure 4-2 shows the results of the assessment of IFU's value additionality (non-financial role) in the selected case studies. The scores are at first sight less positive than for financial additionality. This should, though, not directly be linked to a negative assessment of value additionality as for a significant number of cases the type of investment did not allow IFU to create much value additionality. Some 70% (35/50) of the cases concerned deals with larger companies or investments in funds, and for quite a number of these cases IFU did not have to or could not provide significant value to the project teams as the project teams either already had very knowledgeable and professional (investment) partners. In this case not much was expected of IFU or IFU deliberately did not take an active role as they acknowledged they lacked specific sector or country knowledge. For another 7/35 of the deals with larger companies or funds, IFU only provided a loan and therefore had less opportunity to provide value to the deal.

As indicated above, the 'Crown and the Flag' have played in some cases an important role for investee companies to have IFU as an investor as it provided them with a safeguard in a potentially problematic environ-

ment. For many of the older investments with Danish multinational companies, IFU brought the governmental image (Crown & Flag) element to the project. The focus of the evaluation assessment was on evidence regarding effective action on the use of the Crown & Flag. If no concrete use was made of the safeguarding function (in most of the case studies), a score of 'medium' was attached to this element of value additionality. Some cases were also found where IFU, sometimes together with the embassy, intervened to solve issues between the company and local authorities, which was included in the assessment (as 'high' for Crown & Flag).

When funds and the companies in which IFU invested had much of the required expertise themselves, this affected the scoring of value additionality. The DCIF cases, where more than 70% was rated medium, illustrate this point well as the private participation in the fund drives a demand for less risky and more profitable projects, which in turn tend to be larger and well-developed projects that attract multiple professional investors that dilute the non-financial role IFU can play for the investment. Nevertheless, there are clear exceptions such as a joint project development company in renewable energy, where IFU is one of the co-founders and has a large equity share and IFU is active at various management and board levels.

Most of the 15/50 cases with a positive score on value additionality were SMEs. In these cases, IFU's knowledge of the local markets and development finance had a positive impact. For more than half of SMEs in the sample, IFU played a pro-active role during the pre-investment phase with advice and help on particularly CSR principles, market entry or ownership issues. Some of these companies also specifically mentioned that IFU board representatives contributed to professionalised board meetings and provided regular follow-up beyond what they had expected as investor. In some cases, IFU provided significant added value to the project company thanks to the knowledge of the local markets at its country/regional offices.

IFU's role in the boards of investee companies has also been one of the key reasons for a low score in 21% of cases on value additionality. IFU does not have a structured process in place that enables them to select and appoint the most suitable board member candidates for vacant positions. Often the staff member in charge of management and follow-up of the investment is also the one on the board of the investee company. Other DFIs do often not allow this. In the case of some big investments (especially also in DCIF or DAF cases), IFU has different professionals dealing with daily operations on the one hand and occupying the board seat on the other, and this works out well. However, in a significant number of cases the role of IFU on the board of investee companies has been relatively minor. Particularly in China, where 9/11

low cases come from, the active contribution made through IFU's board seat has been low or even inadequate in times that investee companies were facing difficulties and little follow-up or guidance was provided.

5 DEVELOPMENT OUTCOMES AND CSR PERFORMANCE

This chapter deals with two evaluation issues mentioned in the ToR, namely results measurement and communication and the effectiveness of IFU in promoting development outcomes. Development outcomes is split in two categories, namely CSR-ESG-sustainability performance on

KEY FINDINGS

- Over time, IFU and investee companies have paid more attention to CSR issues, which are recently linked to the SDGs, but this does not mean that sufficient attention is automatically paid to the broader socio-economic effects in developing countries.
- Despite various improvements in IFU sustainability policies and results measurement systems, still only limited information is available to properly assess development outcomes. This is mainly due to a focus on compliance issues rather than on measuring / assessing development outcomes. If outcomes are measured such as job creation, IFU still has to overcome various measurement problems, which is common to DFIs according to international literature. The monitoring system is still too much a 'one-size-fits-all' model.
- The case studies show good to moderate CSR performance (only 12% shows poor performance). Most attention is paid to good labour conditions incl. training of staff, environmental measures such as energy efficiency and adequate waste management, and a large variety of community engagement issues.
- In 50% of the case studies evidence was found on primarily positive development outcomes, and in 20% cases the balance was still positive showing moderately positive development outcomes. It is estimated that IFU contributed to the creation of 80,000-100,000 jobs from 2007 to 2017. Most positive outcomes were found in specific sectors where investments in companies contributed to catalysing or demonstration effects in the value chain or at sector level such as improved capacity and income for smallholders and access to clean and affordable energy for households and enterprises. These effects are most noticeable in the energy sector and to some extent in agribusiness.
- In the 30% of the cases with a low score on development outcomes still some positive development outcomes could be found, but these were not according to expectations and/or decreased over time. These cases included failed projects and cases where production facilities had very little integration in local supply chains and/or distribution or when hardly any new jobs were generated.
- Also, evidence for some negative development effects was found, such as pollution effects or displacement of people. In most cases these expected negative outcomes were identified in the project preparation phase and adequate mitigation measures could be developed to reduce pollution. There is a clear correlation between negative or poor financial outcomes and a low score on development outcomes.
- IFU has reported on CSR performance and job creation in its Annual Reports. IFU also participated in public debates on various issues such as tax havens and IFU engaged in a dialogue with civil society. IFU is a proud institution that communicates well on its successes. However, IFU has still some difficulties in sharing its challenges in measurement and less positive outcomes, while these are quite common for DFIs. While IFU aims to be transparent towards the public, its learning culture can be further strengthened and still more can be done to better communicate development results.
- The MFA has also a responsibility to evaluate and communicate on IFU's development results. Only mandatory Midterm Reviews of some facilities and funds have been commissioned, which are not public and with limited follow-up. During the entire 14 years evaluation period the MFA did not publish any evaluation on IFU or IFU funds.

the one hand and broader development outcomes on the other[77]. In this report we use the term CSR.[78]

5.1 IFU's result measurement through the investment process

Since 2005, IFU's Annual Reports include a section on 'Compliance with CSR' or 'Reporting on Sustainability Policy'. IFU also aims to measure development outcomes and impacts throughout the investment process. During the evaluation period, IFU has worked with two result measurement systems that were introduced in Chapter 4 as they deal also with the assessment of additionality: SCM and DIM. Main development indicators in the SCM were employment impact, transfer of knowledge, CSR compliance (adjusted several times), human rights and labour conditions (since 2007), and payment of taxes in host country (since 2011). An external review of SCM was done in 2015 and concluded that "the SCM score is too much of a proxy indicator that cannot easily be interpreted as a reliable indication of a given project's contribution to development outcomes". The high number of indicators in SCM and the complex way in which they are weighted contribute to this difficulty".[79] DIM includes 75% of the SCM indicators, while sector-specific (number of smallholders in agriculture, installed (renewable) energy capacity) and climate indicators (mitigated CO_2 emissions) have been added.[80] The DIM indicators have to be provided in the BC, but with the exception of jobs, the majority of DIM indicators are (still) not monitored or evaluated during or at the end of the investment, although this should be the case according to the DIM manual for IFU staff. Measurement of gender-related outcomes is done through a gender-disaggregated indicator for permanent direct jobs and some attention in the CSR performance for decent labour conditions (see Section 5.2).

77 During the evaluation, it became clear that it was useful to make this distinction as CSR and ESG garnered ever-increasing attention as investors, financial institutions, employees, customers, public interest groups, government, the media and more monitor closely company's behaviours.

78 CSR describes a company's commitment to stakeholders and socially responsible practices. ESG is used by investors and lenders and refer to a set of standards that are used to screen a company's practices. ESG and sustainability are used interchangeable, also by IFU.

79 IFU Board Seminar, 22 October 2015.

80 The DIM indicators are based on international standards from HIPSO (Harmonised Indicators for Private Sector Operations) for International Finance Institutions (IFI), or also referred to as the EDFI core indicators.

RESULTS MEASUREMENT EX-ANTE

Both the SCM and DIM indicators are assessed in the investment appraisal phase and presented in the BC. As indicated in Chapter 3, the BCs have become more detailed over time, influenced by the PPP funds practices, and this also applies to some extent to the ex-ante assessment of CSR performance and development outcomes/impact. Over time gradually more attention has been paid to ex-ante assessment of CSR performance (recently called sustainability policy). The 2004 investment appraisal documents for the case studies hardly refer explicitly to development outcomes as this was still prior to the introduction of the SCM in 2005.

From 2005 onwards gradually some more development-related issues are included in the appraisal documents, such as the number of expected jobs and scores without providing a rationale behind the scores. Since the start of the PPP funds, more attention is given to CSR and sustainability criteria in the project appraisal, which was elaborated in new CiP and BC templates for the PPP funds, but later for all IFU investments. In the recent BC templates, the 'Sustainability Summary' is part of the main Project Overview, which includes compliance with CSR and mentions the number of expected jobs but does not need to include other development indicators. There are other sections of the BC where development impacts according to the DIM indicators can be mentioned[81], but this is not mandatory. Therefore, in practice still limited information is included on development outcomes.

IFU's system to deal with ESG has recently also been externally assessed at the initiative of one of the pension funds and was compared with other investors such as pension funds (May 2018). According to this assessment, which focused on completeness of indicators and clarity of the system, IFU received a very high score. However, the assessment did not focus on implementation of the system in practice.

In addition, for all DCIF investments an independent third party estimates GHG emission avoidance at the start of the project, and for some specific projects Environmental and Social Impact Assessment Studies are done by an independent third party.

Screening of the minutes of the Board/IC and interviews show that selecting the investments with the highest potential development impact is not part of the investment process. Assessment of development outcomes does not play an important role in decision-making by the Board/IC, although in a few cases attention is paid to mitigation of potential negative effects.

81 Contribution to Sustainable Development' is part of the 'Detailed Analysis and Risk Assessment', while an enclosure on Development Impacts may be included, but is not always available.

RESULTS MEASUREMENT DURING IMPLEMENTATION

Monitoring during implementation is mainly based on self-reporting by the companies. Reporting templates have been adjusted over time. Since 2015 companies are required to submit an Annual Sustainability Status Report (ASSR) focussing to a large extent on compliance and regulations of the company in its immediate environment.[82] The ASSR asks for gender disaggregated job figures and also for a distinction between blue and white collar workers. However, most of the DIM indicators are not included in the ASSR. Companies indicated that the reporting format for IFU is lighter than for most other DFIs. Nevertheless, companies, in particular SMEs, are of the opinion that the annual reporting is still somewhat cumbersome and quite repetitive as compliance does not change every year. The case studies show that there are quite some delays with annual reporting. While the majority of companies submit reports, they do not always do this on an annual basis.[83] IFU is aware that the monitoring system is still too much a 'one-size fits-all'.

IFU has limited or no resources available for verification of the self-monitoring. However, there are a few exceptions: 1) for agribusiness (pigs or cows) investments IFU sends on a regular basis veterinarians or other experts to the farms to check whether they are in compliance with EU standards; 2) the case studies showed that for a few recent investments IFU has commissioned a specific impact study (one case focusing on socio-economic impacts of the Lake Turkana Wind Farm Project, which will be made public in February 2019 and another case focusing on human rights); 3) DanChurchAid (DCA) and IFU commissioned a report on development effects of agribusiness investments, based on three case studies in Zambia and Nicaragua. This study focused on smallholder inclusion in the value chain and the report is publicly available.[84]

RESULTS MEASUREMENT EX-POST

When IFU exits an investment a Final Evaluation Report (FER) is made, based on a two-page template that hardly changed during the evaluation period. Reference is made to the SCM (no FER based on DIM available yet). So far, the number of direct jobs is the only specific indicator included in the FER. Although a brief project overview is included and lessons learned, the main focus is on financial returns and no clear assessment is provided of CSR performance or development outcomes.

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82 Availability of a (certified) sustainability policy/action plan, employment data, labour conditions, health and safety, corporate governance, business ethics and anti-corruption, environment and climate and community engagement.

83 For the majority of case studies at least one ASSR is available. However, some large companies are exempted and do not have to submit the ASSR template. In addition, while ASSR are submitted, it is not common according to the case study analysis that every year an ASSR is submitted. This is due to the format, which is perceived to be quite cumbersome and repetitive on compliance and other issues.

84 https://www.ifu.dk/wp-content/uploads/Smallholder002.pdf.

Contrary to the templates for investment appraisal and monitoring (CiP, BC and ASSR), the FER template has not been updated to include more CSR and development outcome related information. Therefore, the FERs are clearly insufficient as a basis for a synthesis of CSR performance and development outcomes.

IFU commissioned two studies to report ex-post on its development outcomes: 1) a journalist was asked to write two books: one on the IØ investment history and another on IFU's investments in China, which were publicly available at the time;[85] 2) In 2011, a so-called impact study was published based on IFU in-house data 1967-2008.[86] Main findings of this study were presented at a conference and reported in the IFU Annual Report 2011. The study states that IFU plays a central role in Danish investments in developing countries, and that these investments provide benefits to the host countries as well as to Danish trade and industry. Overall conclusions were very positive, but no sound impact evaluation methodology was used, and underlying evidence was weak.[87]

5.2 Corporate Social Responsibility (CSR) performance

The case study scores on CSR performance are presented in Figure 5.1. The scoring of CSR performance is based on four indicators (1) CSR Action Plan or sustainability policy in place, compliance with international standards and norms (Global Compact, etc); 2) Decent labour conditions (salaries above minimum wage, good labour conditions), occupational health and safety measures/health and safety committee; 3) Environmental awareness and measures taken (waste management, energy efficiency, animal welfare, etc.); and 4) Business ethics and anti-corruption policies and guidelines). All indicators have an equal weight in the scoring. See Annex 2 (Table A2-11) for details on indicators and scoring. In the category "decent labour conditions" there is in a few cases explicit attention to labour conditions for women such as wage levels, facilities such as a kindergarten, but also for training of women and career perspectives. However, gender issues, with th exception of the recent attempt to measure gender-disaggregated jobs, is not systematically given attention.

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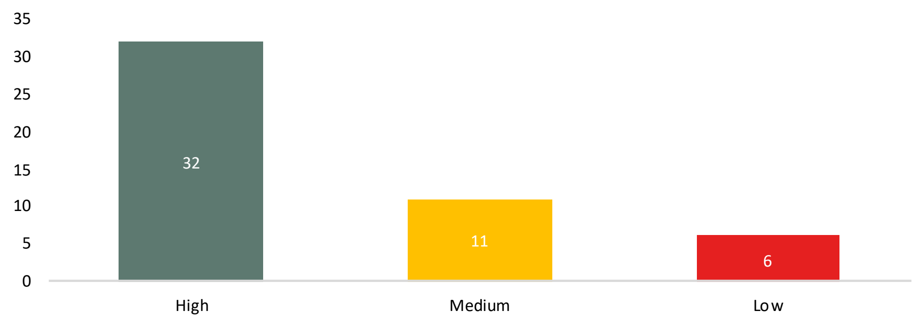
85 Hugo Gärden published Danish pioneers in the east" and "Danish successes in China", based on IFU information. They are considered as case descriptions rather than data analysis.

86 Michael W. Hansen (2011). Impacts of IFU projects in Denmark and developing countries. A quantitative assessment based on IFU in-house data.

87 No verification or validation of IFU data was done. A PhD thesis with IFU co-funding is now done that is expected to do a kind of follow-up impact study in Kenya. Already in 2006 there was a publication on "Danish investments in Developing Countries" based on IFU data.

FIGURE 5-1 ASSESSMENT OF CASE STUDY SCORES FOR CSR PERFORMANCE



The figure shows that two third of the companies score well and more than one fifth still score moderate. This in line with the systematic CSR reporting in IFU's Annual Reports during the entire evaluation period. IFU Annual Reports during the evaluation period present scores for CSR performance based on annual surveys: approximately 27-30% of the cases are rated excellent, 51-55% are rated good and 16-18% are rated fair/poor on a four-point scale. The overall quite good scores illustrate that Danish companies have for a long time been active in this area and many of them show a keen interest to improve their CSR performance. As IFU pays due attention to CSR-ESG criteria during project appraisal and implementation, it is assessed that IFU positively contributed to the CSR-performance of investee companies. However, no rigorous contribution analysis can be done. Therefore, the extent to which good CSR performance is due to IFU and what has been primarily the initiative of the investee company cannot be assessed. The six negative scores apply to companies where no evidence of CSR measures being implemented was found, although in a few of these cases CSR Action plans were made. [88] Most of the companies with a low score were companies with financial problems. The companies with a medium score were companies that made a good start including some ambitious CSR goals, but over time – often because of financial limitations – CSR was given less attention. There was one case where very ambitious CSR goals and standards and state-of-the art technology made the company too expensive to compete adequately in the market segment they were operating in. A detailed explanation of the scores on CSR indicators is presented in Annex 5A.

The breakdown of scores for specific IFU funds, countries, sectors and company size shows the following:

88 A certified management system is very rare and was only found in three cases.

- No significant differences across countries or across the various IFU funds;
- SMEs have lower scores for CSR performance than large companies. CSR measures are costly, and SMEs cannot always afford to pay for these measures;
- CSR measures vary from one sector to another and not in all sectors – e.g. renewable energy, finance, and IT – all CSR areas/indicators are equally important, while in other sectors and type of activities such as agribusiness, power plants, and manufacturing all CSR areas are important.

IFU has two main possibilities to stimulate good CSR performance:

- **Non-financial**: through requirements in the agreements, concrete advice, dialogue with the companies, support to formulation of the company's CSR Action Plan or Sustainability policies, support to CSR/Sustainability reporting (see Chapter 4 on value additionality), and CSR Awards that were granted during some years;
- **Financial support** in particular via the Danida CSR Training Grant Fund, financed by Danida and managed by IFU and to be replaced by the Sustainability Facility (see Annex 4).[89] Prior to this CSR grant fund, IFU provided also CSR grants for investments, while also CSR Awards were given.

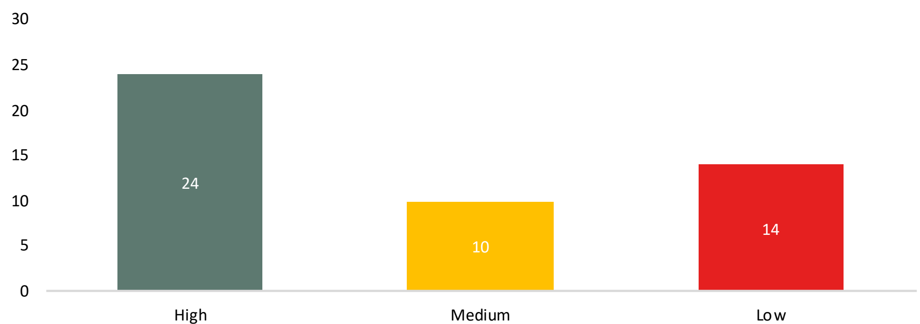
5.3 Assessment of development results

The case study scores on development outcomes are presented in Figure 5.2. The scoring of development outcomes is based on six indicators (1) Jobs created; 2) Value chain effects/ Indirect employment; 3) Transfer of Danish technology and knowhow, improved capacity of local staff; 4) Taxes paid and location of payment of taxes; 5) Climate/environmental effects, i.e. reduction of GHG emission; 6) Demonstration or spill-over effects, broader sectoral or socio-economic effects). All indicators have

89 The CSR Training Fund is discontinued in 2017 (last commitments made in 2018). Each year Danida made DKK 3 million available (in total DKK 27 million). CSR grants are demand-driven, and companies have to submit an application. Two types of grants exist: 1) assessment grant for an expert assessment of CSR issues (max DKK 75,000) and 2) main (implementation) grant to implement CSR measures and for training (max. DKK 500,000). In total, 89 grants were committed (2008-2018) for a total amount of DKK 32 million, but not all grants were disbursed (eight grants cancelled and some grants still ongoing). The size of the grants varies between DKK 25,000 and 1 million, average DKK 360,000. Also, five IFU FOCUS, i.e. networking events are funded through this fund.

an equal weight in the scoring. See Annex 2 (Table A2-12) for details on indicators and scoring. A low (red) score does not necessarily mean that there were (only) negative development outcomes but indicates that development outcomes were less than expected (i.e. lower number of realised jobs than expected, limited or no transfer of technology) or that negative development outcomes (e.g. pollution) outweighed the positive outcomes.

FIGURE 5-2 ASSESSMENT OF CASE STUDY SCORES FOR DEVELOPMENT RESULTS



The scores on development outcomes are more moderate than the scores on CSR performance with 50% good scores, 20% moderate and 30% poor. In total, there are 17 scores for exited investments and 31 scores for still active investments, while for two relatively recent investments scoring of development outcomes was not yet possible. There is a clear correlation between negative or poor financial outcomes and a low score on development outcomes. In cases of bankruptcy or poor financial performance, the company struggles to survive and all measures that increase costs including ESG measures and actions to improve development results are avoided. In the remaining one third of cases with a medium or low score on development outcomes, this is not directly related to problematic financial performance, but in these cases the development relevance of the investment at the time of investment was considered medium to low, and/or the company gave less attention to specific development indicators than originally planned. The cases with low and medium scores may still have realised some positive development outcomes, but these were not according to expectations and/or decreased over time, or the negative development results, e.g. water or air pollution outweighed the positive outcomes.

The breakdown of scores for specific IFU funds, countries, sectors and for SMEs vs larger companies shows the following:

- DCIF shows the most positive score (70% good) and IØ/UFA least positive (40% good), but the differences remain relatively small;

- Performance of Danish SMEs is more moderate than performance on development outcomes of the larger companies, but the differences are less pronounced than for CSR performance;
- The assessment of the exited investments and the still ongoing investments does not show major differences in scoring. The seven 'forced' exits in the sample with financial problems showed in most cases also problematic performance on development outcome indicators. For the 10 exits according to plan, of which eight companies could be visited or at least be interviewed, all companies showed continuation of the activities. However, approximately two thirds of the cases showed substantial growth since the exit with due attention being paid to further improvement of CSR performance and in some cases to broader development results as well. In a minority of the exits according to plan (approx. one third), attention to development outcomes and CSR performance appeared to have weakened, which was often related to problematic financial performance.[90]

CREATION OF DIRECT JOBS

From 2005 onwards, the number of expected and actual direct jobs created has been assessed and monitored by IFU and is reported in the Annual Reports and IFU's audited and annually updated Project Portfolio (list).[91] At the investment appraisal phase, the number of expected direct jobs (once full capacity utilisation is reached) is assessed. During implementation and at exit, the companies report on the actual total number of people employed in the project company.

However, a series of measurement problems has been identified by the evaluation, which complicate the measurement of direct jobs to which IFU contributed. These remarks on the problems of job measurement should be seen in light of the best practices developed in an international context, including those of the World Bank Group and the Donor Committee for Enterprise Development (DCED).[92] The following

90 The 17 exited investments included seven 'forced' exits and 10 exits according to plan, while the number of case studies of exited and active investments is representative for the sample (see Annex 2). None of the forced exit cases could be visited, while interviews could be held with eight of the 10 planned exited investment companies

91 Recently, companies are asked to report gender disaggregated figures on job creation and to make a distinction between white and blue-collar workers. Aggregation of these figures is not yet done and is complicated, because not all companies present disaggregated figures.

92 WBG (2016), Jobs and Development Blog, Overcoming the challenge of measuring jobs; Donor Committee for Enterprise Development (DCED) (2014); Ben Fowler et al, Measuring Job Creation in Private Sector Development; and ODI, Isabella Massa (2013); A brief review of the role of development finance institutions in promoting jobs and productivity change.

job measurement issues for IFU have been identified on this basis, as illustrated in Table 5-1.

TABLE 5-1 OVERVIEW OF MEASUREMENT PROBLEMS REGARDING CREATION OF DIRECT JOBS

Type of issue	Measurement problem
Ex-ante assessment of expected jobs	This is notoriously difficult and overestimation is not uncommon. Various studies on DFIs and PSD programmes show various degrees of overestimation
Permanent vs. temporary jobs	IFU measures all actual jobs during implementation including construction jobs when construction is still ongoing. When construction is finished these jobs are not reported any longer under actual job figures. Another difficulty is related to the distinction between seasonal jobs and permanent jobs.
Follow-on investments	The number of expected jobs is updated various times in the portfolio and often different numbers are presented for the first and follow-on investments. In practice, it is not entirely clear to the evaluation what the basis is for these different figures.[93]
Time of measurement	Companies report at different periods in time. In the FER, the number of existing jobs in the company at exit is reported. However, in some cases the exit takes considerable time and there is only one moment of measurement.
Self-reporting by the companies	The number of realised jobs in the portfolio is annually updated on the basis of the self-reporting by the companies. Despite the guidance provided by IFU, companies have different interpretations of the definition of jobs created. Moreover, company reporting is sometimes irregular and no verification is done.[94]

Type of issue	Contribution problem

93 According to IFU: Expected direct employment is the number of persons expected to be employed directly in the project company once full capacity utilisation is achieved, as foreseen at the appraisal stage (either at the original appraisal stage, or at a later appraisal stage, if additional financing has been provided, and the figure for expected employment has risen). However, in the portfolio data received different figures are presented, which cannot always be related to these definitions.

94 In one of the 50 case studies incorrect reporting related to fraud was found, which was found out by IFU and adequate action was taken.

Greenfield vs. brownfield	IFU does not make a distinction between greenfield and brownfield companies, which means that all jobs are counted and included in IFU's reporting including the jobs that already existed at the start of the investment. IFU also includes in its definition the preservation of jobs.
Investments in funds	IFU has recently changed the measurement of jobs related to its investments in funds. Now all reported jobs in the funds' portfolio companies have been included in the IFU reporting while the share of IFU's investment as part of total investment varies between 1% to 49%.
Substantial expansion of company during IFU investment but without clear financial or anther role for IFU	When an investee company expands substantially – for example, construction of additional factories in the host country or other countries – during the period of IFU investment, but with completely different funding sources, all jobs created are included in the measurement even when there are no clear indications of an IFU contribution.
No contribution analysis	IFU does not estimate its own contribution to job creation, based on its share in total investments and/or taking into account catalysed funding. It has to be acknowledged that almost all DFIs so far report on total jobs created and do not calculate their contribution on the basis of their share of investments, which leads to serious overreporting in the eyes of the evaluators. Some principles on contribution/attribution have been developed, but no uniform system has yet been agreed upon.

Based on its own definitions and measurement methods, IFU indicates in its 2017 Annual Report that in total 373,000 direct jobs were created. No time period is mentioned, but IFU explained that this is the job creation in its entire lifetime for all IFU's funds. However, in 2016, 230,000 expected employment was reported over the same period and 225,000 in 2015. This means that in 2017, more than 140,000 direct jobs were added as IFU decided to include all direct jobs in fund's portfolio companies (see Table 5-1).[95] IFU is aware, as indicated in its DIM Manual, that it cannot always attribute all jobs to its own efforts.[96] According to the DIM Manual, IFU acknowledges that "*as a minority investor it does not take sole credit for the total development outcomes in investee projects. However, IFU is considered to have contributed to these total outcomes through its investments and special role in the project*". While most develop-

95 According to IFU, the decision to include jobs from fund investments should be seen together with the decision to include taxes from funds and was to give a more comprehensive picture of the effects of IFU's fund investments.

96 Also, OECD/DAC and other international organisations discussed the issue how substantial double-triple etc. counting can be avoided in reporting by various investors. Some principles such as a combination of pro rata attribution and attribution according to risks taken have been discussed, but not yet formally adopted.

ment outcomes are fully attributed to IFU and included in its reporting, an exception is made for IFU's investments in funds where the IFU share should be reported "*pro rata to IFU's share and the Danish partner in the investment*". Apparently IFU decided to change this in the 2017 report, without clearly explaining this and without providing a rationale for this change. Furthermore, IFU started to measure actual jobs only in 2005, which means that only rough expected job figures are available for the early years of IFU's existence. It is clear that with changing underlying definitions and measurement issues over time, it is problematic to report on a total number of jobs created since IFU's existence and no useful conclusion can be drawn regarding IFU's contribution to direct employment for its entire lifetime.

Given the measurement problems, there are three ways to estimate IFU's contribution to creation of direct jobs from 2004 to 2017:

1. IFU reports in its Annual Reports from 2004-2017 that approximately 85,000 jobs were *expected* to be created by new investments in the period (based on ex-ante assessments during BC stage) from IFU Classic and IØ. Given the size of the other IFU-managed funds active in the period[97], the overall total expected number of jobs according to its annual reports might have been close to 90,000 for the period.

2. The evaluation's analysis of IFU's underlying portfolio data from investments in this period shows that the total number of expected direct jobs from all its new investments amounts to approximately 103,000.

3. IFU also monitors the number of jobs realised during an investment and when exited. An analysis based on these data reported until the end of 2017 shows that the total number of jobs realised for active and closed investments during 2004-2016 amounts to approximately 70,000.[98]

Based on these three methods, it is estimated that IFU contributed to the realisation of approximately 80,000 to 100,000 jobs from 2004 to 2017.

97 The KIF/DCIF Annual Reports mention a total expected number of jobs of 639, while the DAF Annual Report mention 1000 expected jobs for new investments (and 372 for additional financing of ongoing projects).

98 The expected number of jobs is therefore likely an overestimation of the later to be realised number of jobs. It is difficult to calculate the extent of overestimation. The fact that overestimation occurs is in itself not uncommon for PSD programmes or DFIs in general.

Via the in-depth case studies the number of jobs for large companies and SMEs has been further analysed.[99] For SMEs the actual number of jobs realised varies between 0 and 180 and the average is 40 per investee company. For large companies the average is approximately 10 times higher with 400 jobs and a variation between 15 and 3,350. It should be realised that the case studies included some cases of the early outsourcing wave to China that led to the creation of thousands of jobs, while these cases have become quite uncommon over time. Over time, the average number of jobs created per large investee company shows a downward trend, which is due to the type of sector.

The variation in job creation in different sectors or for different types of activities is large. Over time, IFU has become more involved in capital-intensive investments such as renewable energy where direct job creation is not the primary objective but other development and climate objectives are pursued. Agribusiness in various continents remains a clear focal sector where job creation is important. In general, outsourcing of low-skilled work has created most jobs.[100] Outsourcing was still rather important during the first sub-period,[101] but now the main outsourcing wave is over. Outsourcing of high-skilled work has a high development impact as shown in a factory for high-precision metal components in West-Ukraine where this employment opportunity provides a good alternative for emigration. Another example is the investment in an IT company in Ukraine in 2006 that has now more than 2,500 programmers and is among the top-five of IT companies in Ukraine. This company contributed to the establishment of a very vital, dynamic and international IT sector in Ukraine, thus keeping high-skilled workers in the country. There were also a few examples in the case studies of a decrease in jobs during IFU's investment, where as a result of more efficient production processes and a stagnation in sales, the number of jobs decreased.

As IFU aims to measure actual jobs each year, decreases should therefore be reflected gradually as they take place. However, this were exited investments and the decrease in jobs was not reflected in the IFU figures.

INDIRECT EMPLOYMENT/VALUE CHAIN EFFECTS

For each direct job created IFU estimates that one-two indirect jobs in the value chain are created, which is in line with international standards for measurement. However, it is a very rough indicator as the number

99 Based on information provided by IFU, actual verification during site visits, additional interviews and additional information exchange with IFU.

100 The IFU Annual Reports indicate the highest number of expected jobs in 2004 and 2009.

101 In the case studies there were examples for outsourcing of textile production, furniture, shoes, and metal components.

of indirect jobs varies enormously from one sector to another and even from one investment to another.

It appears that rather than in addition to multiplying the number of direct jobs with a factor, a value chain analysis is more meaningful taking into account the upstream and downstream activities of an investee company. This is particularly useful for agribusiness. Responsible procurement is part of CSR but can go further. In the case of the agroprocessing industry, the raw materials can be obtained from own production, buying from smallholders, buying from big farmers or be imported. The development outcomes vary substantially. IFU has invested in many agroprocessing enterprises.[102] A specific challenge in these industries is how to find the right balance between good quality of the raw materials and sourcing from smallholders. The quality of the product from smallholders tends to be more variable than for big farmers. While the case study companies do provide guidance to the farmers, they indicated that they were not able to do the work of extension workers.[103] Also in other sectors than agribusiness, value chain analysis is useful to know where the inputs are procured and who the suppliers are. So far, IFU has paid very little attention to most elements of the value chain.

102 Milk and yoghurt production, cocoa, honey, coffee roasting, fish feed, foods for treatment of malnutrition.

103 In the case of a fish feed or other animal feed production the supply chain of the final product is important. There is lot of room for improvement in aquaculture as regards hygiene, animal welfare and environmental standards. With improved fish feed, the quality and quantity of the production may increase while at the same time advise can be given by the sales agents on better fish farming, hygienic and environmental standards, use of antibiotics etc. Also here applies that sales agents cannot fully replace extension workers.

TWO AGROPROCESSING CASE STUDIES IN EAST AFRICA

IFU invested in a yoghurt factory and in a coffee roasting factory. Both investments originated out of B2B projects. The raw materials – milk for the yoghurt factory and coffee beans for the roasting factory – were meant to be delivered by smallholders. The coffee factory (30 direct jobs) is working with coffee cooperatives in five countries, in total approx. 85,000 smallholders who sell part of their production (between 5-20%) to this certified fair trade and organic factory. Although for this case an external agency did a detailed study on human rights and development outcomes, no livelihood effects were calculated. The factory provides some guidance and assistance regarding the coffee quality, but they cannot take over the role of extension services. Both the factory and the coffee producers are functioning in a problematic context with restrictive legislation and market conditions, which are beyond their influence. Nevertheless, for such a SME the development outcomes are high especially also because coffee is almost never roasted in the country of origin. The milk for the yoghurt factory was originally supplied by smallholders who were assisted by an American NGO. A specific challenge was to have milk of a good and constant quality. However, the quality of the milk remained variable and the factory was facing managerial and market problems. Therefore, an efficiency measure was taken and a contract was made with a big expatriate farmer to deliver all his milk to the factory and the small holders now only deliver incidentally their milk (less than 10% of the total milk supply).

TRANSFER OF DANISH TECHNOLOGY AND KNOWHOW

In 29 of the 50 case studies there has been transfer of Danish technology and knowhow in many different forms: knowledge of production processes, use of machines and production lines produced in Denmark, specific expertise in a variety of areas from pig farming to operating power plants or wind farms. The transfer of technology and knowhow led to improved capacity in developing countries as staff was trained. In some cases there was no positive development outcome as sometimes the technology was too advanced to be adequately transferred.[104] It did contribute to internationalisation of Danish business.

LOCAL TAXES PAID, LOCAL SUBSIDIES, VAT EXEMPTIONS AND OTHER REGULATORY ISSUES

Since 2012 the payment of local taxes is systematically checked in the investment appraisal phase and monitored during implementation.[105]

104 However, in some cases the technology was too advanced or too expensive for the local context and activities had to be stopped (eg. innovative solar water systems for communities based on solar energy). In other cases, such as outsourcing of already problematic production processes there were no positive development outcomes.

105 IFU has a tax policy in place since 2015, which is annually adjusted and updated, and that deals with compliance and payment of local tax, use of holding company structures and third jurisdictions and transparency.

Companies do report on tax payments in line with national legislation. Adding up the total amount of local taxes paid by the companies in which IFU invested is a logical way of reporting but does not provide clear information on development outcomes or impact. Nevertheless, it is important to state that the large companies and SMEs did pay taxes and it is part of IFU's appraisal and monitoring. Since 2012, IFU has a policy in place on Offshore Financial Centres (OFCs) based on EDFI's Guidelines for OFCs. IFU takes a somewhat more restrictive position on OFCs than indicated in the EDFI guidelines. The evaluation found no evidence that IFU invested in companies based in OFCs on the OECD blacklist. There are, however, companies, that are based on tax havens that are on the OECD white list such as the Cayman Islands and Mauritius. OFCs are under continuous and increased pressure since 2011, which means that they act and react differently. The main issue is transparency (see Section 5.4).

During the field visits, tax payments and the enabling environment were discussed. Changes in taxes and changes in legislation may affect investments to an important extent. For example, in many countries policies are in place to promote renewable energy often with (unsustainably) high feed-in tariffs, which indeed stimulate investments in the short run (e.g. solar energy in Ukraine and to a lesser extent wind energy) but may create an abrupt stop of investments when legislation is changed. VAT exemptions or exemptions for the payment of income taxes (IT sector in Ukraine) may also create a favourable investment climate at least for some time. The evaluation also came across examples of ad-hoc interpretations of tax regulations in all three countries visited, that required long discussions and in some cases the assistance of IFU, the embassy or lawyers to solve the issues.

CLIMATE AND ENVIRONMENTAL EFFECTS

The most important indicator agreed upon is the reduction of GHG emission, which is ex-ante calculated for all DCIF investments by an independent firm. The annual DCIF reports (2014-2017) indicate that expected GHG savings add up to 33,055,000 tCO_2e over the entire 20-30 years lifetime of the projects. In EDFI there is a strong move to report actual annual savings and IFU intends to capture these in the ASSRs in the near future. It is not clear whether ex-post calculations for some or all investments will be carried out.

ENVIRONMENTAL EFFECTS OF FIVE PIG FARM CASE STUDIES

The evaluation has found that negative environmental effects can be mitigated to an important extent in the proper context if sufficient interest and means are available to do so. Smaller SME pig farms with limited means have relatively more negative environmental effects in terms of pollution than more advanced larger pig farms. The most advanced pig farm has sufficient arable land (in line with EU norms) to inject the slurry in a responsible way, has a closed system for separating the solid fraction of pig manure, has a biogas plant, has good housing conditions for the pigs, pays due attention to animal welfare and avoids use of antibiotics to the extent possible. It is rare that all these measures are taken in one single pig farm. The IFU guidelines are that the company must introduce and implement mitigation measures in case of negative impacts. In one of the case study companies, a new slurry system was needed for which IFU provided an additional investment.

BROADER SECTORAL AND SOCIO-ECONOMIC EFFECTS (INCLUDING DEMONSTRATION AND SPILL OVER EFFECTS)

In IFU's reporting there is limited attention so far for broader sectoral and or macro- or socio-economic effects, which is also due to the lack of evaluations. In approximately half of the cases, evidence for broader socio-economic effects beyond the company and/or community level were found. However, for the other half no evidence for positive broader development outcomes was found. In the cases where the overall balance was positive, also some negative effects were found. Investments in energy are clear examples where a broader analysis is useful. (see text box). Demonstration and spill over effects were found in various sectors including agribusiness with adoption of at least some EU/Danish standards by other non-Danish farms.

BROADER DEVELOPMENT EFFECTS OF INVESTMENTS IN THE ENERGY SECTOR

Various DFIs have published evaluations or impact studies on their investments in the energy sector.[106] IFU has taken the lead in an impact study on the Lake Turkana wind farm in Kenya. Advanced econometric and impact methods are used for these studies. The studies shed more light on the balance between the need of developing countries to increase the baseload in the most efficient way (this may still imply the use of fossil fuels under certain conditions). Generation of new power supply needs to be carefully balanced with the improvement of the distribution network (the grid). One common problem is that improvement of distribution network is often given insufficient attention in the investment appraisal and this may negatively affect the ultimate development outcomes. If distribution of the additional renewable power supply (solar and wind energy) or more traditional power plants is guaranteed, the socio-economic effects may be substantial: improved performance of businesses leading to job creation and improvement of livelihoods, GDP increase and increase of government expenditure, and non-economic effects such as increased home study time, enhanced feelings of safety, better performing community services, etc. A less positive effect may be that the Power Purchase Agreements (PPA), both for conventional and renewable energy, are based on sometimes very high IRRs (even up to 18%), which provide high financial returns to the investors (partly explained by high perceived country risk), but which have to be paid for by energy consumers/tax payers in developing countries.

5.4 Communication on results

IFU Annual Reports are the main reporting mechanism on development outcomes and CSR performance (see previous sections). IFU has also commissioned a few studies on development outcomes and impact, of which some are public. In addition, IFU reacts to publications in the media. The MFA also has a role to play when it comes to communication on IFU's development results as the MFA is responsible for evaluation of IFU. In this way, the MFA did not directly contribute to better communication on IFU's development outcomes. The last evaluation was published in 2004. No evaluation was conducted of IØ. Midterm Reviews (MTRs) of some facilities (SME, UFA) and DCIF have been mainly conducted on the basis of document review and interviews. These MTRs are not made public as review is an internal management and quality assurance instrument. This means that during the entire evaluation period of 14 years the MFA did not publish any evaluation of IFU. In addition, the MFA should also ensure that IFU reports in a transparent and satisfactory way on development outcomes (see Chapter 2).

106 Dalberg (2012), EDFI Energy Evaluation 2012; StewardRedQueen (2016), What is the link between power and jobs in Uganda? An independent evaluation commissioned by CDC; FMO (2015), Energy Sector Evaluation.

IFU has been very active in recent years in communicating about the set-up of the PPP funds, and in particular the DCIF and the SDG Fund. Indeed, this represents an innovative change in IFU's business model as discussed in Chapter 3. IFU did participate in many conferences and seminars on climate change and SDGs. It is obvious that in these forward-looking presentations the ambitious objectives are stressed, but there has been no attention to a balanced presentation of development outcomes. IFU has also been to some extent proactive to engage in a dialogue with the NGO community, which is reflected in the establishment of the Sustainability Advisory Board (see Chapter 3) and the set-up of some partnerships with NGOs. However, the Sustainability Advisory Board has a limited role.

From 2004 to 2017, there were several debates in the media, the development community and in Parliament on IFU. One of the main topics in the debate was IFU's focus on countries with favourable business environments, i.e. emerging markets. This was related to the perceived insufficient IFU focus on poorer countries.[107] Also the focus on investments in Danish companies and the perceived lack of financial additionality were subject of debate.[108] These issues are to large extent related to the mandate of IFU as defined by the MFA. Other debates were related to IFU's reporting of employment figures both to civil society and the Danish Parliament (in 2005)[109], and recently (2017) in connection to the Paradise Papers on perceived IFU investments in funds and companies based in tax havens. IFU has disclosed its tax policy, local taxes reported from investees, information on use of holding companies and third country jurisdictions. The MFA had an intensive dialogue on tax issues with IFU. Moreover, IFU has participated in the OxfamIBIS initiated Tax Dialogue. There is a reputational risk of investing in a company based in an OFC that is not transparent, and this requires constant attention. In 2015, IFU acknowledged[110]: "IFU could be more direct about its role and contribution as an instrument in Denmark's international development policy and IFU could be more clear about its impact, special role and value-added". Most stakeholders, including the MFA, are of the opinion that IFU can still be more transparent and less defensive on tax (and other) issues. There is still room for improvement of the learning culture within IFU.

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107 Ministry of Foreign Affairs, Danida (2004). Evaluation. The Industrialization Fund for Developing Countries.

108 Dansk Økonomi Efterår Konjunkturvurdering. Udflytning af arbejdspladser. Vand og natur, november 2004.

109 http://www.ft.dk/samling/20042/spoergsmaal/s39/index.htm; https://globalnyt.dk/content/sven-riskaer-gar-efter-et-kvart-arhundrede-ogsa-ifu-bestyrelsen-skiftes-ud.

110 Note to the Board in 2015 regarding the SCM review.

These debates reflect some fundamental differences of opinion among stakeholders regarding IFU's role and expectations of development outcomes. Interviews with civil society actors indicated that over time more divergence of opinions within the development community emerged regarding the role of IFU. Some NGO representatives decided to work together with IFU in the form of partnerships, as member of the Sustainability Advisory Board, by doing studies, etc., while others prefer to keep a distance. Those organisations and individuals that have opted for an increasing merger of the traditional divides of business and aid underline the necessity of inclusive and sustainable business models. Other development organisations keep a critical distance from IFU and continue questioning the use of aid money to set up (Danish) business abroad. They question issues such as the focus on (high) financial returns rather than development outcomes, the size of firms IFU is investing in, and the ex-ante and ex-post assessment of development outcomes. Although the two diverging groups fundamentally disagree on whether and how to work together with IFU, they do agree that better measurement of development outcomes is needed and that the MFA should pay more attention to this as well.

6 FINANCIAL OUTCOMES

This chapter deals with IFU's and IØ's overall financial results from the viewpoint of the State as owner, the sustainability of IFU's capital position, and the case study analysis on financial results at project level. Methodological detail on indicators is presented in Annex 2 and supporting data can be found in Annex 3.

KEY FINDINGS

- IFU's average Return on Equity was 7% during the evaluation period, which is an acceptable level given the fact that it is unleveraged and a blended return from equity and debt investments.
- Even though the State, since inception of IFU in 1967, has extracted nearly as much capital (DKK 1.25 billion, net of dividends) as it has injected (DKK 1.38 billion), IFU's equity balance at the end of 2017 still stood at DKK 3.3 billion, which must be viewed as a very satisfactory result.
- IØ's return on equity over the evaluation period is estimated at 10.4% and has managed to leverage its capital base about three times by recycling capital and reinvesting profits. As such, IØ proved to be a very profitable investment for the government; at the end of 2016, IØ had repaid DKK 3.6 billion to the State, with a book value of remaining assets of about DKK 120 million, pointing to a net profit upon full divestment, of at least DKK 1.9 billion.
- IFU's actual returns on equity investments are often in double digits, which is higher than what can be achieved through loans. Returns on loans are nevertheless satisfactory, with interest rate margins usually being in the 5% - 7% range, but the average IRR on IFU's loan portfolio was limited to 4% (2003-2012), probably due to loans to SMEs.
- The case studies indicate that 55% generates positive financial results in line with expectations. In view of encountered risk factors in demanding environments, IFU's realised returns on equity and loan investments are overall deemed satisfactory, with IRRs often in double digits on equity investments, and interest margins on loans generally being in line with IFU's risk premium matrix, which appears to be in line with market rates.

6.1 Overall IFU financial results

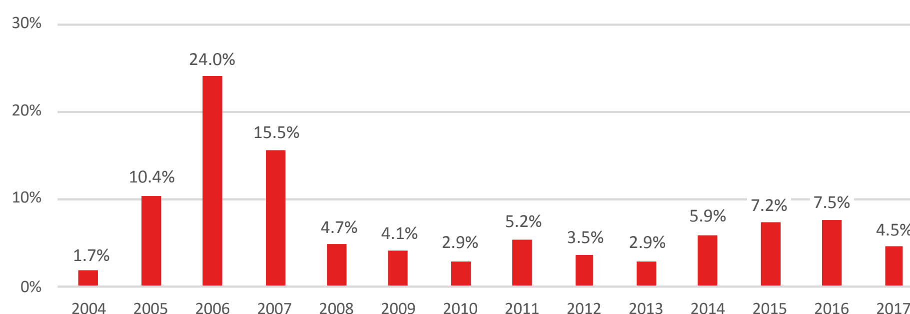
From the viewpoint of the shareholder (the government), return on equity (ROE) is a suitable financial performance indicator. It calculates the earnings attributable to the shareholder from the funds invested in IFU and is thus a measure of how well management uses the shareholder's funds.[111] IFU's net income has displayed high variability over the evaluation period, with an average of DKK 156 million per year. IFU has

111 It is an appropriate indicator for companies with low leverage, as it does not factor in the debt side of the company's funding (IFU has virtually no debt on its balance sheet).

delivered positive returns on equity throughout the evaluation period (see Figure 6.1 based on Table A3-10).

IFU's average ROE was 7.1%. This is an acceptable not a particularly high level – ROE ratios for healthy companies normally exceed 10%. However, it should be recognised that IFU's result is unleveraged and represents a blended return from equity and debt investments, which means that IFU's ROE is not directly comparable with that of leveraged companies. In this connection it can be noted that IØ's return on equity over the evaluation period is estimated at 10.4%. The ROE shows important variation over the years. The high ROEs in 2005-2007 were caused by high net income in those years, when the economic environment in emerging markets was favourable, with good returns from share capital exits and satisfactory performance of the loan portfolio. The capital extraction in 2004 also contributed to the high ROE rates (as the capital base was reduced). On the other hand, it is relevant to note that the State had made no capital extraction from IFU during the preceding 37 years (1967-2003).

FIGURE 6-1 IFU RETURNS ON EQUITY, 2004-2017



As noted above (Section 3.3), management fees are becoming an increasingly important source to cover opex, particularly for the management of the PPP funds. IFU is not viewing these fees as a profit centre as such, since the fees ostensibly are set at levels that are estimated to cover the actual costs incurred in the fund management. Nevertheless, IFU's fund management operation can become a source of additional profits in the case of the PPP funds, where IFU as fund manager will receive 'carried interest' (or 'carry') on top of the management fee, i.e. a share of the fund's profits, once the pre-agreed 'hurdle rate [112] for profit sharing has been met.

112 The hurdle rate is a pre-agreed profit level (measured as internal rate of return, IRR) that the limited partners (in this case the institutional investors) must receive before profit-sharing with the fund manager in the form of carried interest comes into play.

6.2 Sustainability of IFU's capital position

When IFU was set up in 1967, its operations were mainly financed by taxes from coffee and coffee products amounting to DKK 300 million. In 1996, the government decided to provide a new capital injection of DKK 750 million for investments in poorer countries. In addition, IØ was established by a capital injection of DKK 1.9 billion paid in over the period 1990-2000. The most notable capital withdrawal occurred in 2004, when the State extracted DKK 750 million from IFU and DKK 650 million from IØ, but it was followed by more capital extractions until 2013 (see Table A3-11 for an overview for reasons of capital extractions). In the bi-annual meetings with MFA IFU disagreed with the way this was done as IFU's liquidity forecasts were not taken into account. Over time, the government and IFU agreed that a policy basis needed to be defined regarding capital extractions and/or a dividend policy. In 2016, a dividend policy was agreed upon.[113] Table 6-1 shows all capital flows between the MFA and IFU/IØ/IFV over the evaluation period.

In the case of IØ and the Investment Fund for Emerging markets (IFV) it was agreed that the state capital contributions including returns on investments would be returned to the State. A summary of capital movements for IFU is shown in Table A3-12 and for IØ in Table A3-13 (Annex 3).

113 In 2016, in an amendment to the Act on International Cooperation, the following clause is added as a sub-section 4 in §9 "The fund may, at the discretion of the Board, pay dividends to the state. The Minister for Development Cooperation, after consultation with the Board, determines a dividend policy for the Fund. The basic principles are that on the basis of ongoing discussions an annual dividend of DKK 50 million is expected. However, the dividend will not exceed 50% of the result in the previous financial year.

TABLE 6-1 OVERVIEW OF CAPITAL FLOWS BETWEEN IFU/IØ/IFV AND THE STATE, 2004-2017 AND 2018

	Capital injection and allocations (DKK million)						Capital extraction and dividend payments (DKK million)			Balance
	Capital injection	Allocation	CSR Training	SME Facility	NEF	NEIF	IFU	IØ	IFV[114]	
2004							750	650	27	-1,427
2005									38.5	-38.5
2006								300	5	-305
2007								500	17	-517
2008			2				200	600	50	-848
2009							75	100		-175
2010			2					100	3.5	-101.5
2011	44.4*	50 (AIF)	4				75	500	37.9	-514.5
2012	57.0*	275 (DCIF)	3				75	275		-15
2013			3				75	200		-272
2014			3					125		-122
2015		30 (UFA)	1.5	9	10.5			100		-49
2016	14.0*	89 (DAF) 50 (PDP)	1.5	10	0.5		100**	75		-10
2017	200 16.5*		2	6			50**	150		24.5
Total 2004-2017	**331.9**	**494**	**22**	**25**	**11**	**--**	**1,400**	**3,675**	**178.9**	**-4,370**
2018	*100 (SDG)*		*2*			*3*	*50****			55

** These capital injections refer to Norsad shares received from MFA and capital from MFA to invest in new shares in Norsad and some other similar capital injections that are not based on policy decisions. See Annex 3, Table 3-11.*

***The first annual dividend payment was for the operating year 2015, but only entered into the accounts for 2016 (actual pay-out took place in 2017). The dividend payment for 2016 was also entered into the accounts for 2016 (and paid out in 2018). The dividend payment for 2017 was entered into the accounts of 2017 (and will be paid out in 2019).*

**** Expected.*

114 The IVF is the fund for emerging markets, which the government decided to close in 2004.

Taking into account all capital flows, the Danish State received DKK 4.4 billion from IFU, IØ and IFV during the period 2004-2017. The funds for IØ were provided from the general state budget and not the development budget. From the start it was clear that the capital contribution including return on investments would be returned to the State. IØ proved to be a very profitable investment as it managed to leverage its capital base about three times by recycling capital and reinvesting profits (IØ invested since its inception about DKK 5.5 billion). At the end of 2017, IØ had repaid DKK 3.7 billion to the State, with a book value of remaining assets of about DKK 120 million, pointing to a net profit for the government, upon full divestment, of at least DKK 1.9 billion (in nominal prices. Since the inception of IFU in 1967, the State has extracted nearly as much capital (DKK 1.25 billion + DKK 0.1 billion in dividends) as it has injected (DKK 1.38 billion). IFU's equity balance at the end of 2017 still stood at DKK 3.3 billion, which must be viewed as a very satisfactory result. IFU/ IØ can thus be viewed as a source of income for the State budget.

In addition, for DCIF and DAF, separate entities (KIF and LIF) were set-up in which MFA invested its funds (see Annex, Figure A3-9. These facilities are managed by IFU, are legally part of IFU, but are treated as facilities separately from IFUs capital (off-balance funds). Initially no clarity existed over the distribution of the funds (LIF and KIF) after the funds would come to a close. In 2018, The MFA requested the Finance Committee to merge AIF, KIF, LIF and UFA with IFU Classic with effect from the 2018 financial year. On 22 November 2018, this was approved by the Parliament's Finance Committee. This means that these funds will no longer be off-balance in IFU's accounts. This is not yet reflected in the above analysis covering the period 2004-2017. The State investment in the SDG Equity Fund is made in another way an also includes DKK 800 million state guarantees as reflected in Annex 3, Figure A3-10.

6.3 Assessment of financial results at project level

The methodology and the indicators used for scoring of the case studies on financial results are presented in Annex 2. The evaluation bases its scoring in particular on indicators such as performance of the portfolio company as compared to plan (incl. market aspects); expected and realised return on investments (both equity and loans); capital gains following exits from equity investment; as well as interest payments and repayment of principal of loans (incl. any impairments and restructuring).

IFU uses the internal rate of return (IRR) as a measure of the financial results for individual projects. The IRR returns on equity investments are derived from outgoing and incoming (divestments and dividends)

IFU'S INTEREST RATE MATRIX FOR LOANS

IFU's pricing for loans is based on a risk-compensation matrix for interest rate ranges. The matrix is linked to IFU's internal risk model (see Section 3.5). Each loan is classified into one of four risk categories: A, BBB, BB, and B (where A represents the best risk and B the worst risk). For the last two years (2016 and 2017), IFU has only extended loans with BBB and BB ratings.

cashflows as well as value adjustments.[115] Returns on loans are derived from outgoing and incoming (repayments, interest and fees) cashflows as well as value adjustments (e.g. loss provisioning and exchange rate adjustments[116]). IFU's net results may fluctuate considerably from year to year due to the value adjustments made on the investments.

Interest margins on loans are generally in line with IFU's risk premium matrix (see box) and are presumed to basically be in line with market rates. While we do not have access to data for market spreads on bank loans with comparable risk profiles to support this presumption, IFU has presented an analysis showing that IFU's loans are priced above the market for corporate bonds with similar credit losses (using bond spreads as proxy for interest margins on bank loans).

Equity investments display high variability between negative/low and high returns, but with the latter being more frequent than the former. Variability in equity returns is in some cases mitigated by pre-agreed exit arrangements, such as put option with a pre-determined minimum return. Such financing structures may be referred to as quasi-equity, as they combine the potential upside of an investment shares with loan characteristics such as pre-defined repayment terms. This may change the risk-return profile to the benefit of IFU, but to the possible detriment of the investee company.

IFU's actual returns on equity investments are often in double digits, which is higher than what can be achieved through loans. Returns on loans are nevertheless satisfactory, with interest rate margins usually being in the 5-7% range. However, the end result on loans is dragged down on a portfolio basis by credit losses; e.g. the average IRR on IFU's loan portfolio was limited to 4% over the 2003-2012 period. The largest share of loan losses falls on projects where the borrower is classified as a B-risk. This segment of the loan portfolio, which typically concerns investments in SMEs, generated a negative IRR (- 6.7%) over the 2003-2012 period.[117]

115 IFU measures its investments at estimated fair value in accordance with the accounting principles set out in the Danish Financial Statements Act.

116 The denomination of IFU's loan portfolio is a mix of DKK (approx. 20%), EUR (approx. 30%) and USD (approx. 50%) and a few local currencies. IFU hedges USD-denominated loans through cross currency swaps to DKK.

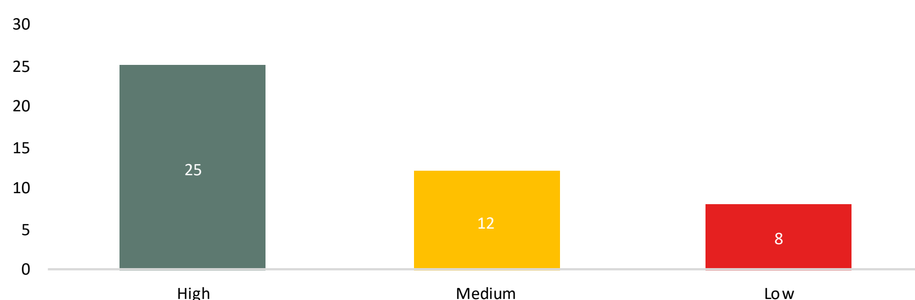
117 Based on a sample of all direct investments with a loan contracted in the period 2003 to 2012. [Source: IFU internal document: Interest Rate Levels – Annual Review (2018).]

HARD CURRENCY-DENOMINATED POWER PURCHASE AGREEMENTS (PPAS)

In order to make projects investable, most PPAs include tariffs in hard currency, so that Independent Power Producers (IPPs) can service their debt and pay distributions to their equity investors. On the other hand, the revenues that the off-takers (typically the national power utility) earn are denominated in local currency. As a result, the off-taker bears the risk that the local currency will depreciate against the hard currency in which the tariff is denominated under the PPA. Each 1% drop in the value of the local currency against the hard currency would result in the tariff becoming 1% more expensive in local currency terms. This extra cost is typically passed on to the end-consumers through periodic increments in the retail tariff. For example, through a foreign exchange rate fluctuation adjustment and a fuel cost charge that are adjusted and added on a monthly basis to the kWh price across the customer base.

The case study scores are presented in Figure 6-2. The scoring of financial outcomes is based on six indicators (1) IRR (expected and realised); 2) Performance company in line with expectations; 3) Timely interest payments on loans; and 4) Dividends payments; 5) Financial results after exit from equity: value of shares; 6) Repayment of loan. All indicators – if applicable aso some indicators apply only to equity and others to loans – have an equal weight in the scoring. See Annex 2 (Table A2-13) for details on indicators and scoring.

FIGURE 6-2 ASSESSMENT OF CASE STUDY SCORES FOR FINANCIAL OUTCOMES



The figure shows that more than half (55%) of the case study investments score well and more than an additional quarter score moderately when evaluated for financial results. There are no significant differences between the countries, but it can be noted that Kenya has the highest share of non-satisfactory results, while China has the highest share of moderate results while still displaying a good overall score. As for breakdown of the scores for specific IFU funds, DCIF has the markedly highest share of well performing investments. As expected, SMEs have the low-

est score for financial results. The comparison is naturally not perfect, as it does not account for differences in complexity between markets and types of projects. The case studies show that positive returns are due to factors such as good performance of the investee companies and good conditions set in the agreements with IFU (see above). Negative returns are due to factors such as unfavourable market development; construction time & cost overruns; macroeconomic deterioration/sharp depreciation of currency; and dishonest partner/fraud.

As mentioned in Section 3.5, with the increased importance of PPP funds, it could be expected that the overall risk profile of IFU's portfolio may move towards safer investments, given the PPP funds' focus on financial returns and less on additionality. The clearest example of a relatively 'safe' investment that offers predictable high returns are power generation projects, contracted through Power Purchase Agreements (PPAs) that are based on feed-in tariffs supported by guarantees or other undertakings by the host government (e.g. where the off-taker is the national power utility). PPAs can thus create considerable risk for the host government in the form of contingent liabilities. Moreover, some PPAs have 'take-or-pay' provisions that obligate the off-taker to pay for contracted generation capacity even in periods when the plant is not used/dispatched. While such projects can offer a high financial IRR for the project and its investors, the economic IRR from the society's perspective will be reduced if payments are made even if energy is not delivered.

For PPAs denominated in USD or EUR, the currency risk falls onto the off-taker (typically the national power utility) and is then transferred to consumers through adjustments in electricity tariffs[118] (see text box). This can give rise to affordability/sustainability issues, as the effect of exchange rate movements will feed through to the electricity bill paid by the end-consumers. Critics may consider this going against one of the added value aspects ascribed to DFIs, namely, to address affordability issues by providing appropriate financing (e.g. by endorsing at least partial local currency pricing in the PPA).

118 For example, through a foreign exchange rate fluctuation adjustment and a fuel cost charge that are adjusted and added on a monthly basis to the kWh price across the customer base.

7 CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusions

The conclusions are based on the main findings per evaluation issue. However, the conclusions are not rigidly structured around the evaluation issues, as the focus is on overarching issues based on the linkages between key findings on a combination of evaluation issues.

1. **The Ministry of Foreign Affairs did for a long time not develop explicit policy guidelines for IFU, with the exception of the mandate (see Conclusion 2). The relations between the MFA and IFU gradually improved over the evaluation period, but despite formal arrangements government oversight has been quite limited throughout the evaluation period.**
   The Ministry of Foreign Affairs is responsible for policy guidelines, supervision and oversight of IFU. The Minister for Development Cooperation also appoints the Board and the CEO as IFU is a state-owned institution. In2017, the MFA developed for the first time a specific strategy for IFU for the period 2017-2021 with some specific outcomes. The MFA and IFU meet regularly at various levels in formal and informal meetings. While relations were rather tense at the beginning of the evaluation period, they gradually improved over time. Nevertheless, throughout the evaluation period the MFA did hardly ever ask for specific reporting on key issues. IFU reported through its Annual Reports. The government did also not commission any external evaluation, for example of IØ, the important fund for Central and Eastern Europa that was phased out in 2010. This points at rather limited government oversight and supervision of IFU.

2. **The IFU mandate was the main government instrument to steer IFU.**
   IFU as independent state-owned institution has to function within the mandate and policy guidelines provided for by the Minister for Development Cooperation. The mandate has been the main instrument for the Government to steer IFU in a certain direction. This mandate changed considerably over the evaluation period as shown in Table 7-1.

TABLE 7-1 OVERVIEW OF MANDATE CHANGES FOR IFU, 2005-2017

Period	Country mandate	Tied/ untied
2005-2010	Focus on poor developing countries: mainly LICs and LMICs	Fully tied
2011-2014	At least 50% of investments in poor developing countries (LICs and LMICs), and other investments in UMICs (up to 50% GNI limit) are allowed	Fully tied
2015-2017	At least 50% of investments in poor developing countries (LICs and LMICs), and other investments in all UMICs are allowed	Partially untied (Danish interest 2015 and 2016) and fully untied in 2017

Although the intentions of the country mandate are clear (to ensure a development focus of IFU's activities), it was not defined in sufficient detail. The MFA left the specific operationalisation of the mandate to IFU. IFU did develop internal guidelines for its staff on how IFU should operationalise the mandate, including phasing-out rules and exceptions agreed upon by the Board and the MFA in 2003. The mandate asks for a balancing act between the intention to serve (poor) developing countries' needs on the one hand and Danish business on the other but does not formulate explicit expectations on this aspect. The Danish business community was in favour of tying and a broad country mandate. Although the mandate is now fully untied, there will be a continued focus on Danish business interests both in the newly created SDG Fund as well as in IFU Classic, although the number of non-Danish partners may increase.

3. **It is very plausible that IFU has been compliant with its mandate during the evaluation period. While the MFA defined eligible country categories, the operationalisation of the country mandate was entirely left to IFU. IFU aimed to live up to its mandate, but a number of issues such as how investments in regional funds should be allocated, are difficult to assess in terms of compliance with its mandate. The portfolio also shows a steady increase in investments in Africa over the entire evaluation period, and since 2011, a rapid shift towards more investments in middle income countries.**
The operationalisation of the mandate by IFU included a number of exemption and phasing-out rules that were defined in 2003, which are still applied today. These rules allowed IFU at the time to manage the effects on its ongoing business as it had to phase out its activities in a large number of countries. IFU aimed to live up to its mandate, but IFU did not report separately to the MFA regard-

ing its compliance with the mandate in the three sub-periods. There is also hardly any public information on the operationalisation of the mandate.

A detailed portfolio analysis was done to assess IFU's compliance with its mandate. In general, the conclusion on whether IFU met its mandate depends on the country allocation of IFU's investments in regional funds i.e. which country income category they belong to. For some years (i.e. 2011, 2013 and 2014) it is directly clear that IFU complied with its mandate, because even without considering the investments in regional funds a sufficient amount of investments was made in lower income countries. However, for all other years assumptions had to be made regarding the country allocation of IFU's investments in regional funds.

The portfolio analysis also shows that since 2010, there is a rapid shift towards more investments in upper middle income countries (varying between 20-45% of the annual investment volume) , which is logical given the broadening of mandate and the preference of PPP funds to invest in countries where risks are perceived to be lower.

In line with the ambition shared by the MFA and IFU in 2005, the share of annual investments in Africa increased over time from 3% in 2004 to 40% in 2017.

4. **The portfolio of IFU has been primarily demand-driven by the Danish business community. The focus has shifted over the evaluation period more to larger Danish companies and the number of investments in Danish SMEs decreased over time.** During the evaluation period, IFU has been changing from managing a primarily demand-driven portfolio to more pro-active sourcing of investments in a rapidly evolving context. Given the tied mandate for a long time, IFU could react to demand from Danish business for expansion abroad. More than half of the total value of investments during the evaluation period was in large Danish companies representing approximately one third of the number of investments. However, over time this demand gradually decreased as some large companies now are able to finance their investments in developing countries in other ways, as they can find the money on the capital market. The number of investments in Danish SMEs was on average above 50% during the period 2004-2013 but decreased from 2014 onwards. IFU indicated that investments in Danish SMEs appeared to be quite time-consuming and commercial and financial returns were often below expectations. Therefore, IFU changed the focus towards improving the quality of investments in Danish SMEs rather aiming for a high number of investments. Driven by its untied mandate, the estab-

lishment of the PPP funds and the rapidly evolving FDI context, IFU is now more pro-actively searching for non-Danish partners for its investments, although IFU remains responsive to Danish interests.

5. **IFU has generally been financially additional to the market during the evaluation period. Its role as service provider providing non-financial value to investments is less pronounced. For SMEs, IFU was strongly additional to the market from both a financial and a value perspective.**
IFU's financing was generally additional to the market as IFU managed to invest either at the right time or in the right type of places when and where risk oriented capital was difficult to get. This was especially the case for some SMEs that otherwise would not easily have obtained financing or where IFU succeeded to attract other investors (leverage factor). However, SME performance on all other evaluation issues such as development outcomes and financial returns was lower than for larger companies. Due to its tied mandate, many Danish businesses saw IFU as preferred and trusted investment partner for ventures overseas, with presence on the ground and local knowledge. However, there were also a significant number of cases (36% of reviewed investments) where IFU was not or only partially financially additional, as there was clear evidence that companies could have (easily) obtained private finance or where IFU's role was limited to a signal or safeguard function by bringing the 'Crown & Flag'. The latter factor is an important part of IFU's value additionality. Nevertheless, in most cases value additionality was assessed to be medium (45%) as there was little concrete evidence on whether IFU actually provided useful non-financial support that influenced the company's actions. An issue of concern related to IFU's value additionality is the lack of clear criteria or terms for IFU Board membership of investee companies.

6. **While the portfolio of IFU has been primarily driven by the demand from Danish business, also relevant development needs were addressed. Nevertheless, there was no explicit effort to maximise development outcomes.**
The evaluation found evidence that IFU did address in 75% of the cases relevant development needs of developing countries. Nevertheless, the internationalisation needs of Danish business remained the main investment focus for a long time in the evaluation period. This created some tensions between developing country needs and Danish business needs, which do not automatically go hand in hand. Development needs from partner countries were mainly taken into account through the assumption that direct and indirect employment would be created and that the transfer of know-how and adoption of CSR standards would promote development in host economies. IFU indeed aimed pro-actively to

promote the adoption of CSR standards and to mitigate negative development results. Investment proposals, however, were not selected on the basis of the highest potential development impact. With the untying of the mandate in recent years and improved risk assessment due to the PPP funds, the reputational risks related to non-respect of CSR standards are taken into account somewhat more consciously but remain of lesser importance vis-à-vis considerations around financial returns.

7. **IFU and the investee companies were, in addition to the financial returns, mainly focused on CSR or sustainability performance; and at company level evidence on some good achievements was found to which IFU contributed.**
The case studies show good to moderate CSR performance (only 12% shows poor performance). Most attention is paid to good labour conditions incl. training of staff, environmental measures such as energy efficiency and adequate waste management, and a large variety of community engagement actions. The overall rather good scores on CSR performance illustrate that Danish companies have for a long time been active in this area and many of them show a keen interest to improve their CSR performance and did so with IFU's assistance. The cases with a low score were mainly companies with financial problems.

8. **In contrast with the attention to CSR performance, there is still insufficient attention to measuring and reporting on development outcomes in all stages of investment, i.e. screening, appraisal, implementation and exit with the exception of one indicator namely the number of jobs.**
Despite various improvements in IFU sustainability policies and results measurement systems, still only limited information is available to properly assess development outcomes. This is mainly due to a focus on compliance issues rather than on measuring / assessing development outcomes. If outcomes are measured such as job creation, IFU still has to overcome various measurement problems, which is common to DFIs according to international literature. The monitoring system is still too much a 'one-size-fits-all' model based on self-reporting by the investee companies. The monitoring is more based on CSR indicators and only a limited number of development outcome indicators are monitored. The final evaluations at the exit of IFU hardly pay attention to development outcomes, with the exception of the creation of direct jobs.

9. **In more than half of the case studies evidence was found on primarily positive development outcomes. However, in one third of the case studies development outcomes were negligible or below expectations or the positive outcomes were offset by negative development outcomes.**

In 50% of the case studies evidence was found on primarily positive development outcomes, and in 20% cases the balance was still positive showing moderately positive development outcomes. Main positive development outcomes were job creation, transfer of (Danish) technology and knowhow, climate effects and sector effects such as better access to energy. It is estimated that IFU contributed to the creation of 80,000-100,000 jobs from 2007 to 2017. Most positive outcomes were found in specific sectors where investments in companies contributed to catalysing effects in the value chain or at sector level such as improved capacity and income for smallholders and access to clean and affordable energy for households and enterprises. These effects are most noticeable in the energy sector and to some extent in agribusiness. In the 30% of the cases with a low score on development outcomes still some positive development outcomes could be found, but these were not according to expectations and/or decreased over time. Also, evidence for some negative development effects was found, such as pollution effects or displacement of people. In most cases these expected negative outcomes were identified in the project preparation phase and adequate mitigation measures could be developed to reduce pollution and resettle the population.

10. **IFU has become more transparent over time and IFU communicates better on development and financial outcomes, but there is still room for further improvement.**
During the evaluation period, IFU has communicated more and better on its CSR performance and on some development outcomes, in particular in its Annual Reports. IFU has set up a Sustainability Advisory Board with representatives from academia, private sector and civil society. However, its role is rather limited and strictly advisory. IFU has also been engaged in dialogue with civil society and established partnerships with some civil society actors to do studies and/or to provide advice. However, despite the fact that IFU opened up to a certain extent, communication on sensitive issues remains challenging. IFU still tends to be rather defensive in its communication. Furthermore, IFU is focused too much on communicating its success stories which do not tell the entire story, while ignoring some undisclosed downside effects. More and better learning can and should take place on the basis of complete and more credible stories, including some negative results.

11. **The Danish State received over the evaluation period DKK 4.4 billion (net) from IFU and IØ, which shows that the State has been provided with a substantial source of income through continued capital extractions throughout the evaluation period (with some limited capital injections towards the end).**
Especially IØ proved to be a very profitable investment as it man-

aged to leverage its capital base about three times by recycling capital and reinvesting profits. In addition, since the inception of IFU in 1967, the State has extracted nearly as much capital (DKK 1.25 billion) as it has injected (DKK 1.38 billion). Nevertheless, IFU's equity balance at the end of 2017 still stood at DKK 3.3 billion, which must be viewed as a very satisfactory result. In 2011, one argument of the State to broaden the country mandate was that this should provide IFU (and the State) with better financial returns. In addition to promoting blended finance and securing mobilisation of private capital, the expected high financial returns for the SDG Equity Fund will also benefit the State.

12. **In general, IFU has made good financial returns on its equity investments, often in double digit figures, which is higher than its returns on loans with interest margins usually in the 5%-7% range.** The case studies indicate that 55% generates positive financial results in line with expectations. In view of encountered risk factors in demanding environments, IFU's realised returns on equity and loan investments are overall deemed satisfactory, with IRRs often in double digits for equity investments, and interest margins on loans generally being in line with IFU's risk premium matrix, which appears to be in line with market rates.

13. **IFU has been very pro-active in mobilising private sector funds to set up PPP funds, which can be considered as an important innovation in line with international priorities for DFIs. The set up of these PPP funds such as DCIF has been the main driving force for change in IFU. Despite the focus of DCIF on important goals such as the reduction of greenhouse emissions, the PPP funds tend to be relatively risk-averse, which explains the focus on upper middle income countries.**
    Regarding the rapidly increasing international attention to blended finance and mobilising private sector capital for investments in developing countries, IFU can be considered as an innovative frontrunner as it has set up various PPP funds. Especially the PPPs were a driver for change within IFU, which led to better risk assessment and more focus on financial returns. DCIF focused on the important relatively new area of climate investments with the main development aim to reduce greenhouse gas emissions. DCIF, and other PPP funds, are more risk-averse than IFU Classic. Therefore, they focus on countries where risks can be better managed, i.e. mainly upper middle income countries.

    For the PPP funds, a programme document is made by the MFA when the decision to set up a new PPP fund is a taken, while a Private Placement Memorandum (PPM) is made to attract institutional investors or when a fund is closed. The two main documents

for each fund, show differences regarding important aspects, e.g. focus on both climate adaptation and climate mitigation is mentioned in the government document, while the PPM mentions only climate mitigation. As climate adaptation projects are not yet commercially feasible, there is an explanation for this difference. However, different programme documents and different interpretations can create confusion about what the main objectives and principles are.

14. **Over the evaluation period, IFU had an increasing number of mainly financial and a few non-financial instruments at its disposal to realise its ambitions. In addition to the PPP funds, the government also set up a relatively large number of investment and grant facilities, which could not be given sufficient attention by IFU.**
From 2011 onwards, IFU had a growing number of financial instruments at its disposal, varying from the statutory fund IFU Classic to PPP funds such as IIP, DCIF and DAF, to government investment funds such as AIF and UFA, and grant facilities such as the SME Facility and the CSR Training Fund. The government-initiated funds and facilities have in most cases never received strong attention during the rise of the PPP funds, with the exception of the CSR Training Fund. They did not act as a driver for change. IFU has also some non-financial instruments at its disposal, but these instruments did not undergo much change during the evaluation period. In 2018, IFU in consultation with the MFA, decided to drastically reduce the number of instruments from eleven in 2017 to six in 2019.

15. **So far, IFU has shown to be fit for purpose and changes are being made to adjust IFU to the changing requirements and context**
IFU's operational efficiency measured in terms of number and volume of investments approved and active in relation to the number of IFU staff, has improved over the evaluation period. Also, IFU's operational expenses, in relation to incremental investments, has been fairly constant throughout the period, hovering around 10%, which is deemed satisfactory for a DFI of IFU's size. The focus on larger, more financially attractive deals in the new PPP funds has come to some extent 'at a cost' of fewer investments in (Danish) SMEs as attention to risk assessments increased. Investments in Danish SMEs showed an inadequate risk-return balance. The set-up of the SME Investment Facility and the SME investment team did not influence this trend. As the operational efficiency is related to the total size of the capital, IFU still lags behind other DFIs as it is a relatively small DFI. This indicates that there is still room for further improvement. IFU has been rather pro-active in making changes in order to better meet stakeholders' and market

requirements. A main reorganisation took place in 2014. The nine country offices can be considered as a particular strength of IFU in the market where on-the-ground experience becomes more and more important given the scarcity of bankable projects. Staff development programmes are in place to update the competences of investment professionals and the sustainability team. In the area of development cooperation knowledge, the main focus has been on CSR and sustainability competences. However, recent international cooperation insights on how to maximise development outcomes and how to monitor and evaluate development outcomes are insufficiently taken into account and in this area IFU is lagging behind.

7.2 Decisions already taken on the way forward

The MFA and IFU already took important decisions on the way forward at the time this evaluation started. These decisions are reflected in MFA's strategy document for IFU 2017-2021 with as main objective "IFU shall promote investments that support sustainable development in developing countries and contribute to the realisation of SDGs" (referring to Denmark's strategy for development policy and humanitarian action,"The World 2030"), the SDG Equity Fund programme documents and IFU's most recent "Strategic Directions" document from October 2018. It should be realised that the recent MFA Strategy for IFU mentions different funds and facilities, including the SDG Fund, but only overall generic results have been defined (mobilisation of private sector capital with a factor seven, creation of about 8,000 jobs per DKK 1 billion invested, and reduction of greenhouse gas emissions). The strategy further mentions that next to the SDG Fund, IFU will still invest in frontier markets with higher risks, but where development impacts are expected to be higher. However, no specific targets for IFU Classic were defined. Most of these recent changes have been mentioned in this evaluation report, but the assessment of their implications is beyond the scope of this evaluation. The main changes affecting future IFU directions can be briefly summarised as follows:

1. **Establishment of the SDG Equity Fund (PPP fund).**

   - Total capital as per January 2019 (second close) is DKK 4.85 billion, consisting of DKK 2.92 billion from private investors and DKK 1.94 billion from IFU, in keeping with a 60/40 partnership between private investors and IFU/the State. Out of the amount channelled through IFU, DKK 1.1 billon is to be financed out of IFU's capital base (representing one third of the capital base of DKK 3.3. billion as at end of 2017). This implies an average yearly investment volume around DKK 1 billion for the SDG

Fund, compared to a total annual investment volume (IFU Classic and PPP funds) of DKK 1.3 billion in 2017;

- Targeted net return 10% to 12% p.a. in DKK (gross return 12-16% p.a. in DKK);
- Preference return model of 6% p.a. for private investors and an upside to IFU at higher returns;
- First right of refusal within IFU to all equity and mezzanine investments above DKK 25 million;
- Focus on areas where Danish industry are frontrunners and contribute to the fulfilment of the SDGs;
- Country focus: all OECD/DAC countries, but at least 20% of investments in host countries with GNI per capita below 80% of the upper limit for LMICs (WB classification);
- Sector focus: 30-40% climate; 20-30% agro&food; 20-30% infrastructure and water; 10-20% industry and 0-10% finance;
- A separate Investment Board (IB) has been set up with an independent chairman and four members appointed by anchor investors and two IFU board representatives. The IB has appointed an Investment Committee that can take investment decisions on investments up to DKK 100 million.

This overview clearly shows the enormous turnaround IFU has to make to realise the very high (financial) ambitions of the SDG Equity Fund, which will tie up an important part of of IFU's capital and resources. There are two key documents specifying the key characteristics and objectives of the SDG Fund: 1) The MFA document "Project Document SDG Investment Fund, 15 August 2017; and 2) The IFU Private Placement Memorandum for the SDG Equity Fund, January 2018. Although the overall objective for the Fund is the same in the two documents "to contribute to the achievement of the SDGs", there are important differences as well. The government document still assumed that both loans and guarantees would be provided, but private sector investors proved to be less interested in loans; hence, the exclusive focus on equity and quasi-equity. The first document mentions a few specific targets such as the creation of about 30,000 direct jobs and some more generic targets such as a comprehensive reduction of greenhouse gas emission and considerable tax payments. These targets are not included in the PPM that gives more attention to issues such as a balanced risk profile and attractive financial returns.

2. **Create synergies between IFU and Danish Business Finance (DBF)**

   In 2017, the MFA transferred the management for DBF from Danida to IFU. DBF is a programme for concessional lending to infrastructure projects, which often entail PPP structures, which is a new area for IFU.

3. **Streamlining of investment entities and grant facilities**

   - In 2017 IFU still managed seven investment vehicles varying from the statutory IFU Classic to government facilities such as UFA, to PPP funds such as DCIF and DAF. In 2019, this will be brought down to two, namely IFU Classic and the SDG Equity Fund.

   - In addition, there will be DBF and three grant facilities left (the SME Facility, the grant facility related to the Neighbourhood Energy Investment Facility, and the IFU Sustainability Facility). In 2018 the management of investment into the African Guaranteed Fund was transferred from Danida to IFU.

   Furthermore, IFU and the MFA are considering some other options on the way forward:

   - The set-up of an IFU Debt Fund or other options to increase the loan portfolio, which may include a direct IFU capital contribution, and/or a state-on lending programme or IFU borrowing either by issuing bonds on the capital market or through private placements.

   - MFA capital contribution to IFU in 2019 with two possibilities: DKK 50 million for a water initiative and DKK 200 million for investments in fragile states.

7.3 Recommendations

Important lessons can be derived from the main findings and conclusions for this evaluation. This evaluation is also meant to be forward-looking and to formulate recommendations on the way forward. In order to formulate useful recommendations, strategic directions on the way forward as summarised in the previous Section 7.2 should be taken into account. While IFU was already facing important challenges towards the end of the evaluation period, the challenges have substantially increased with the decisions on the way forward (the fact that the main focus will be on the SDG Equity Fund). Overall, the increased importance of these funds has changed IFU from a traditional development finance

institution for Danish businesses to a broader focused institution, which has an important role as manager of PPP funds. In turn, IFU also starts competing to some extent with other fund managers in an increasingly competitive market. This is also illustrated by the recent set-up of the A.P. Møller Africa Infrastructure Fund with capital from four Danish pension funds, which will be active in the same market as IFU. Therefore, on the basis of the key findings and conclusions, the main focus of the recommendations is on the overall relations between the MFA and IFU, the future of IFU Classic and specific issues concerning mandate, M&E, fund and facility agreements, and IFU human resources.

RECOMMENDATIONS TO MFA (IN CONSULTATION WITH IFU):

1. **Develop an overarching long-term supervision agreement for IFU with several attachments on specific issues for specific periods.**

   The Act on International Development Cooperation forms the legal basis, in which issues are defined regarding the status of IFU, general objective and governance principles. Furthermore, the MFA Strategy for IFU for the period 2017-2021 could serve as a point of departure in which main policy guidelines and principles are defined. In addition, it is recommended to elaborate a supervision agreement in addition to these documents, specifying the following:

   - **Governance system** defining the purpose and frequency of meetings at different levels between MFA and IFU;
   - **Reporting requirements for IFU**;
   - **IFU Board composition**: profiles and terms of Board members (including at least two persons with a professional development cooperation background in combination with financial expertise), and complementarity of Board members.

   In addition to this overall long-term governance agreement, it is recommended to elaborate attachments in line with the overall agreement and strategy. This should still be done in the remaining period for the present strategy (2017-2021), with regard to the issues raised in the following recommendations:

2. **Define a new clear mandate for IFU Classic for 4-5 years (2019-2022/23) with specific development outcomes, clear and transparent investment criteria, focus on poor (and fragile) countries and with a variety of financial instruments.**

Given the new broad mandate for the SDG fund and its first right of refusal, it is urgent to define a new mandate in clear and operational terms for IFU Classic, as it should be avoided that all rejected investment proposals by the SDG Fund will easily get funded by IFU Classic in the absence of own specific investment criteria. IFU Classic should have a strong development focus aiming to maximise development outcomes. Therefore, the new mandate for IFU Classic should indicate the country focus (main focus on LICs and LMICs), a clear focus on development needs of host countries including attention to an enabling business environment and attention to the needs of local partners, synergies with DBF to be achieved with clear and specific targets (for development outcomes, and for financial and value additionality). An explicit focus on poor (and fragile) countries for IFU Classic should mean that the government and IFU are prepared to accept lower financial returns, in return for IFU taking more calculated risks (in challenging environments and countries). Furthermore, IFU Classic should continue using a variety of financial instruments – loans, equity, guarantees – to counterbalance the focus of the SDG Fund on equity. The guarantee instrument can be used as collateral to cover part of the credit risk for projects operating in a challenging business environment.

3. **Prepare a M&E protocol for 4-5 years:** such an M&E protocol should specify the minimum monitoring and evaluation requirements for IFU in line with the MFA and IFU strategies, and overall reporting requirements as specified in the supervision agreement. The monitoring system should be further improved: the focus should be broadened from CSR indicators to more development outcome indicators as at present monitoring of development outcomes is limited. Final evaluations at exit should be urgently improved in terms of assessing both CSR performance and development outcomes. In addition to monitoring, an evaluation plan should be agreed upon with evaluations to be commissioned by IFU and by the MFA. IFU could be made responsible for commissioning independent sector or thematic evaluations. However, evaluation capacity needs to be built up within IFU to manage these evaluations according to international standards, while also the IFU internal learning culture needs strengthening. The MFA should be responsible for more overarching evaluations. All evaluations should be internationally tendered and should be made public in order to increase the transparency. This M&E protocol for IFU could replace the MTR requirements for specific IFU instruments, which are often too limited in scope and set-up. Ideally, an external, international steering group or advisory board should provide methodological guidance and be responsible for quality assurance. All evaluations should be set up with a focus

on learning and further improvement of IFU working practices. Experiences of other DFIs can help to develop this M&E protocol.

4. **Develop and revise agreements/programme documents regarding specific funds and facilities to be managed by IFU:** At present, for each new facility or instrument a separate agreement or programme document is made. These agreements and programme documents should be an attachment to the overall agreement between the MFA and IFU as indicated in Recommendation 1. Revision of existing programme documents may be needed to make them more specific. More attention is required to check the consistency of objectives in the different programme documents. The programme documents should also be fully consistent with the Private Placement Memoranda (PPM), which may require adjustment of the government programme documents once the PPM is available. As in the past too many government funds and facilities were set up, the set-up or transfer of new instruments to IFU should in principle be avoided. For all grant facilities clear and transparent criteria for their performance should be set.

5. **Agree on additional expenditures for strengthening IFU's development expertise:** as IFU needs to strengthen its development expertise at all levels (see below) and more attention needs to be paid to M&E, this requires more resources. The MFA and IFU should discuss whether IFU should spend a certain share of its operational expenditures on development issues and whether additional resources would be needed.

SPECIFIC RECOMMENDATIONS TO IFU (TO BE ALIGNED WITH MFA RECOMMENDATIONS):

6. **Strengthen the development expertise within the organisation at all levels.**
   While the CSR/sustainability expertise is at a reasonably good level, the development expertise should be further strengthened at all levels, including the Board, the Investment Board of the SDG Fund, management level and with investment professionals both at headquarters and the country/regional offices (in particular in focus countries for IFU Classic). The sustainability team should be reinforced and its functioning as part of the front office should be strengthened, as development knowledge should be a crosscutting competence in the organisation. The role of the Sustainability Advisory Board should be more prominent, and a first step could be to give them a guiding role in the process to strengthen the development expertise.

7. **Focus on expansion in sectors where IFU has already built up (some) good expertise such as agribusiness, industry and more recently in renewable energy and finance, in principle, no expansion in the coming years to new sectors where IFU has hardly any expertise.**
   Given the big challenges IFU is facing and learning from past experiences, IFU should in first instance focus on consolidating and further strengthening its sector expertise to create a niche in the increasingly competitive DFI market. As IFU is active in promising sectors such as agribusiness and renewable energy, there should be sufficient scope for expansion in the years to come. Over time, there may be a need to expand/experiment into new sectors to remain competitive on the DFI market, and to avoid stagnation.

8. **Improve M&E (see the M&E protocol above):** from the present focus on compliance with CSR standards to more pro-actively monitoring and evaluation (at exit) of actual CSR performance and development outcomes with a clear focus on learning.

9. **Improve further the transparency of IFU, its learning culture and communication.**
   IFU should further improve its communication of development results and be more transparent and open in the dialogue on sensitive issues such as investments in OFCs/tax havens and issues raised by civil society and in the media. The good news and successes should be told, but also a more balanced realistic story on what has been achieved and what not and the lessons learned.

10. **Set clear criteria for Board membership in investee companies:** at present there are no clear criteria, which are needed in order to improve the value additionality. Clear criteria will increase the non-financial value that IFU can deliver to investee companies.

11. **Further strengthen and/or expand the role of the country/ regional offices:** in order to build further on the on-the-ground experience to procure bankable projects and to maximise development outcomes.

EVALUATION OF THE INVESTMENT FUND FOR DEVELOPING COUNTRIES (IFU) 2004-2017

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