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**Foreign Affairs,
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Evaluation of the Belgian Investment Company for Developing Countries (BIO) - Phase 1 Summary






Special Evaluation Office
of International Cooperation

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Office of the Special Evaluator of the International Cooperation

Evaluation of the Belgian Investment Company for Developing Countries (BIO)

Phase 1

Study conducted by

CARNEGIE CONSULT
Investment Advisory Services

Executive summary
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Executive Summary

1. Context

1.1 Reason for and organisation of the evaluation

The evaluation was scheduled to take place in 2012 in accordance with BIO's Investment Charter. As a result of recent publications in the press, a very critical report published by the NGO 11.11.11 about the functioning of BIO and the ensuing questions and discussion in the Belgian Parliament, the evaluation took on a political dimension, and as a result things moved ahead altogether more quickly. The decision was made to accelerate the evaluation and split it into two phases in order to obtain an independent opinion about BIO's functioning as soon as possible.

The present report concerns the first phase of the evaluation of BIO. It involved a review of files, (phone) interviews with a large number of stakeholders and visits to three other Development Finance Institutions (DFIs) and intermediary structures. In the frame of the file review the team focused on BIO's portfolio the documentation relating to the establishment of BIO and the agreements with the government as well as the organisation and the processes of BIO. The second phase involves field visits and the team will also be able to focus more on the quality of the investments, in financial and development terms. The final actual results of the investments can also be examined in this phase.

1.2 Purpose

The purpose of the evaluation was to check to which extent BIO was capable of fulfilling its role as a financial institution and as a stakeholder in the field of development cooperation. The Terms of Reference (ToR) of the evaluation emphasise three main components: the relevance (development relevance and consistency of development cooperation policy), the effectiveness and the efficiency of BIO's activities. The ToR comprise five main questions and 28 sub-questions. The main questions are the following:

1. Do the mandate and the situation of BIO in the field of Belgian development cooperation allow BIO to fully fulfil its role as a development actor?
2. What is the current and potential added value of BIO in the frame of Belgian development cooperation, more specifically within the support of the private sector?
3. Are BIO's ownership structure and financing arrangements adequate for the implementation of its mandate and the institution's continuity?
4. To which extent does BIO strike a good balance between return and development relevance? And does BIO have the right (investment) tools to achieve this balance?

5. Is BIO's organisation adapted to achieve its social aim? (efficiency of BIO’s Board of Directors and other management bodies and of its management)

Finally the evaluation team was also asked to pay special attention to investments through intermediary structures (qualified by some as tax havens).

2. The most important findings, conclusions and recommendations

2.1 Development relevance and consistency

2.1.1 Mandate and objectives

When BIO was established in 2001 its mandate and its objectives were carefully and deliberately formulated. As an actor for private sector development BIO was purposefully incorporated in a separate enterprise in order to enable it to achieve its double objective (financial and development profit). In this frame we can conclude that the Belgian Government thinks of BIO as the 'channel' of choice to implement its policy in terms of private sector development. In 2001 the government consciously chose to transfer this function from BTC to BIO.

The objectives which were formulated for BIO over the years are quite ambitious, both in terms of financial profit and of development objectives. Examples include the geographic focus which involved investing a substantial share in Belgium's partner countries and the desire to have the SME Fund invest at least 70% in Africa and 25% in the Great Lakes Region of Africa. The latter especially was quite difficult and involved a much bigger commitment than is the case for many other European DFIs. The results, however, indicate that BIO almost achieved the objectives for the SME fund (68.3%).

The evaluation concludes that the mandate which was granted to BIO was good but ambitious and that BIO has done what it set out to do, namely serve as a development actor for businesses in developing countries.

BIO's field of activity is not static. It requires BIO to continuously reflect on its (additional) role and function and to regularly adapt its strategy in function of developments. BIO's development strategy was defined quite recently (2011). During the evaluation period the Board of Governors and BIO's management did not pay sufficient attention to the strategy. The strategy lacked an integrated vision with attention to niches, sectors and geographic spread and direction. In view of the rapid development of many developing countries it is important to continuously focus on BIO's role and function as a development organisation and finance institution in order to determine the additionality of its activities. The balance between financial and development profit was also insufficiently addressed from a strategic point of view. This was partly done in 2011: the 2011 strategy document adequately addresses a number of these niches and sectors.

Recommendations:

- Reconfirm BIO's role as an important actor for private sector development as part of the Belgian development cooperation.

- The strategy should continuously be on the agenda of BIO's management and its Board of Directors in order to determine which role BIO should play as a finance institution and development organisation.
- Make clear choices in terms of sectoral focus, fields of activity, geographic objectives and spread and always strike a proper balance between profit and development relevance.

2.1.2 Coherence and embedding

The study has revealed that the interface with other Belgian development cooperation stakeholders were limited. The limited collaboration with BTC does not come as a surprise given the completely different mandate and field of activity of both institutions. Nor did the DGD (Directorate-General Development Cooperation and) focus on a policy for private sector development in a broader context in recent years, which would have allowed to better connect the various stakeholders with each other.

The collaboration with NGOs also proved to be rather limited, mainly as a consequence of the lack of communication between BIO and the NGOs and in some cases, due to a different perception of risk and profit. Including representatives from the NGO sector on the Board of Directors apparently did not stimulate this either. In this respect BIO lacked a clear communication strategy. Recently BIO amended its strategy to reflect this and will try more actively to establish a dialogue and a potential partnership with the NGOs. Finally BIO does not seem to have a good network with representatives of the private sector and of local organisations in the South.

Recommendations:

- BIO should also focus on development fields and sectors in which a good exchange with other Belgian development cooperation stakeholders is possible – within its possibilities.
- BIO should adopt a more active approach in a dialogue with the other Belgian stakeholders in terms of private sector development and should more actively explore development partnerships with them.

2.1.3 BIO’s portfolio and return

With its current product mix (with an important share of equity capital in its portfolio) BIO should be capable of achieving a return of 3-5%. The choice to invest an important share through intermediary organisations has contributed to this, as well as the investments in infrastructure which seem to give rise to good results, in a partnership with FMO (the Dutch development bank). In the long term BIO would probably be able to fund infrastructure more independently – after having acquired the necessary practical experience. The share of local currency funding in the portfolio is currently still too limited and the exchange rate risk is usually covered.

Local currency fund

The local currency fund has not been adapted after the previous evaluation and is also barely used. The previous evaluation concluded that the use of the fund is inexistent. The current evaluation confirms this conclusion and moreover finds that the profit requirement which applies to BIO and to this fund actually constitutes an obstacle for using this fund.

Funds

The Belgian Government has established various funds in BIO, each with its own conditions and criteria. The research team shares the conclusion of the previous evaluation, which states that the raison d'être of these funds is insufficiently clear and the subdivision per fund is confusing.

BIO is one of the few DFIs which focuses on the direct investment in SMEs. Up until now BIO's SME portfolio is making a loss. Most other DFIs have established a threshold under which they will not directly invest in companies or they will not or rarely invest directly in companies.

The investments in SMEs are usually limited in scope and take up a lot of time because of the approval process and the follow-up. BIO, however, has insufficient knowledge of the local environment, which requires clear analyses and an emphasis on certain countries or strong partnerships with local organisations (financial partners and others).

An example of support to small SMEs is the Athena Fund, which was established in 2010 by BIO and the Centre for development of enterprise (CDE). Practice has shown that this initiative was not very successful among others because the CDE's local partners did not have the adequate skills for identifying investment proposals and the structure of the investment process was too complicated. This example illustrates how difficult it is to directly fund SMEs without local representation or a professional local partner.

BIO's expertise fund was used in a sensible manner to underscore the partners' development relevance. This technical assistance was used among others to assist BIO's financial partners in terms of environment and social screening and to provide support to SMEs.

Recommendations:

- Unite the various funds in a joint fund with specific criteria and conditions for the various types of activities and sectors.
- Continue the technical assistance programme and also focus on strengthening the development relevance of the investments.
- The technical assistance programme needs to become more flexible thus making it possible for BIO to proactively make an offer to its customers as regards relevant themes and to appoint consultants on BIO's behalf.

2.1.4 Results assessment, monitoring and evaluation

BIO has a tool at its disposal, the so-called GPR/EPOL tool, which is used to measure the development impact of potential investments beforehand. The DEG (Deutsche Entwickelungs Gesellschaft) introduced this tool and several DFIs have used it in a satisfactory manner. The tool provides a limited analysis of the local situation and it is not always possible to arrive at a realistic analysis, among others because of the lack of information. However, BIO does not systematically apply this tool for an ex-post measurement. This would significantly improve the quality and the reality of the impact assessment. The evaluation also shows that BIO's staff is still not sufficiently familiar with how to measure the development impact of investments, meaning that they often lack the time, attention and priority for a carefully considered analysis. The development impact is also insufficiently taken into account in the decision-making process at the level of the Board of Directors for investment proposals. The same applies to the social and environment aspects, which are related to BIO's investments.

Recommendations

- The GRP/EPOL analysis needs to be used more and needs to be given more priority and attention. More attention needs to be paid to the careful gathering of information and to analysis, among others by using third-party sources. These GPR/EPOL analyses also need to be used more in the decision-making process about investments.
- Introduce a structural ex-post evaluation and incorporate it in the organisation. In case this is financially not feasible then try to establish partnerships with bigger DFIs, which have already developed ex-post evaluations and regularly conduct such analysis, as much as possible.

2.1.5. Development relevance as an aspect of the internal organisation

The development goals do not receive sufficient attention within BIO. This conclusion applies to all the organisational levels (Board of Directors - Management - Account Managers).

BIO tends to first and foremost concentrate on its financial expertise and considerations and is insufficiently aware of the importance of the development goals and their relevance. A number of other DFIs also have this problem. The Dutch FMO, however, has focused on this issue and has introduced interesting tools to solve this problem.

Recommendation:

- Strengthen the organisation in terms of the evaluation of social, environmental and development issues by training Account Managers and creating a fully-fledged position in the organisation in terms of impact assessment and evaluation. The top tier (Board of Directors and Management) will have to convey this new approach and supervise it.

2.2 Effectiveness

2.2.1 Financing process

BIO grants loans, mezzanine capital and own capital to financial institutions, funds, SMEs and infrastructure projects. The financing process has been organised carefully and professionally. When BIO finances a customer it has the option of using its financial contribution as leverage for other demands, in terms of the environment or labour conditions for example. BIO avails itself of this option and this is transposed into agreements (so-called financial and non-financial covenants) and conditions precedent, with which the party which receives the funding has to comply. BIO’s non-financial input to its client is limited. In many cases a representative is appointed to the Supervisory Board or the Advisory Board of the institution or enterprise which receives the funds.

2.2.2 Additionality and catalyst effect

When BIO grants financing, this has to be additional to the market, without distorting the market. The evaluation has shown that BIO’s additionality vis-à-vis commercial stakeholders was evident. A subsidiary objective is to mobilise other (commercial) capital flows (the so-called catalyst effect). The evaluation team found that this catalyst effect was not always easy to identify at the time of the investment. The catalyst effect was only obvious in direct investments in SMEs.

Recommendation:

- Continue to clearly focus on being additional to the market and serve as a catalyst for commercial stakeholders where possible.

2.2.3 Tools

BIO provides direct and indirect funding to SMEs (through investment funds or financial institutions). In view of the fact that BIO has no local representation it is almost impossible to closely follow up on the investment, to adequately monitor it and to acquire sufficient local knowledge. However this is needed to be able to make proper direct investments.

Indirect investments have the advantage that the specialist knowledge resides with a local stakeholder. The question remains, however, whether BIO can have a sufficient impact on the focus and the criteria for investments of these local stakeholders. That is why a rigorous selection of financial institutions is so important. After examining the files, the preliminary conclusion is that BIO rigorously selects its financial partners.

Recommendations:

- Review the legal framework in which the minimum percentage has been set out which BIO has to fund through intermediary structures. When BIO succeeds in making a sufficient number of good direct investments the legal framework should not be restrictive.
- It is important that BIO establishes a partnership for direct investments with professional partners that have a good understanding of the local market and the conditions and which have sufficient financial and development-relevant expertise to identify and monitor investment proposals. BIO could also consider local representation in a specific region (depending on the expected deal flow and cost structure).

2.2.4 Intermediary structures

BIO’s control of intermediary structures is often limited, especially in the case of bigger funds, in which BIO has a relatively small share. BIO has more options of exerting influence in the case of smaller funds.

Investors and fund managers prefer stable and clear structures that offer the necessary guarantees. Unfortunately many developing countries can not yet offer such guarantees. That is why an important share of the investments in developing countries is done through so-called Offshore Financial Centers (OFCs). BIO, and other European DFIs also, make use of such intermediary structures. In its report the Belgian NGO 11.11.11 expressed considerable criticism of the investments through OFCs. This criticism was mainly founded on ethical considerations. The OFCs are considered to be tax havens which lack transparency.

However, following interviews, a literature study and contacts with EDFI members, it became clear that there are valid regulatory, legal and tax reasons for creating intermediary structures in OFCs. Often OFCs are the only way to raise commercial capital from investors through funds for investments in developing countries. But DFIs are confronted with a dilemma here. On the one hand developing countries benefit considerably from the fact that these OFCs attract investments for essential economic growth (which help to tackle poverty). On the other hand transparency is a key factor in the organisation and operation of these OFCs.

Recommendations:

- The team did not find significant objections to the use of OFCs. BIO can thus continue this practice subject to the proper application of the know-your-customer principle. Moreover, the presence of other DFIs and IFIs in OFCs serves as a good indicator of the organisation's quality and the transparency of its activities.
- In consultation with BIO the Belgian Government should only allow investments in OFCs if the OFCs in question have concluded a tax treaty with Belgium and have made agreements about transparency.

2.2.5 Strategy

BIO's Board of Directors and Management have listened to the recommendation to pay more attention to the long-term strategy. The strategy document sets out a number of clear choices as regards financial and non-financial aspects, sectors, exclusions and the geographic focus. BIO will continue to focus on direct investments in SMEs - in accordance with the agreements with the Belgian Government - in spite of the bad experiences which other DFIs have had with such investments and the finding that these investments so far have incurred a loss. The new policy of also investing in bigger SMEs may produce better results. The quality of the local representation or of the local partner is essential in this frame.

So far the strategy still focuses insufficiently on the implications of the organisation’s structure. The lack of delegation of tasks to management has also contributed to this.

Recommendation:

- BIO should develop a clear strategic and long-term policy, focused on creating a professional and more decentralised organisation, with local partnerships and with an emphasis on certain countries, regions, industries and projects. BIO should seriously consider partnerships with local partners or other DFIs (as is currently the case with FMO in terms of infrastructure).

2.2.6 Capital structure

When defining the resources to be attributed to BIO, the Belgian Government does not take into account the need for resources based on a properly substantiated business plan. Instead the amount that is earmarked is treated as a balancing item to achieve the ODA objective.

In recent years the Belgian State has made available significant funds to BIO without taking into account its implementation capacity and liquidity needs. Because of BIO’s significant liquidity there was no direct reason for considering the attraction of outside funds. If BIO were to develop a strategic business plan, however, it should address the issue of outside funds (in relation to the (desired) size of its own capital) for the longer term. As a result of BIO's significant liquidity it is nearly impossible to achieve a return of 5% given the current capital market conditions. This return also has to be achieved on funds that were not used. On the other hand the SME portfolio so far has made a loss.

Another important aspect is the risky nature of part of BIO's investments. These include investments in very risky countries, small investments, investments in risky sectors (agriculture) and niches. Other DFIs have received special off balance funds from their governments which allow them to make more risky investments.

Recommendations:

- Part of the resources should be made available to BIO as Code 5 resources in order to allow BIO to make more risky investments (off balance). As a result BIO's investments would tie in better with those of some other Belgian stakeholders which focus on private sector development.
- BIO and the Belgian Government need to develop a multi-annual plan for BIO to grant funds and for the funds needed to do this. The option of attracting outside funds should explicitly be included in such a plan.

2.3 Efficiency

2.3.1 Management structure

When BIO was founded in 2001 the Government consciously chose to structure the funding activities of the private sector in a separate financial company, at a distance from the Government. The majority of BIO's capital consists of government funding. The Belgian State holds 50% of the shares and contributed additional capital from the development cooperation funds (ODA) by issuing so-called development certificates. BMI also holds 50% of the shares, thus underscoring BIO's public-private nature. As a result of this significant financial involvement the State is entitled to appoint ten members to the Board of Directors, including two Government Commissioners. BMI is entitled to appoint four Directors.

The evaluation assessed BIO's management structure and the way it operates and led to the following conclusions and findings:

1. The Board of Directors focuses too much on operational matters and not sufficiently on strategic matters. The Board hardly delegates tasks to management. As a consequence the number of meetings of Board of Directors and the associated committees is exceptionally high (over 40 meetings a year);
2. The Board of Directors is too numerous (14 members and two government commissioners) in order to operate efficiently. The Board has no clear profile based on skills;
3. In comparison with other DFIs BIO's decision-making process and policy are heavily influenced by the Belgian Government. Clear examples include: the proposal of directors because of government positions and political considerations, the strong presence of the Government Commissioners on the Board and in the Committees and their right to suspend the Board's decisions and the detailed nature of the regulations and restrictions in legislation and the Additional agreements. One wonders whether the independent position as set out in the Law founding BIO is thus guaranteed;
4. BIO's accounts are checked twice: BIO is checked by the Court of Audit as well as by an external auditor. Belgian legislation does not provide for agreements

between the Court of Audit and the external auditor about the contents of the audit (with a protocol) as is for example the case for some other DFIs.

The Belgian State holds 50% of BIO’s shares, while BMI holds the remaining 50%. This participation was organised for two reasons: on the one hand to highlight the aforementioned public-private nature of BIO, and to capitalise on BMI’s years of experience regarding investments in SMEs in emerging markets. The study revealed that the synergy between BIO and BMI was very limited due to the different geographic focus of both institutions. The general impression is that this partnership was insufficiently explored and that there was hardly any knowledge exchange.

Recommendations:

- Draw up a profile for the Board of Directors with the right skills (financial and development sector) and appoint members based on this profile.
- Delegate operational matters to BIO’s management where possible and organise BIO adequately to reflect this.
- Try to reduce the very dominant position of the Government Commissioners on the Board and in the Committees as much as possible within the confines of legislation so that the starting point of a public-private partnership is respected and that BIO can operate separately from the Government.
- Reduce the number of members of the Board of Directors to reasonable numbers, like other DFIs. A number of six to maximum ten members seems appropriate for BIO.
- Review the potential for a more intensive collaboration with BMI, especially in terms of the funding of SMEs (bigger SMEs).

2.3.2 Organisation

BIO has experienced managers and account managers at its service, who generally come from a professional financial background and who take a special interest in the question of developing countries. In recent years investments by BIO grew significantly. However, the organisation did not follow suit. The front vs. back office ratio is not balanced and the Account Managers are in charge of the entire investment and management process of clients. The organisation mostly lacks analysts who can provide support to the Account Managers in certain fields. There should be more people focusing on Risk management and the Communication strategy and HR policies have not followed suit.

Recommendation:

Strengthen BIO's organisation and ensure that it is in line with the growth of the investment portfolio. Functions such as risk management, communication and HR have to be significantly strengthened. The Account Managers need to become more knowledgeable about social and ecological matters and about impact analysis and a separate position needs to be created, focusing on such matters as GPR, ESG and evaluations.

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