University of Nairobi

Institute of Diplomacy and International Studies

European Development Finance Institution and Private Investment in Africa: A Case of Kenya (2000 – 2009)

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(R50/72028/2008)

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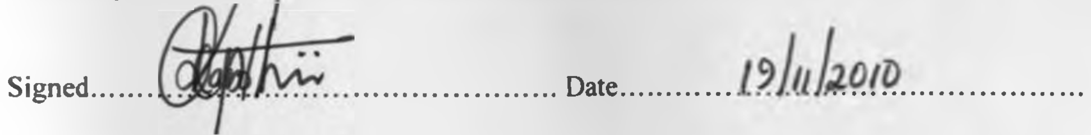
A Research Project Submitted in Partial Fulfillment of the Degree of Master of Arts in International Studies

October 2010

Declaration

I, Caroline C. Chepkwony hereby declare that this research project is my original work and has not been presented for a degree in any other University.



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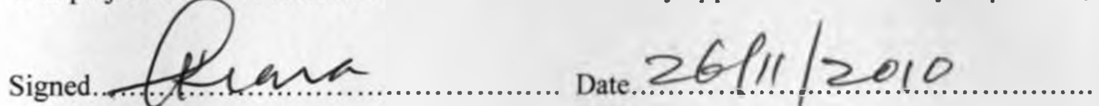

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Gerrishon Ikiara

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Dedication

This study is dedicated to all the financial institutions that have endeavored to bridge the gap between the poor and the rich thereby promoting favorable economic growth.

Acknowledgement

I wish to express my sincere appreciation to my supervisor Gerrishon Ikiara for having agreed to supervise this research paper and for his utmost patience in reading the drafts, educating me and offering his guidance without which the study would not have been completed.

I would like to thank my friends and classmates for their encouragement and support that kept me going. I would also like to express my sincere thanks to my family especially my daughter for their love, understanding and support particularly when I had little time for them in pursuit of my education.

Last but not least. I thank Almighty God for his guidance and providence which has enabled me to undertake this project that has been involving in terms of time and resources.

Abstract

Many African countries have undertaken reforms that have produced significant results in terms of growth and stability over the last decade. The continuation of the positive trend in economic growth is essential for poverty reduction and generally attainment of the Millennium development Goals. However, many countries are still facing many obstacles in achieving the targets of poverty reduction. Some of the poor people in Africa and the world at large believe that getting a job is the best way to escape poverty. African governments are challenged by the fact that they are not able to create jobs with the same pace as the population growth. One of the major players in the job creation field is the Private Sector. For the sector to continue growing, it is critical to encourage investments within the private sector as it`s strongly associated with economic growth. This means that if the private sector in Africa does not grow very rapidly, many of the African youths will grow up without prospects of a job.

Small and medium sized enterprises (SMEs) represent the backbone of economic activity in many developing countries. But access to finance is often better for large and micro enterprises than for SMEs in developing countries. There are enterprises with the potential to grow and create jobs but without access to the financing they need. This is where Development Finance Institutions (DFIs) have played a key role in funding sustainable and profitable businesses in developing countries. DFIs are well understood in most of Europe where they have a strong track record in promoting development. However, their methods and achievements are less understood in emerging markets particularly in Africa.

This study provides an insight into the European DFIs and their countries of operation in Africa. It also highlights the various investments they have made in Africa and Kenya in particular. It puts them into the context of the sectors they invest in and their preferred financing structures and instruments. The research concludes that the DFIs are an important pillar in the Kenyan economy especially in their contribution to the Kenya government objectives of creating jobs and growing sustainable world class businesses.

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Abbreviations

AEF	Access to Energy Fund
AFD	Agence Française de Développement
BIO	Belgian Investment Company for Developing Countries
CD	Capacity Development
CDC	CDC Group plc
CDM	Clean Development Mechanism
COFIDES	Compañía Española de Financiación del Desarrollo
DAC	Development Assistance Committee
DB	Development Bank
DEG	Deutsche Investitions- und Entwicklungsgesellschaf
DFI	Development Finance Institution
EAIF	Emerging Africa Infrastructure Fund
EDFI	European Development Finance Institution
EIB	European Investment Bank

FinAccess	Finance Access
FINNFUND	Finnish Fund for Industrial Cooperation
FISEA	Investment and Support Fund for Businesses in Africa
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden
GDP	Gross Domestic Product
IDF	Inhomogeneous Distribution Function
IFC	International Finance Corporation
IFI	International Finance Institution
IFU	Danish Industrialisation Fund for Developing Countries
MASSIF	Manager, Micro and Small Enterprise Fund
MDG	Millennium Development Goals
MFI	Micro Finance Institution
MW	Mega Watts
NORFUND	Norwegian Investment Fund for Developing Countries
OECD	Organisation for Economic Co-operation and Development

OeEB	Oesterreichische Entwicklungbank
PPP	Purchasing Power Parity
PROPARCO	Société de Promotion et de Participation pour la Coopération Economique
SACCO	Savings and Credit Cooperative Societies
SFI	Specialize Finance Institution
SIFEM	Swiss Investment Fund for Emerging Markets
SIMEST	Società Italiana per le Imprese all'Estero
SME	Small and Medium Enterprises
SOFID	Sociedade para o Financiamento do Desenvolvimento
SWAp	Sector Wide Approach
SWEDFUND	Swedfund International
USAID	United States Agency for International Development

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Development finance institutions (DFI) are institutions that provide alternative sources of funding from the traditional sources of financing. They include microfinance institutions, community development financial institution and revolving loan funds.[1]

These institutions play a critical role in making available higher risk loans; equity and risk guarantee instruments to private sector investments in developing countries with the support of their respective states from the developed economies.[2]

The main role of DFIs is investment especially in areas where otherwise, the market fails to invest sufficiently. They have a general mandate to provide finance to the private sector for investments that promote development.[3] DFIs aim to be catalysts i.e. helping companies implement investment plans and also seeks to engage in countries where there is restricted access to domestic and foreign capital markets. They provide risk mitigation instruments that enable investors to proceed with plans they might otherwise abandon. Some DFIs specialize in loans with longer maturities while others may prefer equity and others financial products. DFIs have a

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[1] Levere, A., Schweke B. and Woo B., *Development Finance and Regional Economic Development*. Washington. DC: CFED, July 2006 and Charitonenko, S., *"The Nigerian legal and regulatory framework for microfinance: strength, weakness and recent development"*. Lagos Micro Finance Regulation And Supervision Resource Centre. 2005.p.43

[2] Velde D. W. and Warner, M., *"Use of Subsidies by Development Finance Institutions in the infrastructure sector."* Overseas Development Institute (ODI) Project Briefings Publication series, 2007.p.98

[3] ibid

unique advantage in providing finance that is in line with the design and implementation of reforms and capacity-building programs adopted by governments.[4]

There is no region in the world where private investment is needed more than in Africa. This is because domestic capital formation and international investments are seen as drivers of development and are important for sustaining higher living standards.

Many African economies have experienced encouraging economic development since the beginning of the decade. The same economies have expanded domestic investment and have managed to maintain high output growth. In terms of international investment, overall inflows still represent a small fraction of global international investment. Furthermore, the inflows available remain predominantly in the natural resources sector, concentrated in a small number of African countries. In a nutshell, the challenges of achieving sustainable development in Africa go hand in hand with creating an enabling environment for investment in the continent's countries.[5]

Distinct from aid agencies through their focus on profitable investment and operations according to market rules, DFIs share a common focus on fostering economic growth and sustainable development. Their mission lies in servicing the investment shortfalls of developing countries and bridging the gap between commercial investment and state development aid.

DFIs provide a broad range of financial services in developing countries, such as loans or guarantees to investors and entrepreneurs, equity participation in firms or investment funds and

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[4] Levere, A., Schweke B. and Woo B., *Development Finance and Regional Economic Development*. Washington, DC: CFED, July 2006. p37.
[5] Yaron J., Benjamin, M. P. and Piprek, G. L., Rural Finance: Issues, Design and Best Practice. *World Bank, Environmentally and Socially Development. Studies and Monograph Series14*. Washington D.C., 1997.

financing for public infrastructure projects. DFIs initiate projects in industrial fields or in countries where commercial banks are reticent about investing without some form of collateral.

DFIs are also active in financing small and medium-size enterprises, supporting micro loans to companies, often viewed as too risky by private sources of financing. A benefit of this approach is that DFIs often find themselves with first-mover advantage in markets with strong growth potential.[6] A good example is the experience from Celtel Telecommunications Company, where DFIs invested early as part of their developmental charter and later found themselves ending with enormous profits.[7]

Some DFIs are majority-owned by national governments and have been used to implement government foreign development and co-operation policing and as a result having bilateral relationship with host governments hence being viewed as bilateral development finance institutions. Multilateral DFIs, also known as international finance institutions (IFIs), usually have greater financing capacity and provide a forum for close co-operation between governments. Both types of institutions retain operational in-dependence from their funding governments. Backed by government funds and guarantees ensuring their credit-worthiness, DFIs can raise large amounts of funds on international capital markets to provide loans or equity investment on competitive, even subsidized, terms.[8]

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[6]Dickinson, T., "Development Finance Institutions: Profitability Promoting Development", *Organisation for Economic Co-operation and Development Sector Development Unit.*, 2007. p.57

[7] Levere, A., Schweke B. and Woo B., *Development Finance and Regional Economic Development*. Washington. DC: CFED. July 2006. p.14

[8] Booz, A. and Hamilton. I., *Final Report Evaluation of the Latin American Agribusiness Development Corporation of Central America*. Washington. D.C.: A.I.D. 1985.p.31

According to Biddle, Sinha, Farbman and Sillers, the DFIs invest in private sector companies and projects with the aim of generating development impact while at the same time delivering a financial return. They seek to invest in projects that would not receive funding without their involvement and to attract co-investors from the private sector who would not otherwise have invested in those projects or countries. DFIs also seek to promote responsible corporate governance and to uphold social and environmental standards in the projects in which they are involved.[9]

Developing country governments have supported the creation of DFIs and have promoted other forms of intervention in credit allocation. The result has been a confusion of many different kinds of directed credit programs implemented by many different institutions. For example, the Kenyan Government has supported the creation of eight DFIs, targeted to a range of economic sectors from agriculture to housing, industry, and tourism. This complex situation has been further aggravated by donors setting different terms for their assistance and establishing different interest rates and loan criteria for sub-borrowers in each of the DFIs assisted. Not surprisingly, sub-borrowers are confused, donor loan funds are often underutilized, and the viability of the DFIs is undermined.[10]

Several donors particularly the World Bank and the United States Agency for International Development (USAID), have given greater attention to helping developing countries improve

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[9] Biddle, S. Sinha, S. Farbman, M. and Sillers D., *"Microenterprise Stock-taking: The Financial Institutions Development, Puskowanjati Women's Cooperation, Maha Bhoga Marga, and Yayasen Dian Desa Projects - Indonesia."* 1989.

[10] Booz, A. and Hamilton, I., *Final Report Evaluation of the Latin American Agribusiness Development Corporation of Central America.* Washington, D.C.: A.I.D, 1985.p.35

their economic policies in order to build strong financial systems, rather than to directing additional resources to DFIs.

The DAC agenda for the 1990s stressed the importance of financial market development, financial sector development and reform, which requires an appropriate policy framework. Appropriate institution-building efforts must therefore be a fundamental priority in these developing countries where domestic resource mobilization is low or where allocation and use of financial resources is inefficient and financial institutions are faced by low or non-performing assets. A well functioning financial sector is critical to the evolution of the private sector and critical to the promotion of equity.[11]

At the same time, donors are increasingly acknowledging the inability of DFIs to reach the informal sector and marginalized farmers. They have thus given priority to developing alternative programs to reach these target beneficiaries. A good example is the United Nations' International Fund for Agriculture and Development and other donors who have supported the Grameen (Rural) Bank program for the informal sector in Bangladesh. This small private initiative reaches the rural poor with group-based lending schemes and has an excellent loan recovery record; this effort is in marked contrast to government-run development bank programs aimed at similar beneficiaries.

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[11] Bouton, L., & Sumlinski, M. "*Trends in Private Investment in Developing Countries: Statistics for 1970–1998*", International Finance Corporation, Discussion Paper 21, (2000), Washington DC.pg 3

1.2 Statement of the Research Problem

Development in the poor countries of the world, most of them in Africa has been slow and some have stalled. Some of the poor countries have not been able to grow fast or long enough to lift most of their people permanently out of poverty.

While there are many reasons for this, including bad governance, another important reason is the wide spread poverty. As a result, there isn't enough money to invest in private business projects.[12]

Another reason is getting access to finance, this presents a challenge to companies in many developing countries. The majority of low income countries do not have well established credit rating agencies that would provide information on credit ratings of a company seeking credit facilities. This discourages private investors, making it difficult and expensive for entrepreneurs and companies to raise the finance they need in order to grow their businesses. This gives rise to a class of small and medium sized enterprises (SMEs) who lack finances to implement their business ideas. As a result companies and businesses with perhaps the greatest potential to grow and create jobs are the very ones that have the least access to the investment they need to finance that development.

This brings our focus to the role of the financial sector as leading contributor to growth and development. Scholars have questioned the evidence on whether the financial sector has a positive contribution to economic development and growth and have emphasized on that the effects may vary due to specific conditions by country and time period.[13] Others conclude that

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[12] Schmidt, R. and Culpeper, R., *"Private Foreign Investment in the Poorest Countries"*. The North-South Institute Ottawa, Canada. 2003.p.25

[13] Arena, M., C. Reinhart, & F. Vasquez, *"The Lending Channel in Emerging Economies: Are Foreign Banks Different?,"* NBER Working Paper. (2006). p.7

the weight of evidence from a range of studies suggests that the financial sector does not only respond to the economy but other factors as well.[14] This has in turn led to the question of the relationship between financial sector development and poverty reduction among others.[15] In Kenya, access to financial services has been identified as a major problem experienced by many whom in attempt to start and maintain sustainable business. Though research has shown that credit in formal banking has grown steadily over the years, the same is not available to all the people who require it especially in the rural areas.[16]

The scarcity of funding brings us to consider other potential sources of funding. One of them is the Development Finance Institutions (DFIs). They have been important intermediaries for with the aim of channeling financial resources to priority groups in an attempt to fill the long-term credit gap.

According to Rotich MC, DFIs and their financial viability have come increasingly under scrutiny as some see them as having outlived their usefulness and wonder whether they have a place to play in our changing economies.[17] This has been much more so in countries where liberalization has given the private sector a greater participation in the economy.

While the role of DFIs in economic development has been an area of extensive research in other countries, in Kenya, limited research has been conducted on the performance of development

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[14] Lall, S., "*Competitiveness, Technology, and Skills*", Northampton. MA. Edward Elgar. 2001.p.54

[15] Bouton. L.. & Sumlinski. M. "*Trends in Private Investment in Developing Countries: Statistics for 1970–1998*" International Finance Corporation. Discussion Paper 21, Washington DC. (2000) p.3

[16] Mutuku. D., Case for Consolidated Financial Sector Regulation in Kenya, *Retirement Benefit Authority Publication* June. 2008.p.23

[17] Rotich. M. C. Rotich. M. C., "*Agro Industries: Policy and Strategies to Encourage Food Value Addition in an Industrial Setting*". Paper Presented At Workshop on Value Addition on Agricultural Products. (2005) p.6.

finance institutions in Kenya.[18] One of the studies covered the period of 1964 to 1989. Since then, no study has focused on the same leaving a wide knowledge gap. In addition to the gap, there has been a lot of financial restructuring and monetary policies since 1989 besides changes in regimes. This makes it imperative for another study to be conducted on Development Finance Institutions so as to establish their relevance in today's economic environment and how they have contributed to the economic development. Therefore, this study seeks to fill the knowledge gap by studying how European development finance institutions have contributed to private investment in Kenya.

1.3 Objectives of the Research

The overall objective of this research was to study European Development finance institutions in Africa and in particular focus on Kenya. The aim was to understand how they invest or team up with fund managers to provide sustainable sources of funds to a broad base of firms that require the funding. More specifically the study had three main objectives:

i. To improve the understanding of EDFIs by giving a brief account of their investments

ii. To outline amounts committed for investments by selected EDFIs and examine their investment patterns.

iii. To spark more debate by scholars about the potential benefits of expanding the role of EDFIs in development policies.

[18] Grosh. B., *"Performance of development finance institutions in Kenya"*, 1964-89. *Working Paper (University of Nairobi, Institute for Development Studies)*. 1987.p.17

1.4 Justification of the Study

A recent study on access to financial services in Kenya, FinAccess, reveals that fewer than one in five of the Kenyan adult population is currently formally banked. Alternative financial institutions such as SACCOs (credit unions) and micro-finance institutions (MFIs) reach one in seven.[19] Collectively these institutions provide services to only just over a quarter of the population including the formally banked. Though there is significant reduction of the proportion of Kenyan population without access to formal banking, the percentage still remains high from 38% in 2006 to 33% in 2009 according to the national financial access surveys conducted by the CBK and Financial Sector Deepening (FSD) Kenya.[20]

This makes the presence of DFI in the country an important tool for filling this credit gap. Therefore, by this study appraising the contribution of European DFI through private investment will help establish the relevance of DFIs to the Kenyan economy and if not suggest what should be done to make the same more relevant.

Secondly, this research presents a view of major EDFIs as a source of financing. It is aimed at understanding how these institutions and their respective governments team up to create sustainable private investment using various instruments available and thus helping businesses. The information presented in this research is applicable to EDFIs and various investors interested in understanding the significance of private investments to a country's development and more specifically in Kenya.

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[19] Nelson, C. and Wambugu, A., *"Financial Education in Kenya: Scoping Exercise Report"*. Financial Sector Deepening (FSD) Kenya, August.2008.p19

[20] Ndung'u, N., *"Kenya's vision for a strong and accessible financial sector"*, Remarks during the 2009 Alliance for Financial Inclusion (AFI) Global Policy Forum, Nairobi, ((2009).

Thirdly it will help the existing and any new EDFIs seeking avenues to invest their money, to know and identify the sectors underfunded by other players in the market and thus positioning themselves to maximize on the opportunities created by the gaps in financing.

Fourthly, it will assist Policy makers, NGOs, other finance institutions, government departments and corporate social responsibility programmers move in the right direction in seeking to stimulate economic growth and development. Lastly, the study will benefit entrepreneurs looking for sources of finance for their growing businesses.

1.5 Literature Review

Economic Development

Economic growth and development is achieved largely through productivity and is very important to both developed and developing nations. According to Sanjaya Lall, the appropriate strategy for any country to develop depends not only on its objective economic situation but also on its government policies and national views regarding the appropriate role of the state.[21] Even though we know that higher productivity leads to improved economic outcomes (for example, higher income, more choices to the consumers, better quality products, etc.), there has been no consensus among researchers about either the desired path of development or the role of state in economic development. Government's policies are critical in determining a state's economic development. With EDFIs, they are largely owned by their respective governments. A states policies will determine if the EDFI will find the country favourable for business and investments

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[21] Lall, S., "*Competitiveness, Technology, and Skills*" Northampton, MA, Edward Elgar, (2001). pg 6.

or not. Regarding the appropriate role of the state, it seems that for every argument in favour of a smaller government role one can find a counter argument in favour of a more active government role. The role of the state in economic development began to change dramatically with the advent of the Industrial Revolution. In the West, the resulting industrialization and economic development were based on the establishment of individual property rights that encouraged the growth of private capital. Competition and individual enterprise thrive in this environment because individuals pursue their self-interest of survival and wealth accumulation.

The instinct to survive under competitive pressures leads to innovation and hence increases productivity, which eventually leads to both increased profits for business and lower prices to consumers.

As observed by Krueger, many policymakers saw market failures as quite common and therefore assumed that only appropriate government interventions could guide an economy to a path of sustained economic development.[22] However, the rise and spread of capitalism led a number of thinkers to examine the consequences of the market-based approach to development. Socialists argued that capitalism (or private ownership of capital) can lead to greater inequalities of income and wealth, while developmental economists argued that private decisions may not always lead to socially desirable outcomes particularly in the case of market imperfections.

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[22] Krueger. A. O. *"Political Economy of Policy Reform in Developing Countries"* Cambridge. MIT Press. (1993).p.43

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Role of the Private Sector in Poverty Reduction

Poverty reduction remains a major challenge to most leaders in the world. According to a report by The 2009 MDG Gap Task force, in 2008 one in four people in the developing world, a total of 1.4 billion, were living in extreme poverty, defined as less than US USD1.25 (PPP) per day. They further estimated that the global financial crisis that then developed had the effect of adding an extra 55-90 million more to that total in 2009 than had previously been anticipated.

It is also estimated that as many as one billion people will still live in poverty by 2015, the target date for the achievement of Millennium Development Goals. Apart from major global economic challenges such as the recent financial crisis, progress in the fight to reduce poverty faces numerous other obstacles such as the growing need for sustainable energy, the increasing threat of climate change impacts and a global food crisis.

As indicated in a report by the Africa Progress Panel in 2008, developing countries have made substantial, although uneven, progress in poverty reduction over the past thirty years with the result that the total number of people living below the official poverty line has leveled off, despite population increases. [23] The report points out that the proportion of people living in extreme poverty has been almost halved since 1990, when almost half of the developing world's population fell into this category. The report states that the proportion of people living in poverty has decreased across Asia and Africa, but held constant in Latin America and the Caribbean. Poverty has however decreased in Eastern Asia because of rapid economic growth in China

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[23] Africa Progress Panel., *"Africa's Development Promises and Prospects"*, (2008) http://allafrica.com/download/resource/main/main/idatcs/00011562:4c783003143276a7417677e26b875b18.pdf.

where the number of people living on less than USD1.25 (PPP) per day was reduced significantly.

You, D., Wardlaw T, Salama P, & Jones G. state that, infant and child mortality decreased where as primary school enrolment significantly increased over the years to 2008.[24] This he attributes to improved healthcare with the help of key interventions such as the distribution of insecticide-treated bed nets and immunization campaigns.

Collier, P., & J. L. Warnholz (2009) said that macroeconomic reforms in many African countries are producing results in terms of delivering growth and stability and several African economies are now becoming success stories.[25] A good example is sighted in a USAID (2009) report where Ghana has implemented political and economic reforms since the early 1990s, leading to significant declines in inflation and poverty and impressive economic growth. [26]

Economic Growth as a driver for Poverty Alleviation

Dollar, D. and Kraay, A. (2002), in their research "Growth is Good for the Poor" assert that economic growth is an essential pre-requisite for poverty reduction. This link is demonstrated based on economic data from 80 countries over a period of four decades. The report shows that as the economy grows, the income of poor people (here defined as the bottom fifth of the

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[24] You, D., Wardlaw T, Salama P. & Jones G. *"Levels and Trends in Under-5 Mortality, 1990–2008."* Lancet, (2009).p45

[25] Collier, P., & J. L. Warnholz, "Now's the Time to Invest in Africa. *Harvard Business Review*", 2009.p.89

[26] USAID. (2009): "Ghana. http://www.usaid.gov/locations/sub-saharan_africa/countries/ghana/." 30 August 2010

population) rises by about as much as the income of everyone else.[27] Higher growth rates are needed to speed up economic development.

Private Sector Growth and Economic Growth

Private sector investments are crucial in supporting the development of a national infrastructure, including education, health and transport systems. A robust private sector can support the growth of private businesses by helping to create an enabling environment with a strong regulatory structure and an educated workforce. However, poverty reduction cannot be achieved simply through direct aid donations to social sectors; it also requires public and private sector investments. The findings of a January 2010 report by Dutch think-tank _WRR the Scientific Council for Government Policy,' signaled an increased awareness that fighting poverty can best be achieved not simply through direct giving to social sectors but also through the indirect effects of investments in underserved areas like SMEs. [28]

Bouton, L., & Sumlinski. M., maintain that private investment is more closely associated with growth than public sector investment. This argument is also supported by an analysis of public versus private sector investments in developing countries. A comparison between investments in the public and private sectors from 1970 - 1998 in both high and low growth developing

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[27] Dollar. D. and Kraay. A., *"Growth is Good for the Poor"*, World Bank, Development Research Group, (2002), and Kraay. A. *"When is Growth Pro-poor? Evidence from a Panel of Countries"*, Journal of Economics. Vol 80, (2008). p198-227.

[28] WRR, (2010),*"Less Pretension, More Ambition. Development Aid That Makes a Difference"*. WRR Scientific Council for Government Policy. http://www.wrr.nl/english/content.jsp?objectid=5190. 18, August 2010

countries shows that high growth countries invested 15% of GDP in the private sector compared to 10% for low growth countries.[29]

Private firms are a powerful source of job creation in the developing world. Two surveys, from the World Bank and Gallup point to the link between job creation and poverty reduction. The World Bank survey, "Voices of the Poor" highlights the fact that more than 70% of the world's poor believe that the best way of escaping poverty is to get a job.[30] Another survey conducted by Gallup in 26 Sub-Saharan African countries asked 26,500 Africans to rank what they consider most important to development.[31] The provision of jobs for young people was identified as one of the most urgent needs. According to a Copenhagen Statement by the African Commission (2009), strong growth and employment opportunities are required to achieve the MDGs, and to sustain progress already made in the areas of health, food security and education.[32]

According to a report by SEAF (2004), on "The Development Impact of Small and Medium Enterprises: Lessons Learned from SEAF Investments", it asserts that not only does private sector development generates private income, but also contributes to general economic and social development through employment, wage increases, non-salary benefits and labour

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[29] Bouton, L., & Sumlinski, M., *"Trends in Private Investment in Developing Countries: Statistics for 1970–1998"*, International Finance Corporation, Discussion Paper 21, Washington DC. (2000). p.143

[30] World Bank. (2009): *"Global Monitoring Report. The International Bank for Reconstruction and Development and The World Bank"*. http://siteresources.worldbank.org/INTGLOMONREP2009/Resources/5924349-1239742507025/GMR09_book.pdf

[31] Tortora, R. (2009): *"Sub-Saharan Africans Rank the Millennium Development Goals (MDGs)"*. Gallup Inc" http://www.gallup.com/poll/File/116116/Gallup/SubSaharaAfricans/Rank_MDGs.pdf

[32] Africa Commission. (2009): "The Copenhagen Statement" Retrieved on 20th August 2010, from http://www.africacommission.um.dk/en/menu/About+The+Commission/CommissionMeetings/3rdMeetingCopenhagenMay2009/TheCopenhagenStatement/ Retrieved on 19 August 2010.

mobility through training. government revenues through taxation, improved quality and/or lower price goods and services for consumers.[33]

As the market grows, suppliers overall will experience increased demand from business customers and they will likely grow as well. The broader local communities may also benefit in several different ways among them through potential environmental gains, new physical infrastructure and improved social infrastructure, including better environmental, social, and governance (ESG) practices.

1.6 Theoretical Framework

For a long time, it has been possible to divide the world into two groups of countries the poor and the wealthy. The wealthy group is composed of most of the Western European countries, Canada and the United States. Inhabitants of these regions are perceived as living in great affluence and consume a large part of the world's resources. The other group consisting of Latin America, Asia and Africa has for a long time been seen as poor and underdeveloped with high population. Economists and government policymakers, especially those in developing countries, began to look for reasons to explain this disparity and for ways to eliminate it.[34] One of the theories they used to explain the disparity is the classical economic development theory where they look at the efficient and cost effective allocation of scarce.

The roots of economic development are founded on the experience in the reconstruction of Western Europe after the end of World War II. With the help of the Marshall Plan, they were

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[33] SEAF (2004). "*The Development Impact of Small and Medium Enterprises: Lessons Learned from SEAF Investments*", http://www.seaf.com/main_report.pdf (2004). Retrieved on 20 August 2010.

[34] Nurkse, Ragnar, "*Problems of Capital Formation in Underdeveloped Countries and Patterns of Trade and Development*"(New York: Oxford Press).1952.p.132

able to finance the reconstruction of infrastructure and physical capital destroyed by the Second World War[35]. With the quick economic recovery achieved, it was assumed that, with decolonization, a similar injection of finance into developing countries would lead to their rapid economic development. The proposition that a deficiency in capital is the fundamental cause of underdevelopment was the basic principle on which the World Bank (originally called the International Bank for Reconstruction and Development), the IMF, and bilateral foreign assistance programs were established.[36] The charters of these international institutions reflect this philosophy as did their activities. Both multilateral and bilateral aid programs concentrated on supplementing the meager domestic savings available for domestic investment on concessionary terms. They financed externality-generating, large infrastructural projects in transport and energy almost exclusively and took mostly the form of project, rather than program, assistance. The classical development theorists viewed economic development as a growth process that requires the systematic reallocation of factors of production from a low productivity, traditional technology, decreasing returns, mostly primary sector to a high productivity, modern, increasing returns, mostly industrial sector.

Around the mid-nineteen sixties development economists and development policy makers realized that there were serious absorptive capacity constraints to foreign assistance: Beyond a certain point the injection of extra capital became subject to sharply diminishing returns. As a result, the provision of foreign aid and the undertaking of government-sponsored investment projects were failing to induce sufficiently rapid growth of privately owned and managed

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[35] Kuznets, Simon, *"Towards a Theory of Economic Growth with Reflections on the Economic Growth of Modern Nations"*. (New York: Norton). 1968. p.57

[36] World Bank. *"World Development Report: From Plan to Market"*, New York: Oxford Press). 1996

industry. This failure was attributed to missing entrepreneurship. There were simply not enough potential industrialists willing and able to undertake industrial projects, especially when commercial, import-license related, and "non-productive" real estate investments provided such high rates of return in the inflationary and protected trade environments generated by government-sponsored, accelerated development. The classical development theorists argued that, in the absence of private entrepreneurship, governments would have to continue to perform the entrepreneurial job while at the same time fostering the development of a cadre of private entrepreneurs willing and able to take over. The realization that entrepreneurship was scarce did not challenge the need for continued substantial role of government in development. On the contrary, it reinforced it. By recognizing that a critical complementary factor to the government's efforts to promote development was missing, it emphasized that government policy would have to pay attention to ways of structuring its own activities so as to increase its supply. In the foreign aid area, the "missing entrepreneurship" school led to the establishment of the International Finance Corporation (IFC) within the World Bank for financing private entrepreneurial activity in developing countries. Besides the IFC many institutions have come up to complement their efforts.

A good example is the European DFIs which was founded in Brussels in 1992. EDFI is the Association of European Development Finance Institutions, a group of 15 bilateral institutions providing long-term finance for private sector enterprises in developing and reforming economies. The objectives of the EDFI members are to provide finance for investment in the private sector of non-mature economies and to promote responsible corporate governance, and upholding of social and environmental standards in the projects in which they are involved. The

Association also strives to strengthen information flow and cooperation between it members and other bilateral, multilateral and regional development finance institutions. Using this classical development theory this research will examine the activities of the EDFIs and how they are reallocating scarce resources to the less developed economies.

1.7 Hypothesis

The direct and indirect effects of European DFIs' portfolio companies contribute to reducing poverty and achieving the Millennium Development Goals (MDGs) of which economic growth is central. Sector specific private investments generate value and pave the way for other investors. This in turn helps to improve the investment climate and the transfer of technologies and know-how to local players while also facilitating the building of global partnerships. Based on these premises, the following are the hypotheses of the research:

H_1: European DFIs investments have had generally limited impact in Africa Kenya in particular.

H_2: European DFIs extend loans as a preferred instrument of financing

1.8 Research Methodology

Research Design

The study used both primary and secondary sources of data. Direct questioning of the investors to obtain insights regarding their decisions and decision making processes was undertaken. Structured questionnaire was used to obtain the desired information. The study is

expected to add to the appreciation of the contribution made by European DFIs to economic development in African countries.

Secondary data was used for estimating and assessing the impact of EDFIs in Kenya i.e. the statistical analysis of results from EDFIs. [37] This was useful in drawing conclusions on the advanced hypotheses. Annual time-series data for the variables of interest was collected from all the sources possible including Annual Reports of the institutions under study. Since the study focused on EDFIs located in the Diaspora, secondary data was the most appropriate since primary data instrument was unfeasible given the geographical divide.

Target Populations and Sample

The target population of the study was the EDFIs institutions and members. These organizations are 15 in number by the end of 2009 and they include: BIO from Belgium, CDC from United Kingdom, OFIDES from Spain, DEG of Germany, FINNFUND of Finland, FMO from Netherlands, IFU from Denmark, NORFUND from Norway, OeEB from Austria, PROPARCO from France, SIFEM of Switzerland, SIMEST of Italy, Portugal's SOFID and Sweden's SWEDFUND.

The research adopted the survey type of research in which a sample from the target population will be used for the study. The targeted population for the study focused on a few of the established EDFIs who have a strong presence in Africa and in Kenya particularly.

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[37] Glass, G. V (1976). "*Primary, secondary, and meta-analysis of research*". Educational Researcher, 1976 p.3-8.

The sampled institutions included Norfund, DEG, PROPARCO, and FMO. This sample was arrived at after looking at the portfolio of all the EDFIs by the end of 2008. DEG & FMO are the largest by portfolio with DEG boasting a portfolio of USD 6 billion and FMO USD 5.7 billion. FMO and DEG were selected to represent the largest EDFI; PROPARCO represents the medium sized EDFIs with a portfolio of USD 2 billion and Norfund with portfolio of USD 0.7 billion to represent the smaller sized EDFIs with operations in Africa and more specifically in Kenya.

Data Collection

The study used both primary and secondary data collected from email communication with the representatives of the EDFIs and secondary data from various publications and reports by the EDFIs. The primary data was collected by administering a questionnaire. The questionnaire used structured questions, consisting of approximately 6 questions. A sample is attached in the appendix 1. Secondary data was obtained from internal sources. This included organizations website and external sources including websites of other organizations and publications by various institutions.

The data was collected for the period: 2000 to 2010. One of the advantages of secondary data over the other primary data sources was that secondary data was far cheaper to collect secondary data than to obtain primary data. The time involved in searching secondary sources was much less than anticipated. Secondary sources of information can usually yield more accurate data than that obtained through primary research.[38]

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[38] Green. P.E. D.S. Tull. & G Albaum. "*Research methods for marketing decisions*": 5th edition, Prentice Hall. (1993). p.136.

Data Analysis

The purpose of this research was to study provide adequate evidence that European DFIs have indeed invested in Africa, their sector preference as well as their preferred investment instruments and investment areas as they pursue their developmental impact objectives. The contributions through private investments by each institution was measured and compared to the investments made from sector to sector and their preferred mode of investments. A trend on investment was selected because the research is interested in the total amounts contributed by various EDFIs. Qualitative and quantitative data was also collected. The data was analysed in two fold, one general approach which applied descriptive statistics including measures of central tendency, such as the mode, percentages and bar graphs. The second approach was through detailed case studies where four EDFIs were selected for detailed study.

1.9 Scope and Limitations of the Study

Data collected was determined by the available time and resources. The study could not cover all the EDFIs. The scope of this research was limited to four selected European Development Finance Institutions who focus on Africa and in particular Kenya. The research specifically targeted the supply side of private investments. Some of the topics that fell outside of the scope of the study are the demand side perspective of private financing by EDFIs, angel investors who assist to meet the demand of funding and policy in place to stimulate and encourage EDFIs to continually invest.

The research involved interviewing some of the selected EDFIs. Apart from the fact that some of these institutions were not easily accessible, it was also difficult to interview the managers. The

exercise involved extracting useful information from their records. This was however not possible because a lot of the time the information on their transactions is classified. While this did not affect the research materially, the information would have broadened the scope of findings. It's also useful to note that brochures the most common source of information was inadequate. This is because the brochures from these institutions contained outdated information.

The study was also limited by the validity and reliability of the source information. Even though primary data was obtained, the study relied more on the secondary data and the reliability and level of precision of the source data may be reflected in this research.

1.10 Chapter Outline

The rest of the research study is organised in the following chapters;

Chapter two examines the global activities of the EDFIs through private investments and looks at their role in development policy, the sectors and geographical coverage of the EDFIs, their investment strategies and their preferred instruments of investment.

Chapter Three looks at DFIs investment patterns in Africa and examines the role they play to unlock the barriers to access of funding and growth of private sector in Africa.

Chapter Four critically examines the various EDFIs and their investments in Kenya. It also looks at the various EDFIs among them Norfund, FMO, PROPARCO and DEG and the various projects they have invested in.

Chapter five provides summary, conclusions of the study, gives recommendations and provides suggestions on areas for further study.

CHAPTER TWO: EUROPEAN DEVELOPMENT FINANCE INSTITUTIONS AND PRIVATE INVESTMENT

2.1 Overview of European DFIs

European Development Finance Institutions (EDFI) is a group of 15 bilateral institutions providing long-term finance for private sector enterprises in developing and reforming economies. The members are Belgium's BIO, the UK's CDC, Spain's COFIDES, DEG of Germany, Finland's FINNFUND, the Netherlands' FMO, Denmark's IFU, Norway's NORFUND, Austria's OeEB, France's PROPARCO, SIFEM of Switzerland, SIMEST of Italy, Portugal's SOFID and Sweden's SWEDFUND. They are all mandated to invest in developing countries and emerging markets.

Since it was founded in Brussels in 1992, their mission has been to foster financial and technical co-operation among its members and to strengthen information flow and co-operation between its members and other bilateral, multilateral and regional development finance institutions. They also aim at providing information to the general public and government stakeholders about their contribution to development.[39]

The objectives of the EDFI members are to provide finance for investment in the private sector of non-mature economies and to promote responsible corporate governance, and upholding of social and environmental standards in the projects in which they are involved.

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[39] Arena, M., Reinhart, C. and Vasquez, F. *"The Lending Channel in Emerging Economies: Are Foreign Banks Different?"*, NBER Working Paper, June 2006. p32

According to Velde and Warner, in 2005, total commitments (as loans, equity, guarantees and debt securities) of the major regional, multilateral and bilateral DFIs totaled USD45 billion (USD21.3 billion of which went to support the private sector).[40]

The investment objectives of European DFIs are to maximize development impact while being financially viable. Although development impact is the key focus for all European DFIs, they have varying approaches to the way in which they deliver on the demand to be financially viable. This is seen in their desire to at least break even by some institutions while others set specific return targets on investment

European DFIs are unlisted entities and their owners have a long-term approach to investments. This means that they are under less pressure to deliver short term results and are therefore better positioned to invest in countries that have high traditional risk ratings but where a long term approach reduces the risk. They thus focus on investing in developing countries as these markets are underserved and development impact potential is high. They also focus on under-developed sectors and segments considered too high risk for most investors.

Geographically, European DFIs invest primarily in countries included in the OECD and DAC definition of developing countries, with older investments in certain poor regions of Russia remaining as key exceptions. European DFIs also prioritize investments in Least Developed Countries that are often considered high risk, including post conflict and conflict states.

According to the EDFI report of 2010, Asia has the highest share of the European DFI portfolio whereas Africa has the second largest share. The other funds are invested in Central and South

[40] ibid

America, Russia and CIS countries. With new commitments made in 2009 and 2010, the focus on Africa has increased significantly, compared to Asia, Central and South America.[41]

In terms of sectors, European DFIs focus their investments where they will have strong effects in developing the local commercial infrastructure and capital markets. Since they have developed expertise within these fields they bring it to their investments in the local markets. The financial sector is a key target to the EDFIs acknowledging that this sector is key to economic development, generating benefits for other sectors by helping financial institutions to facilitate access to finance for large companies and SMEs.

European DFIs investments in micro businesses and SMEs are conducted within a wide range of sectors where access to finance is lacking due to high risk profiles or other barriers, whereas the focus of large business investment typically involves building up key elements of the local infrastructure such as power and telecommunications networks.

EDFIs tend to focus on industry and manufacturing, agribusiness and infrastructure. The main sub-sector focus within the infrastructure sector is in power related investments, telecommunications and roads, ports and airports.

At independence, the financial sector in Kenya was unable to serve the interest of African farmers and businessmen, or provide adequate long-term capital to finance economic growth. This was largely due to the inherent weak structure of the sector at the time. In response, the Government of Kenya took a deliberate effort to set up various DFIs with the responsibility to

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[41] EDFI. (2010), *"2009 Comparative Analysis of EDFI members"*, p.7

provide enterprises and projects with equity and long-term loans that commercial banks were unable or unwilling to supply.[42]

The local DFIs were specifically established to spearhead the development process by availing credit to those venturing into commerce, tourism and industry, assisting those wishing to venture into small-scale manufacturing enterprises. They were also formed to assist in the initiation and expansion of small, medium and large-scale industrial and tourist undertakings, provide long-term lending (Project financing) to sustain economic development, provide Technical Assistance/Co-operation extension services, provision of special Financing and Support services to stimulate Private Sector to live up to its potential and create jobs and wealth, develop and expand indigenous skills.[43]

In Kenya DFI institutions include Industrial Development Bank (IDB Capital)-IDB, Industrial and Commercial Development Corporation-ICDC, Development Bank of Kenya-DBK, Kenya Tourist Development Corporation-KTDC, Development Finance Company of Kenyan (DFCK) and Kenya Industrial Estated-KIE among others.[44] Others outside the country include the East African Development Bank (EADB), the African Development Bank (ADB), the African Project Development Facility (APDF) and the International Finance Corporation (IFC).[45]

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[42] Popiel, P. A., *"Financial systems in sub-Saharan Africa: A comparative Study"*, World Bank Discussion Paper No. 260, Africa Technical Department Series (1994). p.38

[43] Steadman, *"Results of a National Financial Access Survey"*, Financial Access Partnership and Financial Sector Development Trust ,2007,p.23

[44] Urbane, K. *"Kenyan Government policy hurting DFI's"*, Jamii Forum, 2010.

[45] Rotich, M. C. *"Agro Industries: Policy and Strategies to Encourage Food Value Addition in an Industrial Setting."* Paper Presented At Workshop on Value Addition on Agricultural Products Held At Grand Regency Hotel Nairobi. 2005, p.41

Overview of the European DFIs Funding Portfolio

At the end of 2009, the total portfolio of the 15 members of the Association of EDFIs was USD25.2 billion compared to USD 22.7 billion in 2008 with 4,221 projects.[46] This marked an increase of USD2.46 billion over a portfolio of USD22.7 million in 2008 with a similar increase over 2007 portfolio. They collectively earned a profit of USD197.2 million in 2008.[47]

Table 1: 2008 Comparative analyses of EDFI members [48]

Country	Development Finance Institution	Portfolio in $ million	No. of projects	Average project size, € K	Share of portfolio in ACP, Percent	ACP Portfolio in $ million
Austria	AWS	853	474	1,324	1%	9
Belgium	BIO	235	77	2,246	27%	63
UK	CDC	4,128	682	4,451	45%	1,858
Spain	OFIDES	586	120	3,592	5%	29
Germany	DEG	6,021	675	6,559	13%	783
Finland	FINNFUND	421	106	2,917	29%	122
Netherlands	FMO	5,688	873	4,791	28%	1,593
Denmark	IFU	683	303	1,657	19%	130
Norway	NORFUND	668	81	6,065	26%	174
Austria	OeEB	97	5	14,300	0%	-
France	PROPARCO	2,044	300	5,010	45%	920
Belgium	BMI	24	23	775	12%	3
Switzerland	SIFEM	340	57	4,389	20%	68
Italian	SIMEST	709	361	1,444	5%	35
Portugal	SOFID	5	3	1,333	100%	5
Sweden	SWEDFUND	234	81	2,128	36%	84
European		**22,738**	**4,221**	**3,961**	**26%**	**5,912**

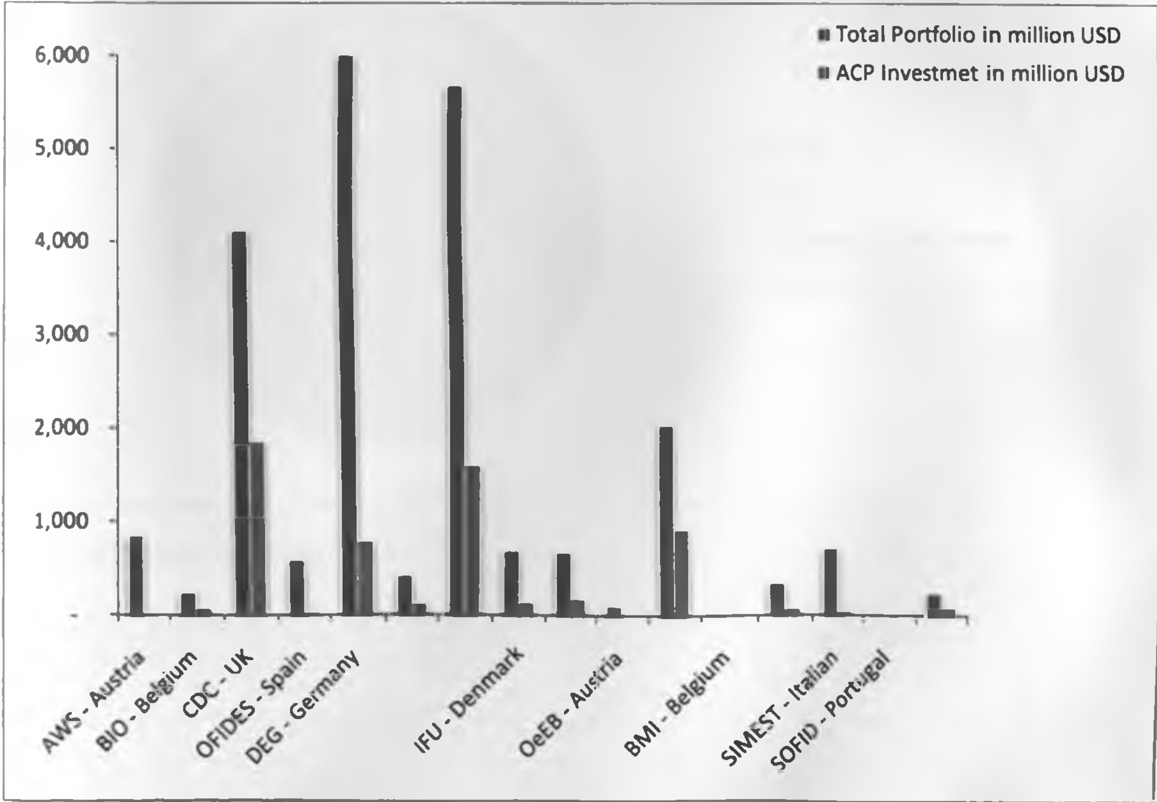
Source: Dalberg 2009: "The Growing Role of EDFIs in International Development Policy."

[46] EDFI. *"2008 Comparative analysis of EDFI members"* 2009.
[47] Ibid
[48] Ibid

Table 1 shows a summary of portfolio of EDFIs with the total projects completed globally. On average 26% of the total EDFIs is invested in ACP in 2008.

Even though the table shows that SOFID has invested 100% of its portfolio in the ACP region, this amounts to only USD 5 million. This is very small compared to large EDFIs like CDC which has USD 1.8 billion in ACP; FMO has invested USD 1.5 billion while PROPARCO has a total of USD 920 million in ACP region. Graph 1 shows a that one of the main region that EDFIs are focusing on is the ECP region. This can is because most of the EDFIs were established to invest in emerging markets of which Africa is the biggest beneficiary.

Graph 1: Total EDFI portfolio at the end of 2009

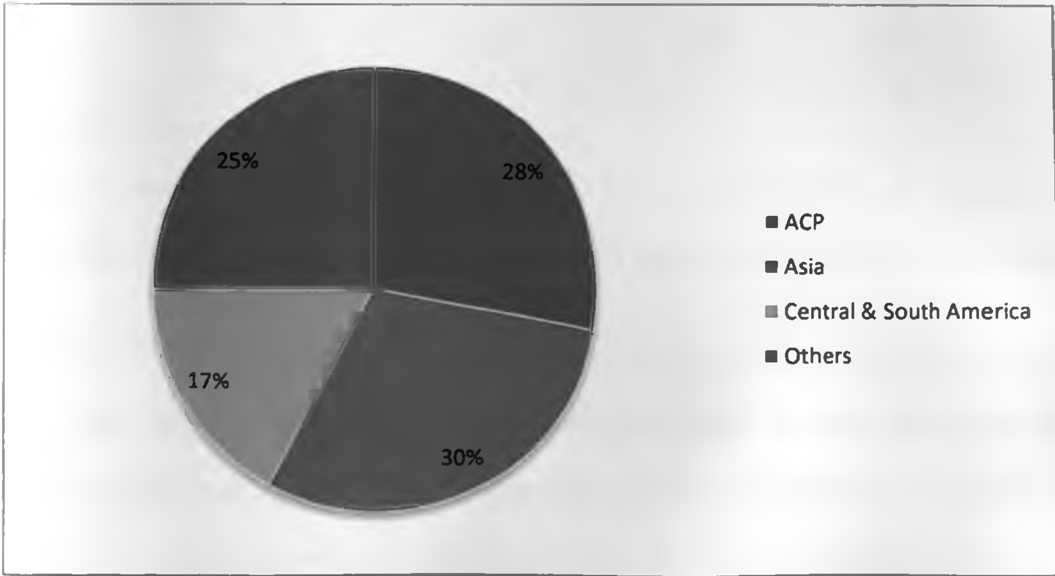


Source EDFI Issue No. 15, June 2010

Out of the total portfolio, Table 1 shows that USD 5.9 billion was invested in Africa, the Caribbean and Pacific Islands (ACP). The total portfolio invested in Africa constitutes almost the entire ACP portfolio with 1,033 projects done out of the global total 4,221 projects. New projects in Africa in 2008 amounted to USD1.9 billion invested in 263 projects.[49]

Chart 1 below represents a summary of the distribution of EDFIs portfolio in 2009. It shows that investments in ACP increased from by 26% in 2008 to 28% in 2009. This means that majority of the new investments between 2008 and 2009 were in the ACP region and particularly in Africa.

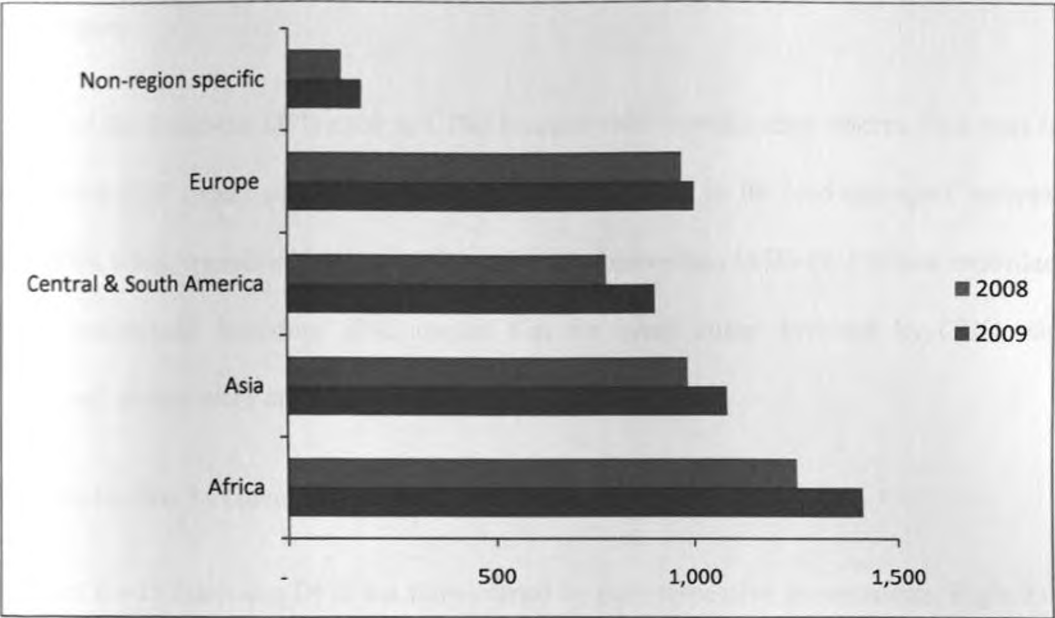
Chart 1: Total EDFI portfolio in the region as at the end of 2009



Source: EDFI Issue No. 15, June 2010.

[49] Ibid

Graph 2: FMO Comparative investments in the Region for 2008 & 2009



Source: FMO Annual Report 2009.

A close scrutiny of FMO's investments in Graph 2, indicate that Africa got a bigger share of funding among new investments both in 2008 (USD 1.3 billion) and 2009 USD 1.4 billion).

European DFIs act as catalysts of participation from other investors both directly and indirectly. Their direct effects comes through the mobilization of other investor capital and indirectly through helping local markets to build strong foundations for commercial activity, making them attractive to other investors by proving that profitable investments are possible in these markets. The mobilization of additional funds is also a way for investors to share the risk, which enables them to act as first movers and work in areas perceived as high risk.

The financing that European DFIs bring to relatively high-risk projects helps to mobilize the involvement of private capital, bringing in commercial banks, investment funds or private businesses and companies. In addition, the DFIs act in co-operation with governments and other

organizations in providing funds for technical assistance, feasibility studies and management consultancy.

Some of the European DFIs such as CDC measure their mobilization efforts. This was reported in a 2008 CDC report where it committed USD 7.1 billion to its fund managers between 2004 and 2008 which translated into an additional sum of more than USD 19.7 billion mobilized from other commercial investors. This means that for every dollar invested by CDC, almost 3 additional dollars were mobilized from private investors.[50]

2.3 Approaches to Governance and Investment strategies

Most of the 15 European DFIs are fully owned by their respective governments. Eight European DFIs have a mixed ownership structure with both private and public sector owners, while two are fully privately owned. The mixed ownership structure helps them align with the interests of key stakeholders through having both public and private sector representatives as owners. The private sector has the potential to provide additional sources of funding if required.

Public sector funding can take different forms, such as Official Development Assistance (ODA), Other Official Flows (OOF) and various additional sources of government funding including grants from aid organizations. Compared to the private sector, government additional injection of funds is relatively low. This can partly be explained by the fact that many European DFIs received significant Official Development Assistance contributions in their early years and are expected to grow organically as they mature. Funding from the private sector is either equity or

[50] CDC, *"CDC 2008 Development Impact Report"*, 2008.

loans based. Private sector owners can inject more capital as required to promote the growth of DFIs, which can also borrow funds in the capital markets.

Some European DFIs manage additional funds for the government, outside the DFIs' balance sheets. This option is often used to invest in particularly high risk projects or projects where the expected financial return is too low to make up for the risk. It can be difficult for DFIs to take such projects on their balance sheets and managing a government fund is then an alternative way to still leverages the capabilities of the DFI while avoiding the risk.

Most European DFIs have a focused strategy within specific sectors and geographies as well as within financial instruments and products. They diversify risk in order to serve markets perceived by traditional financiers to be higher risk for example, SMEs and post conflict countries. There are clear benefits to be gained by specializing within certain sectors or products. This depends on the strengths that the particular DFI have in any sector. They differ in the ways that they balance the benefit they get from high risk projects and diversification needs.

Investments Geography and Sector

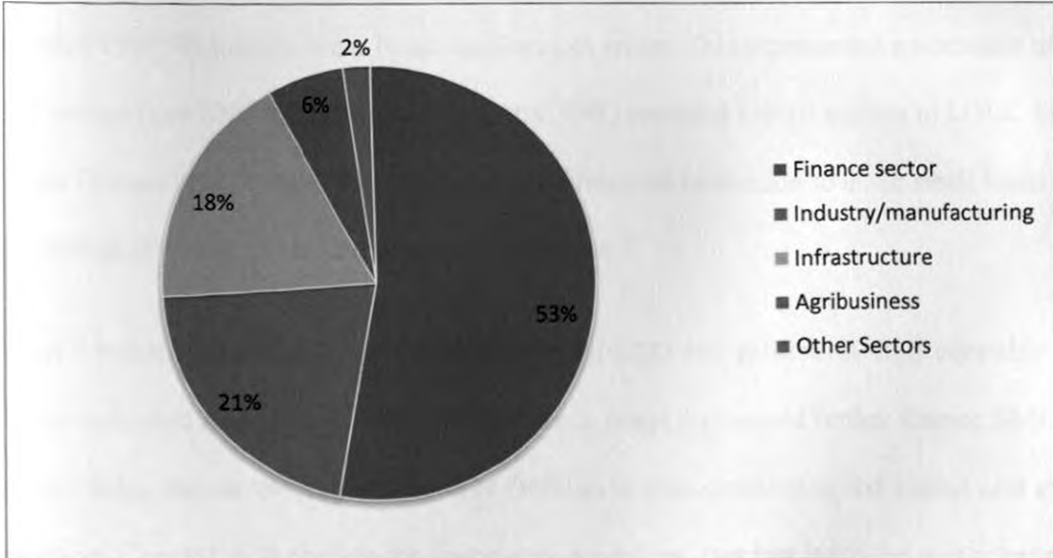
European DFIs focus their investment strategies according to their areas of expertise, with varying degrees of sector and geographic diversification. In 2009, seven of the European DFIs held more than 50% of their portfolio in one sector and eight held more than 30% in one region[51]. The DFIs diversify their portfolio to varying degrees, with a tendency to diversify more on one dimension than others.

[51] EDFI, *"2008 Comparative analysis of EDFI members."* 2009.

According to Tortora (2009), the EDFIs invest in sectors considered to have positive social impact but have varied focus areas dependent on their homeland expertise. On average they invested USD12 billion in the Finance sector, USD4.8 billion in Industry and manufacturing sectors, USD4.1 billion in Infrastructure, USD1.4 billion in Agribusiness and USD0.5 billion in other sectors.[52]

In the past three years, the percentage of financial sector investments has increased from 33% in year 2000 to 54% at the end of 2007. The percentage of agribusiness investments has also increased slightly, while the percentage of investments in the remaining three sectors has slightly fallen between 2006 and 2008.[53] Chart 2 shows that by the end of 2009, 53% of funding was invested in the financial sector. 21% was invested in manufacturing and 18% in infrastructure.

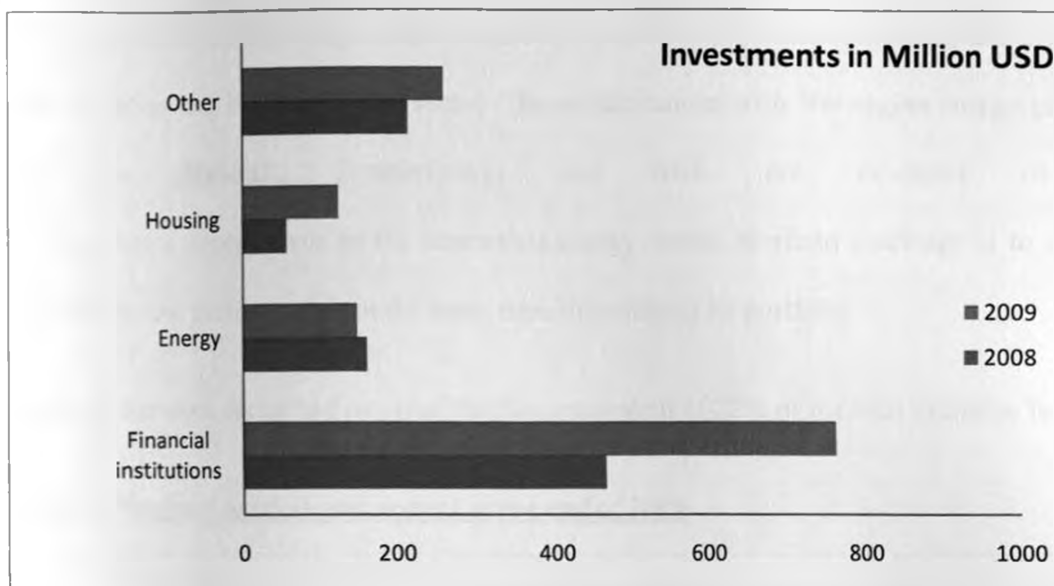
Chart 2: Total EDFI portfolio by sector as at the end of 2009



Source: EDFI Newsletter, Issue No. 15, June 2010

[52] Tortora, R., "*Sub-Saharan Africans Rank the Millennium Development Goals (MDGs).*" Gallup Inc., 2009. p17
[53] Ibid. p18

Graph 3: FMO Investments per sector in 2008 & 2009 in Million USD



Source: FMO Annual Report 2009

Graph 3 above indicates that of the in 2009, out of investments of USD 1.3 billion, FMO invested USD 763 million in the Financial Services sector. This represented an increase of USD 297 million from 2008 the same sector in 2008. FMO provided US 10 million to LOLC Micro Credit Limited in Sri Lanka. This will enable the financial institution to make small loans to individuals in rural areas to start up small businesses.[54]

Chart 3 below indicates that Norfund has invested USD 391 million in the Renewable Energy Sector compared an amount of USD 225 million in funds that would further finance SMEs. They acknowledge that developing hydropower facilities is time-consuming and capital and expertise intensive. Coupled with challenging framework conditions, this has led to the energy potential of most poor countries being grossly under-exploited. Norfund promotes renewable energy

[54] FMO Annual Report 2009

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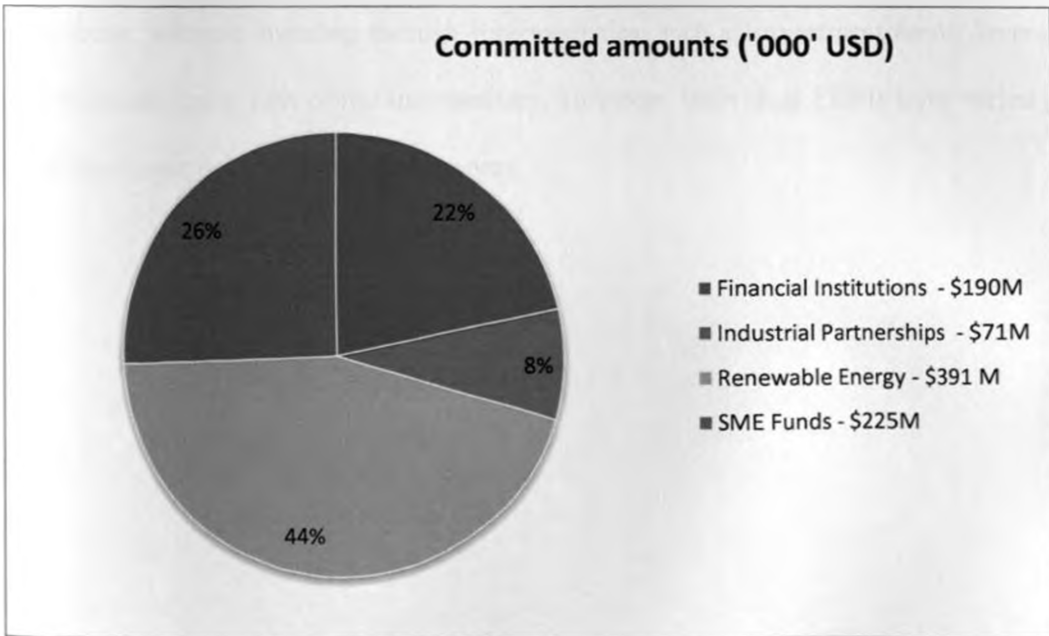
production as a basis for economic growth and enhanced quality of life in developing countries. This is best done by investing in equity, mobilizing other capital and combining this investment with expertise and insight into the sector. The collaborations with Norwegian energy producers such as Statkraft, TrønderEnergi and BKK are examples of this. Norfund has a strong focus on the renewable energy sector. Norfund's strategy is to mobilize sound technical partners while at the same time diversifying its portfolio.

Financial Services sector had received funding equivalent of 22% of the total available funding.

Chart 3: Norfund portfolio per sectors at the end of 2009



Source: Norfund Annual Report 2009.

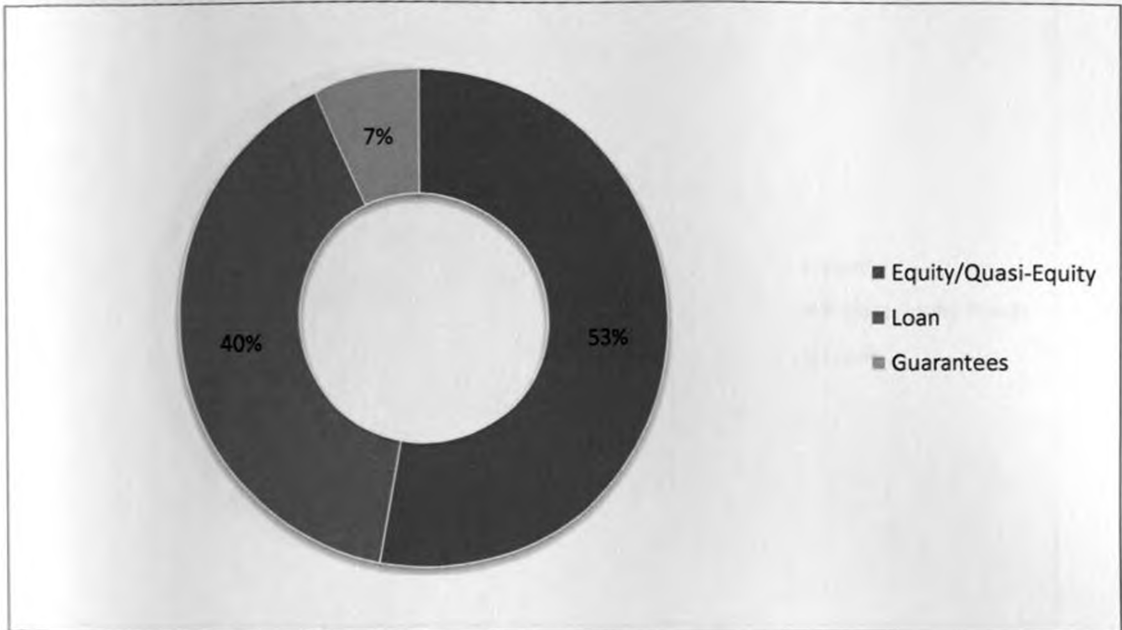
Investments Instruments and Products

European DFIs use three different financial products, with equity and quasi-equity making up 55%, loans 43% and guarantees 2% of the combined 2009 portfolio.[55] In the previous year as shown in Chart 4, equity and Quasi-equity comprised USD12 billion of the portfolio accounting for 53% of the total portfolio, Loans at 40% was USD 9.1 billion while the remaining was disbursed as guarantees.[56]

European DFIs invest in local companies in developing countries both directly and through intermediaries. Managing direct investments requires local knowledge and expertise within the given sector, whereas investing through intermediaries, such as investment funds, leverages the local skills and know-how of the intermediary. However, individual EDFIs have varied product mixes thus invest using different instruments.

[55] EDFI 2010, Newsletter, Issue No. 15, June 2010.
[56] EDFI 2009, "*2008 Comparative analysis of EDFI members.*" 2009.

Chart 4: EDFI investment per instruments as at the end of 2009

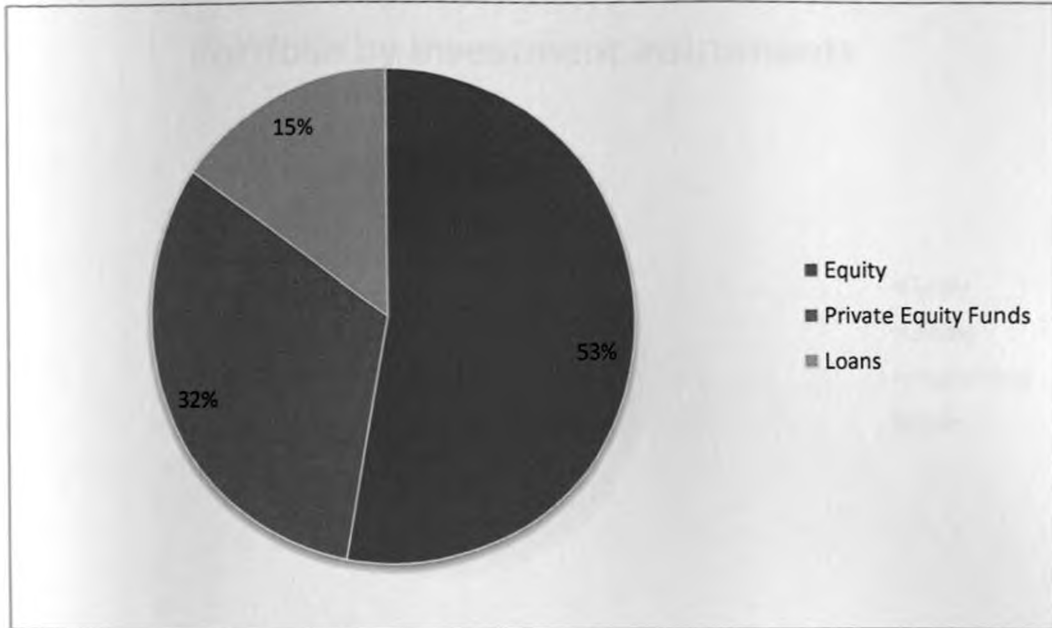


Source: EDFI Newsletter, Issue No. 15, June 2010

Chart 4 indicates that EDFIs made a significant portion of their investments through equity. Most of the members prefer to forge a partnership in the investments. Large banks often have a tendency to favour serving larger and wealthier clients. On the other hand, small businesses are too large to qualify for microfinance often lack debt and equity financing, instead relying on informal networks like borrowing from family members or money lenders. This creates an opportunity for loan and equity financing. EDFI's have 53% and 40% of their financing in Equity and loans respectively.[57]

[57] EDFI, *"The Growing Role of DFIs in International Development Policy"*, 2009 p.6

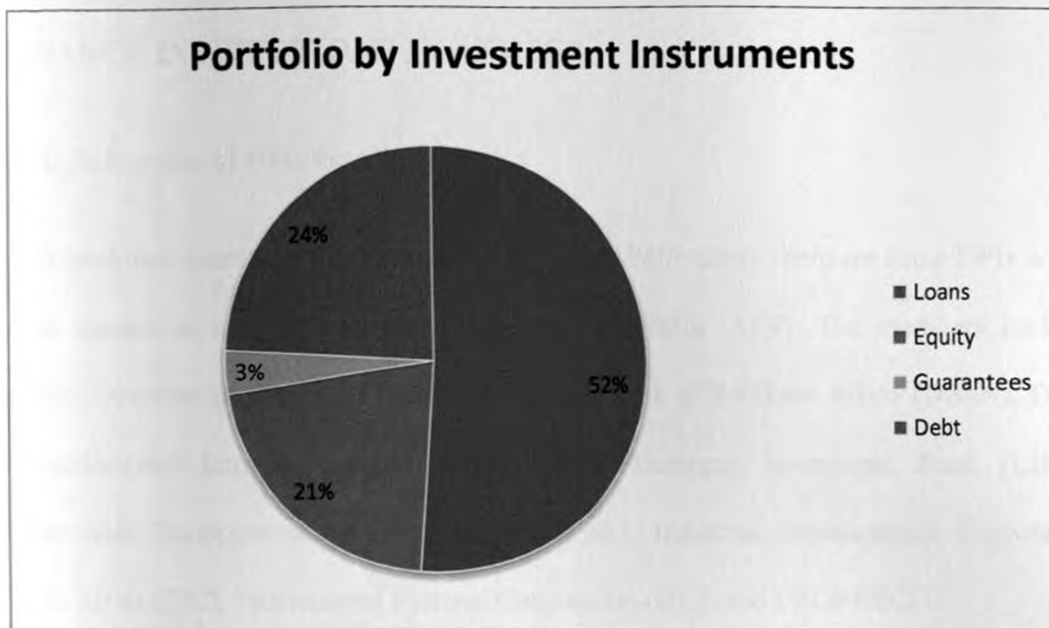
Chart 5: Norfund Portfolio Disbursed by Instrument of investment as at the end of 2009



Source: Norfund Annual Report 2009

Chart 5 shows that Norfund invested 85% of their capital in equity. This normally carries more risk than loans and by investing in equity it mobilizes further capital from other investors. Direct equity investment accounts for 53% and indirect equity investment through private equity funds was 32%. This means that the private equity funds further invest in equity in other funds.

__Chart 6: FMO Portfolio Disbursed by Instrument of investment as at the end of 2009__



Source: FMO Annual Report 2009

In 2009, FMO committed to ten new funds, and increased their funding to two funds which they were already funding. From Chart 6 above, FMO's portfolio has been largely invested through loans at 52%, debt at 24% and Equity at 21%. They work in countries and with clients and projects with a higher risk profile, in order to add value to the market. This means that they provide long-term finance where most loans are short term; provide high-risk, innovative financial structures such as mezzanine debt and equity in addition to regular loans.

CHAPTER THREE: AN OVERVIEW OF EUROPEAN DEVELOPMENT FINANCE INSTITUTIONS IN AFRICA

3.1 Collaboration of DFIs for Africa

DFIs have been instrumental in investment in Africa. Particularly there are some DFIs who have come together to form the African Financing Partnership (AFP). The members include the African Development Bank (AfDB), Development Bank of Southern Africa (DBSA), Deutsche Investitions-und Entwicklungsgesellschaft (DEG), European Investment Bank (EIB), and Netherlands Development Finance Company FMO, Industrial Development Corporation of South Africa (IDC), International Finance Corporation (IFC), and PROPARCO.

By the end of 2009, the AFP members invested over USD 8.8 billion in projects across the continent. [58] This is mainly attributed to the collaboration that enabled greater cooperation and co-financing. This means that they worked jointly on assessment and evaluation of private sector projects across the continent. This is a significant attempt to effectively use donor resources in Africa and to attract greater private sector investment for private sector projects on the continent with strong development outcomes. DFIs worked on Main One Cable a project in Nigeria in 2009 and coordinated a platform for the Joint IFI/DFI Action Plan to respond to the financial crisis in Africa and with a target mobilization of USD 15 billion.[59] Similarly, the DFIs hope to

[58] African Development Bank, *"African Financing Partnership Launched by Leading Development Financial Institutions"*, May 2010, p.15
[59] Ibid.

finance projects in countries such as Sierra Leone and Côte d'Ivoire, in sectors such as infrastructure, power, renewable energy and agribusiness. [60]

3.2 Barriers to Private Sector Growth in Africa and DFIs

There are various challenges facing the private sector which hinder growth. One of the critical one is access to finance where a company is seeking to expand and have no collateral to borrow from commercial banks. Even with rapid changes in technology, access to technology and business information is a threat to the companies seeking to improve their performance amidst competition. While businesses need money and capital to grow, private companies in developing countries have no access to loans and deposit services.[61]

Access to finance becomes a bigger challenge in countries that are not attractive to invest due to prevailing country conditions. In some of them there are no proper credit ratings which make it difficult for private financial institutions to invest. A few countries in Asia are considered good to invest in while in Africa, Botswana, Libya, Morocco, South Africa, and Tunisia are among the top for consideration for investments.[62] This means most of the countries in Africa are either rated as non-investment grade or are not rated at all. Absence of a credit rating tends to increase the cost of borrowing, further discouraging private investors.

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[60] African Development Bank, *"African Financing Partnership Launched by Leading Development Financial Institutions"*, May 2010, p.28
[61] IFC. *"Expanding Financial Services in Africa"*. 2010 http://www.ifc.org/ifcext/africa.nsf/Content/Expanding_FinancialServices.
[62] S&P. (2010): *"Sovereigns ratings. Standard and Poor's."*:http://www2.standardandpoors.com/portal/site/sp/en/eu/page.topic/ratings_sov/html.

A good example is in Sub-Saharan Africa where it's estimated that up to a maximum of 25% of households have a formal relationship with a financial institution.[63] Another issue is interest rates where Africa has an average of 8% with some African countries at 25%, compared to a global average of 5%.[64]

The private sector also relies on an enabling environment to grow. Government regulatory frameworks, good infrastructure and good trade conditions among other things are crucial to private sector development.[65] Regulation and oversight have an impact on what is required to start a new business. Business permits necessary, taxes payable and how easy it is to enforce contracts and partake in international trade are governed by individual country regulations.[66] Corruption inhibits private sector development whether at local or regional and national levels.

The presence of good public and private infrastructure, such as access to electricity, water supply, paved roads and telecommunications cannot be over emphasized in order to stimulate private sector growth. Enterprise Surveys show that private businesses in developing countries often rate a lack of adequate infrastructure as one of their greatest problems.[67]

According to Eberhard, A., et al., it is estimated that the upgrading of a trans-national Sub-Saharan Africa road network could triple the volumes of trade over land annually.[68]

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[63] IFC.(2010), "*ExpandingFinancialServicesinAfrica*".http://www.ifc.org/ifcext/africa.nsf/Content/Expanding_FinancialServices.
[64] World Bank (2010) "World Bank Annual report". pg 12
[65] OECD.(2006): "Promoting pro-poor growth private sector development":http://www.oecd.org/dataoecd.pdf.
[66] World Bank and IEG. (2009): "Doing Business: An Independent Evaluation.":http://web.worldbank.org.html.
[67] World Bank. (2009) pg 13
[68] Eberhard. A., et al. (2008): "Underpowered: The State of the Power Sector in Sub-Saharan Africa": Background paper. Africa Infrastructure Country Diagnostics (AICD). World Bank.

3.3 European DFIs Funding Africa

DFIs' primary contribution to development comes in providing finance to segments of the private sectors in developing countries that are underserved, thereby increasing employment opportunities, income, tax revenue, product availability[69]. The companies that the DFIs invest in help to lift skill levels and facilitate the transfer of technology and knowledge through DFI participation in the management and development of the companies.

One of the approaches of the European DFIs is to invest in private sector projects that not only have development impact but are also financially viable.[70] In making investments they are guided by the need to go where other investors have not reached. They also aim at paving the way for others to follow as well as ensuring that they create sustainable businesses that have long-term viability. This investment approach allows the DFIs to provide access to finance for the private sector in countries where this is a prerequisite for economic development and poverty alleviation.

The European DFIs have a long track-record of investing in private sector projects in developing countries such as Africa. They have accumulated a lot of experience from decades of investment activity with many having been around since the 1960's and 1970's.

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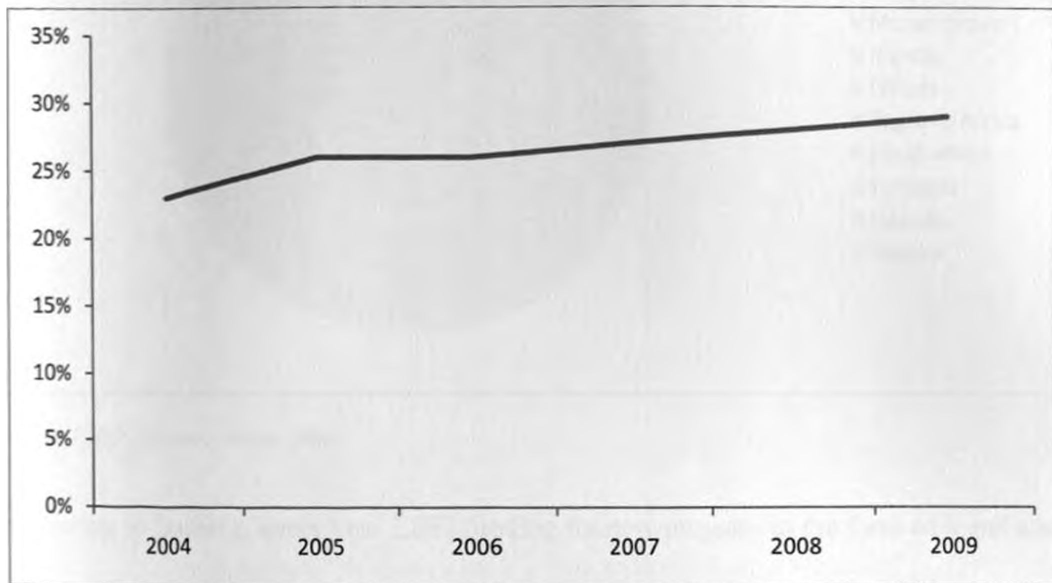
[69] The world Bank report, *"Access Finance"* Issue no.30, 2010, p.17

[70] UN. (2009): "Millennium Development Goal 8 Strengthening the Global Partnership for Development in a Time of Crisis. MDG Gap Task Force Report 2009":http://www.un.org/millenniumgoals/pdf/MDG_Gap_%20Task_Force_%20Report_2009.pdf.

The combined global investment portfolio of all EDFIs amounted to approximately USD 25 billion by the end of 2008. The funds were invested across low and middle income countries, Africa being the largest region with approximately 28% of the portfolio.[71]

Graph 4: FMO Committed Portfolio in Africa as the end of 2009

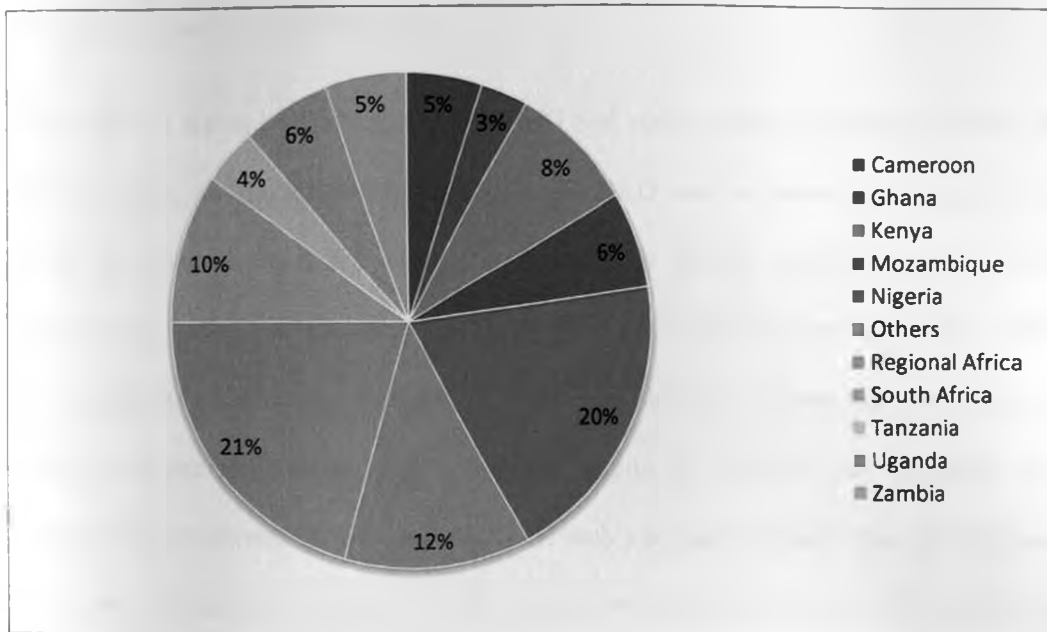


Source: FMO Annual Returns 2009

Graph 4 shows that FMO's funding to Africa have increased over the years from 2004 to 2009. They have continuously focused on low-income countries in Africa, as these present the highest potential development impact, although they must take on higher risks to do so. One of their biggest challenges in the African countries is finding clients with good business practices[72]. Chart 7 below show the breakdown of FMO's Africa portfolio by country and the respective percentage invested in the various countries.

[71] Dalberg. (2010): "The Growing Role of the Development Finance Institutions in International Development Policy", *Dalberg Global Development Advisors, Copenhagen Publication*.p.8
[72] FMO, Annual Report 2009.

Chart 7: FMO Investments by Country as at end of 2009



Source FMO Annual returns 2009

According to Dalberg, every year EDFI funding for new projects in the form of loans and equity investment is approximately 6% of Official Development Assistance provided by the governments of the DFIs' 14 home countries.[73] Successful projects also make financial returns and eventually return the invested capital, which can then be reinvested in new projects. Through this process, the total combined portfolio of the European DFIs has roughly doubled in the last ten years.

In June 2009, IFC, DEG, African Development Bank, and the Bill and Melinda Gates Foundation launched the Africa Health Fund. a new private equity fund that invests in Africa's health sector. The fund, managed by Aureos Capital, invests in SMEs in SSA, such as health

[73] United Nations. "The Millennium Development Goals Report 2009", pg 48

clinics and diagnostic centres, with the goal of helping low-income Africans gain access to affordable, high-quality health services.

According to a report by Dalberg (2010), FMO and some twenty partners including six other EDFI members, multilaterals ADB, IADB, and EBRD and commercial banks in Africa and Europe have pooled funds and created a fund which allows investors to cover their local currency risks, called The Currency Exchange Fund (TCX), thus providing a loss buffer. TCX service offerings are extremely valuable to investment partners in emerging markets and serve to catalyze long-term lending in local currencies despite the inherent risks in these non-liquid emerging market currencies. The importance of such a service for public and private investors is underscored by increased currency volatility related to the financial crisis. Although the on-going crisis created a challenging business environment, TCX's performance indicates that it has been well positioned to absorb currency shocks in a global crisis. TCX's monthly report for December 2009 indicated a profit of USD73 million for the year which exceeded the losses amounting to USD 65 million incurred in 2008 as a result of the financial crisis and the sharp appreciation of the US dollar. TCX is especially important for the microfinance sector, which is the largest beneficiary of its products, having absorbed nearly 40% of the nominal value of TCX's transactions[74].

African continent is the focus of intense activity by emerging sovereign actors. Capital risk funds, backed by bilateral groups and banks of OECD countries such as the English CDC Group, the Dutch FMO, or Scandinavian funds such as the Danish IFU, Norwegian Norfund, Finnish

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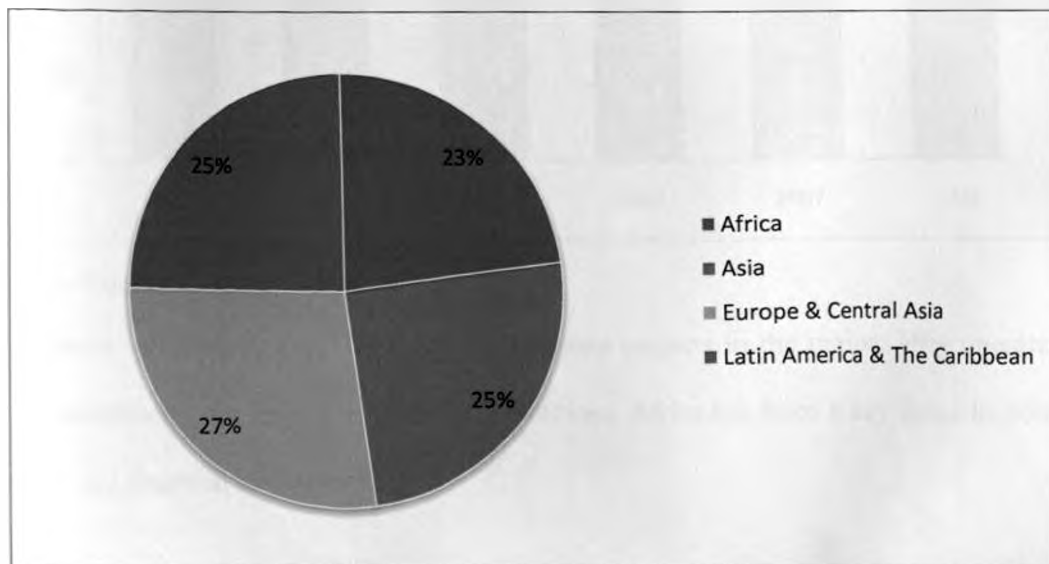
[74] IFC (2010), *"Expanding Financial Services in Africa"*, http://www.ifc.org/ifcext/africa.nsf/content Expanding_FinancialServices. p.7

FinnFund or Swedish SwedFund, are also expanding initiatives towards emerging countries, including Africa. Thus in 2009, the private equity firm Actis, raised USD750 million for an infrastructure fund in Latin America, Asia and Africa. The South African fund Convergence also raised USD500 million to invest in telecommunications in Africa. From France, in 2003 and 2009, CDC Enterprises and PROPARCO launched two funds to invest notably in North Africa.

Another significant project of long-term financing in Africa and in the domain of infrastructure is the Emerging Africa Infrastructure Fund, created at the start of the 2000s and endowed with more than USD500 million. Born from the drive for co-operation between the English (DFID), Dutch (FMO), Swiss (SECO) and Swedish (SIDA), this fund also brings together private and public African institutions, notably South Africans from the Develop Bank of Southern Africa and Standard Bank of South Africa.

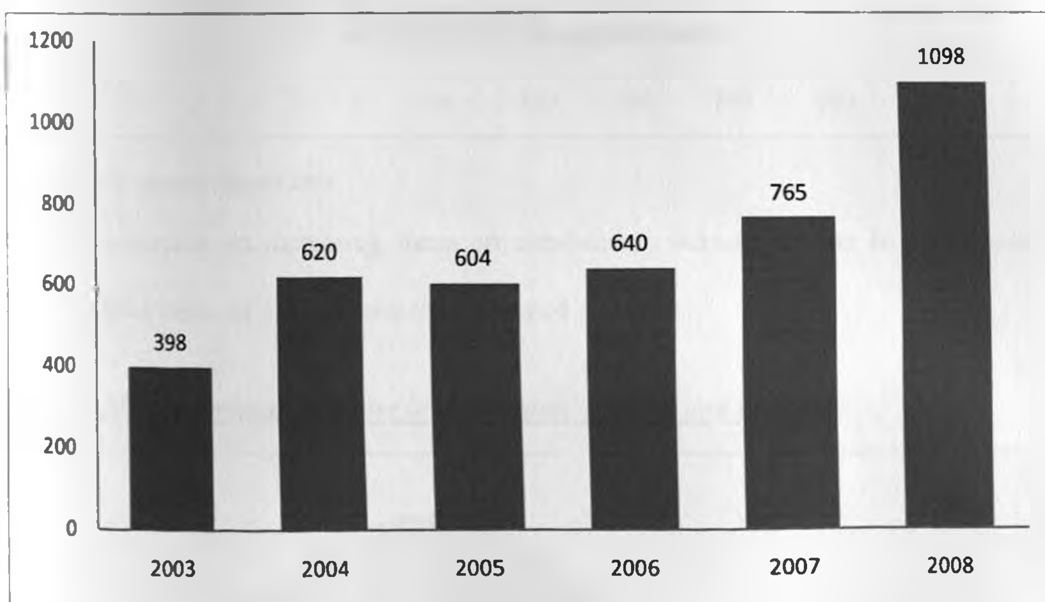
Chart 8: FMO Total Committed Portfolio as the end of 2009



Source: FMO Annual Reports 2009

FMO has placed equal priority to all the regions they have chosen to invest in. Africa has taken up 23% of the portfolio of investments as shown above in chart 8. This has been increasing over the years as noted in Graph 5 below. The amount has increased three fold from 2003 to 2009. This is a significant achievement as a major part of their role in development is can only be achieved once they have improved standards of living in Africa. This will go a long way in achieving the millennium development goals.

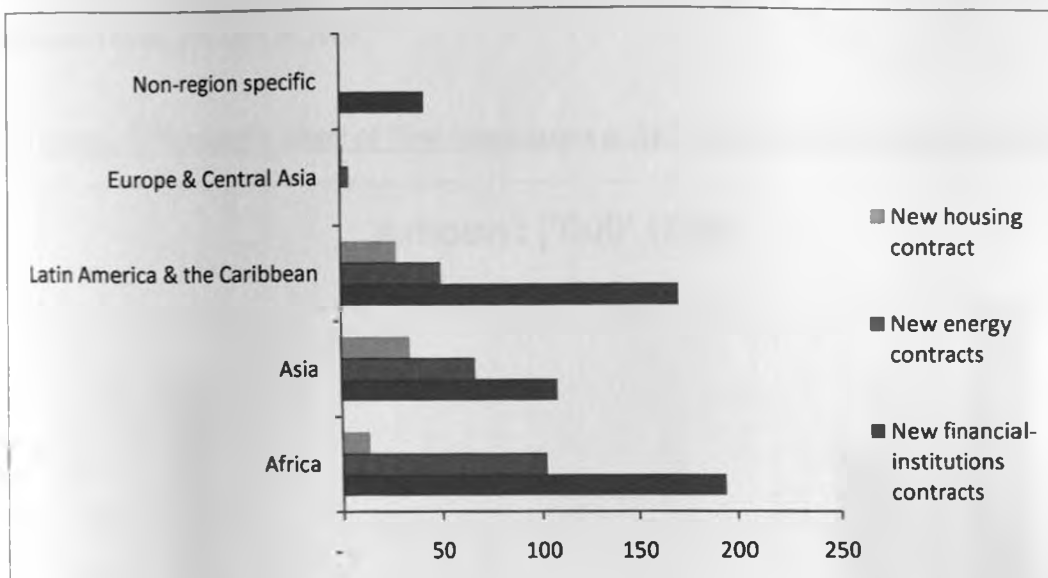
Graph 5: FMO's Funds in Africa between 2003 and 2008



Source: FMO Annual Returns 2009

As shown in Graph 6, FMO has been funding new projects in the regions they operate in. The new investments are mainly in financial institutions. Africa has been a key focus in both energy sector and financial institutions.

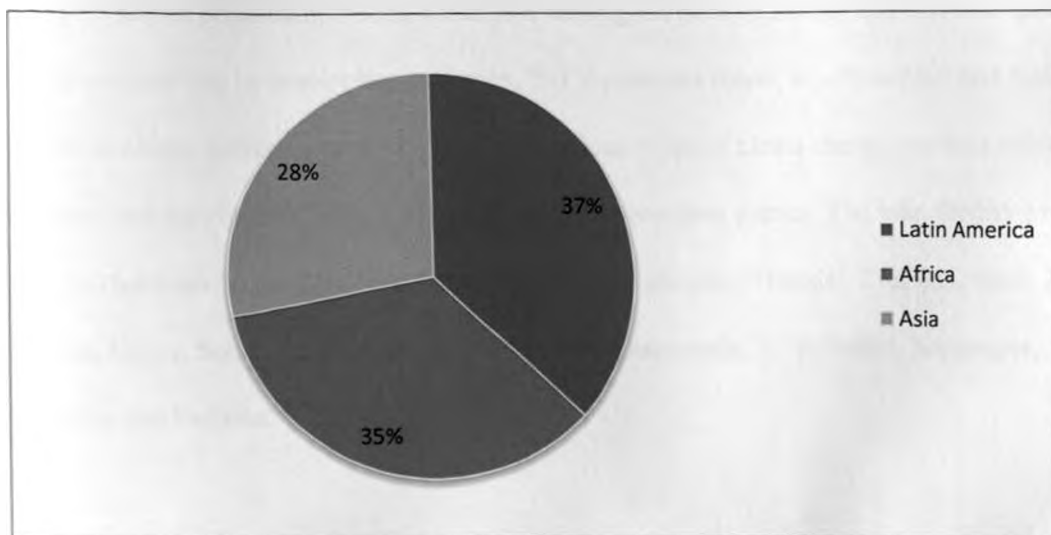
Graph 6: New Investments per Sector in the region as the end of 2009



Source: FMO Annual Report 2009

Norfund maintains an increasing focus on sub-Saharan Africa. As can be seen from Chart 9 below, Africa takes up 35% of their total invested portfolio.

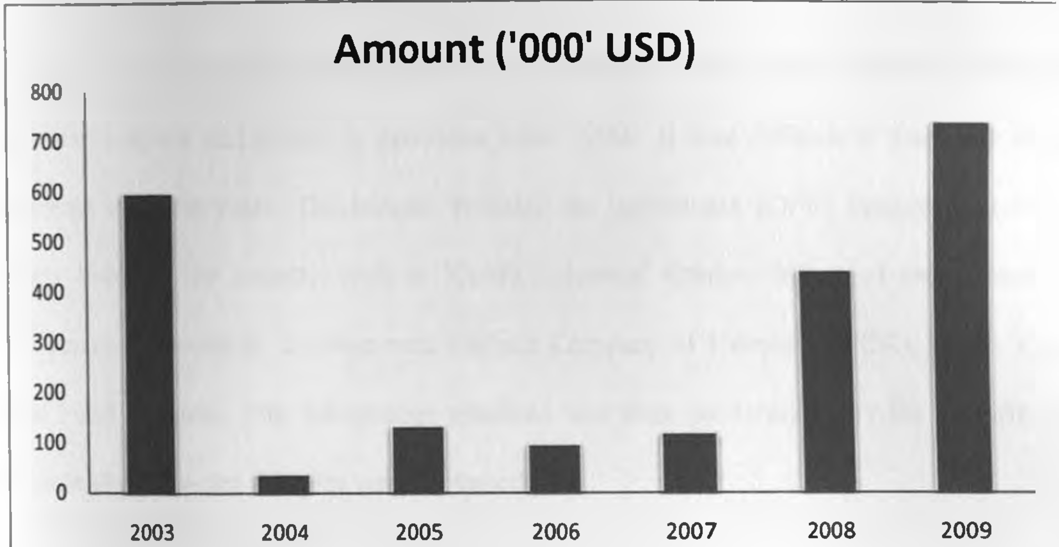
Chart 9: Norfund's total Portfolio in the Region as at the end of 2009



Source: Norfund Annual report 2009

A total of 78 per cent of the new investment agreements signed in 2009 were in Africa, compared to 60 per cent in 2008.[75]

Graph 7: Norfund's Share of New Investments in Sub Sahara Africa at the end of 2009



Source: Norfund Annual Report 2009

In 2009 Norfund invested in E+Co, which is a leading investor in small- and medium-sized energy corporations in developing countries. E+Co provides loans, equity capital and business support to energy entrepreneurs who invest in various types of clean energy, such as solar power, efficient cooking systems, biogas and small-scale hydropower plants. The loan facility provided from Norfund can be used for investments in Ghana, Tanzania, Senegal, Ethiopia, Mali, Zambia, Uganda, Kenya, South Africa, Lesotho, Costa Rica, Guatemala, El Salvador, Nicaragua, Honduras and Panama.[76]

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[75] Norfund, Annual Report 2009, p.16.
[76] Norfund Annual report 2009, p.31

CHAPTER FOUR: EUROPEAN DEVELOPMENT FINANCE INSTITUTIONS AND PRIVATE INVESTMENT IN KENYA

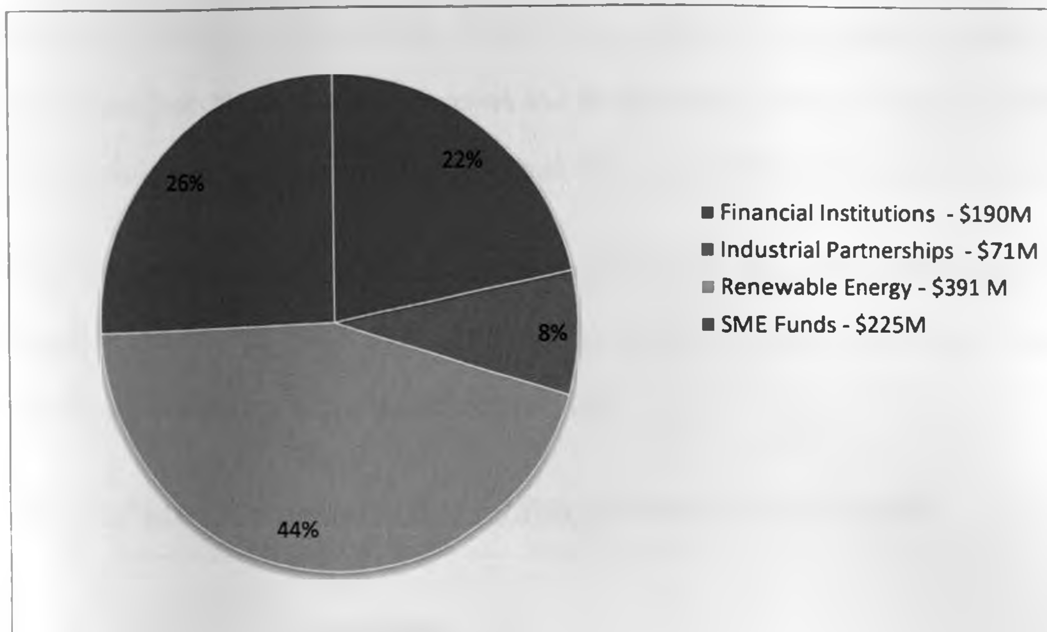
Introduction

The research was conducted on how members of European DFI have contributed positively to economies in Africa and Kenya in particular since 1990. It was difficult to find data on their investments over the years. The sample included the institutions (DFIs) through which EDFI channels funds to the country such as Kenya Industrial Estates, Industrial and Commercial Development Corporation, Development Finance Company of Kenyan (DFCK), Fanisi Venture Capital Fund et cetera. The information obtained was from publications by the specific DFIs. Some data was collected from the country based DFIs.

4.1 Norfund Investments in Kenya

As of year-end 2009 Norfund's total portfolio of investments constituted USD 877 million, where USD 641 million represented net disbursements to the investments. Norfund's portfolio comprises a total of 81 investment projects distributed in four investment areas namely Financial Institutions, SME Funds, Renewable Energy and Industrial Partnerships. Chart 10 below represents the split of the total USD 877 million by the end of 2009 between the various areas of investments.

Chart 10: Norfund Investment instruments of investment as the end of 2009



Source: Norfund Annual Report 2009

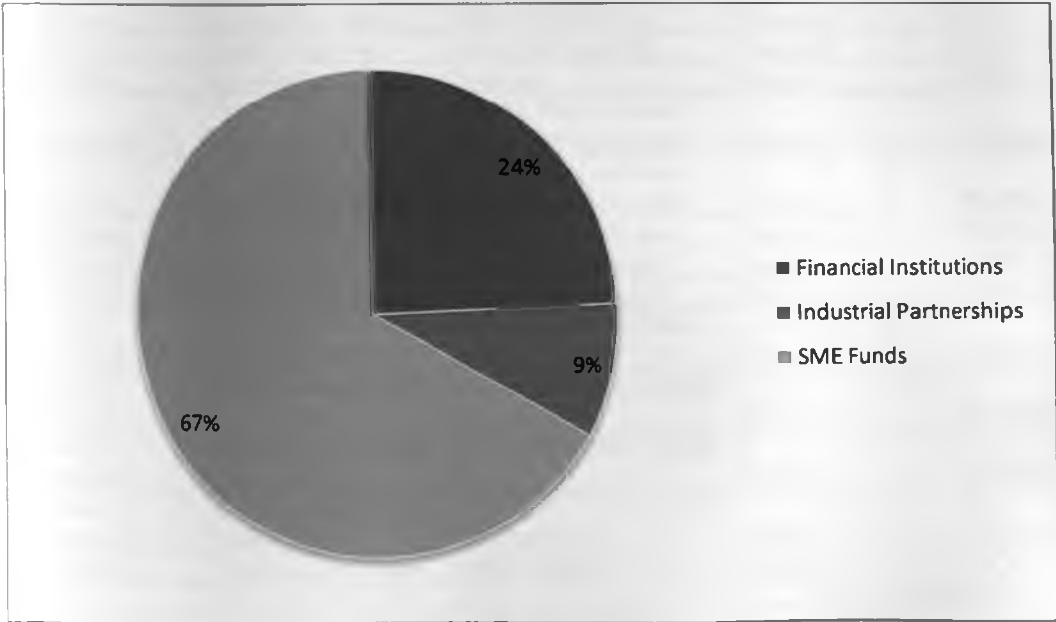
Norfund has a strong focus on the renewable energy sector. They believe that prosperity is strongly linked to access to electricity thus a reliable power supply is a prerequisite for establishing and developing the manufacturing and commercial sectors. Norfund's strategy is to mobilize sound technical partners while at the same time diversifying its portfolio. They invested in renewable energy intended to improve and boost electricity production with the aid of environmentally friendly energy sources, thereby providing a sounder basis for economic development. This is seen where they invested in SN Power.

Financial institutions of which Norfund has invested 22% of their funds include banks, microfinance institutions and other financial institutions in poor countries. The main objective is to extend reliable financial services to small and medium-sized enterprises (SMEs) and individuals who do not have access to these services today.

On SME funds, Norfund has invested 26% of their total funds in Funds that invest in SMEs. They invest directly in private equity funds aimed at SMEs in developing countries thereby strengthening both the companies themselves and the local capital market. Industrial partnerships invest in projects in sectors other than energy and finance in southern and eastern Africa.

Chart 11 illustrates the level of Norfund investment in Kenya. According to the table, Norfund, through its agencies had invested USD 32.3 million on Kenyan private sector firms. These funds were by way of Equity, loans or through SME funds.

Chart 11: Norfund's Sector Investment Portfolio in Kenya as the end of 2009



Source: Norfund Annual Report 2009

The SME funds have further invested in private companies in the Kenya. The table 2 below shows a breakdown of these SME Funds' investments in Kenya.

Table 2: Norfund Investments in Kenya

Department Code	Name	Name of Sub Project	Country	Committed Currency (USD)
SME Funds	Aureos Africa Fund	Brookside Dairy	Kenya	18,708,660.00
SME Funds	Aureos Africa	Seven Seas	Kenya	5,000,000.00
SME Funds	Aureos East Afica	Primefuels Ltd	Kenya	2,000,000.00
SME Funds	Aureos East Africa	Primefuels Ltd	Kenya	2,000,000.00
SME Funds	Aureos East Africa	Safepak	Kenya	2,230,103.00
SME Funds	Aureos East Africa	Safepak	Kenya	1,052,630.00
SME Funds	Aureos East Africa	Athi River Steel Plant Ltd	Kenya	5,475,739.00
SME Funds	Aureos East Africa	Athi River Steel Plant Ltd	Kenya	1,379,000.00
SME Funds	Aureos East Africa	Ovidian	Kenya	4,235,000.00
SME Funds	Aureos East Africa	Cable Holdings Ltd	Regional	2,768,909.00
SME Funds	Aureos East Africa	Cable Holdings Ltd	Regional	2,961,443.00
SME Funds	Aureos East Africa	Deacons	Kenya	600,000.00
SME Funds	Aureos East Africa	Porini (Game watchers Safaris & Porini Camps)	Kenya	165,000.00
SME Funds	Aureos East Africa	Porini (Game watchers Safaris & Porini Camps)	Kenya	460,000.00
SME Funds	Aureos East Africa	Bank of Africa Kenya	Kenya	4,670,000.00
SME Funds	Aureos East Africa	Micro Africa Limited	Kenya	500,000.00
SME Funds	Aureos East Africa	Micro Africa Limited	Kenya	540,000.00
Industrial Partnerships	European Financing Partners SA	42-KE-PRO-0708 - Rabai Power	Kenya	136,051.02
Industrial Partnerships	European Financing Partners SA	37-KE-FMO-1107 - Equity Bank Limited	Kenya	341,489.83
Industrial Partnerships	European Financing Partners SA	12-KE-DEG-0405 - Olkaria III	Kenya	243,921.30
Industrial Partnerships	European Financing Partners SA	GroFin Kenya	Kenya	913,264.00
SME Funds	GroFin Africa Fund	GroFin Kenya	Kenya	913,264.00
Total				**57,294,474.15**
Mean				**2,604,294.28**
Median				**1,215,815.00**

Source: Norfund (2009)

According to David study on Kenyan financial markets International Finance Institutions have played a major role in economic growth. From David's perspective, IMF/World Bank Financial

Sector Assessment Program (FSAP) introduced benchmarking of financial system, World Bank and DFID supported reforms so as to create enabling environment for financial sector development through a Government Financial and Legal Sector Technical Assistance Project; World Bank, DFID, SIDA supported the Financial Sector Deepening (FSD) Trust to sustain market driven financial inclusion which funds the FinAccess Survey and is supporting a number of initiatives to build inclusive markets at the sectoral and retail levels.[77] MESP Trust and Jitegemee Trust provides wholesale finance to low-income market oriented retail providers and Making Finance Work for Africa initiative shares insights and undertake benchmarking.

4.2 Netherlands Development Finance Company (FMO)

The Netherlands Development Finance Company (FMO) is the international development bank of the Netherlands. FMO invests risk capital in companies and financial institutions in developing countries. With an investment portfolio of USD5.7 billion, FMO is one of the largest bilateral private sector development banks worldwide. FMO is able to take risks which commercial financiers are not yet prepared to take because of its relationship with the Dutch government. FMO's mission is to create flourishing enterprises, which can serve as engines of sustainable growth in their countries.

In Kenya it partners with financial institutions such as Equity Bank a client and partner of FMO. Equity Bank is one of the largest banks in Kenya and the leading MFI, serving 3.3 million micro and small clients with total assets in excess of USD1 billion. FMO has provided two loans

[77] David, P. The Access Frontier as an approach and tool in Making Financial Markets Work for the Poor, *FinMark Trust* (2005)..

to Equity Bank Kenya totaling USD53 million and seeks to further support Equity Bank in its regional expansion and low income housing endeavors. [78]

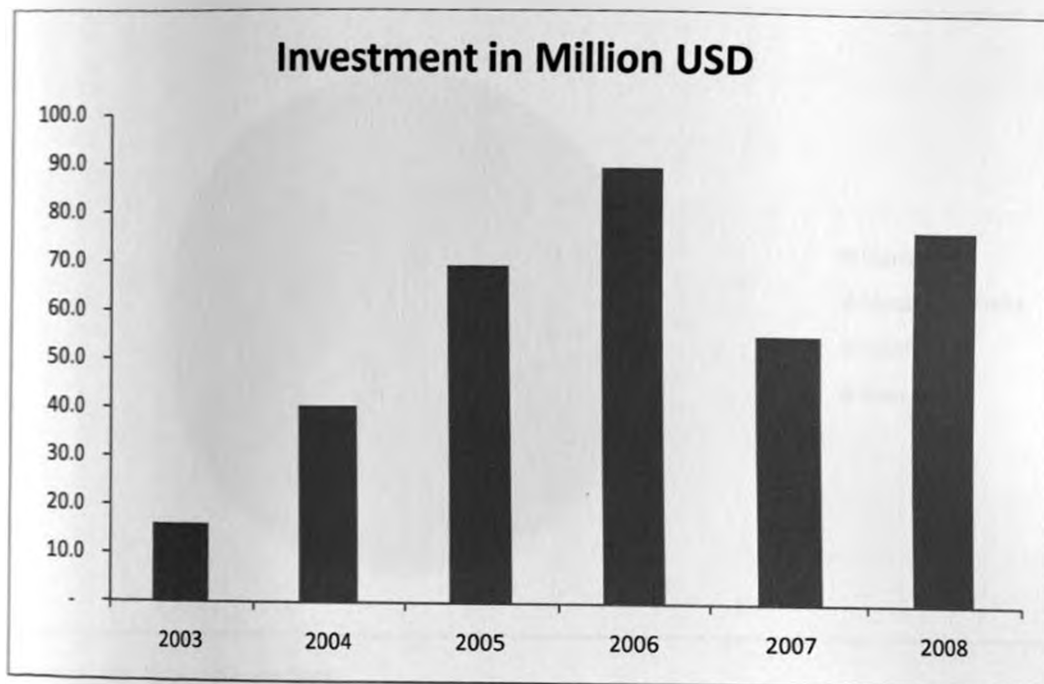
Through K-Rep Bank, FMO facility has lead to increased access to financial services for people who are now under-serviced in Kenya. The bank currently services many deposit-clients and has many lending customers of which the vast majority women. FMO injected USD 7 million by 2007 as loan to the Bank.

It has also partnered with Bank of Africa to provide long term funding for the Bank's SME, consumer and mortgage lending activities. This will enable SMEs to grow, create employment and improve private individuals' living standards.

According to FMO country by country portfolio in Kenya, by the end of 2009 it had an investment portfolio worth approx. USD 80 million. This has been growing steadily save for 2007 where the amount was low. A breakdown of trend in investments in Kenya between 2003 and 2008 is presented below:

[78] Mwangi, J. & van Kampen, G. (2009). FMO client Equity Bank Kenya launches banking operations in Uganda, at launch Equity Bank Uganda on 30 March 2009.

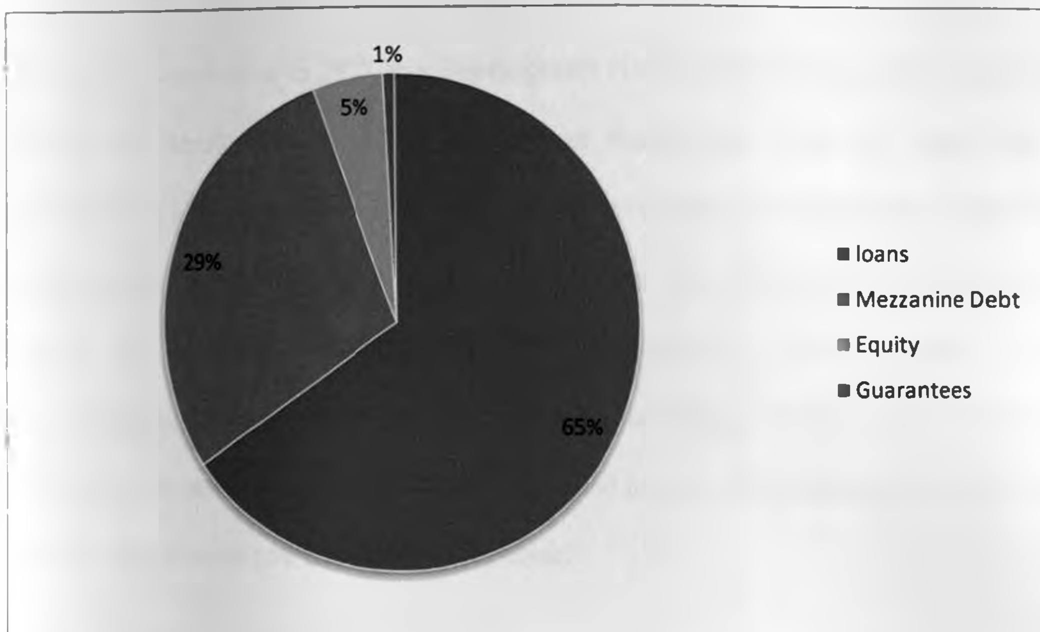
Graph 8: FMO Investments in Kenya from 2003 - 2008



Source: FMO Annual Report 2009

The graph 8 suggests that FMO has increased its investments in Africa and in Kenya. From the total investment in Kenya, 65% was given in the form of loans. This shows that FMO prefers loans as a mode of investment compared to equity and guarantees. This is illustrated in chart 12 below;

Chart 12: FMO Committed Portfolio by Instruments in Africa as the end of 2009



Source: FMO Annual Report 2009.

An analysis of their investment in Africa by country indicates that it has invested 8% of their funds in Kenya. Nigeria and Zambia have the largest share.

Rabai Power Project in Kenya was recently awarded African Power Deal of the Year by Project Finance Magazine. This project comprises the development, construction and management of a 90 Megawatt thermal power plant in Kenya. FMO played an important role in the realization of this transaction. Other investors are bilateral financial institutions DEG and PROPARCO, as well as the Emerging Africa Infrastructure Fun. [79]

[79] http://www.fmo.nl/smartsite.dws?ch=DEF&id=1473

4.3 PROPARCO

PROPARCO was created in 1977 as a Development Financial Institution partly held by Agence Française de Developpement (AFD) and private shareholders from the North and South. PROPARCO's aims at being a catalyst for private investments in developing countries which targets growth, sustainable development and reaching the Millennium Development Goals (MDGs). It favours operations which are economically viable, socially equitable, environmentally sustainable and financially profitable. Its strategy on investing in various sectors is tailored to the level of a country's development and focuses on the productive sector, financial systems, and infrastructure and equity investment.

PROPARCO invests in a geographical area ranging from major emerging countries to the poorest countries, in particular in Africa, and has high-level requirements in terms of Social and Environmental Responsibility. It has a wide range of financial instruments including loans, equity, guarantees and financial engineering to meet the specific needs of private investors in developing countries.

It has developed a systematic impact measurement tools which is used to pre-select project financing and used throughout the project life to monitor the investment. PROPARCO has a team of 150 people, 10 regional offices and is supported by 50 AFD Group agencies worldwide. It does not have an office in |Kenya and therefore was difficult to obtain data on their investments in Africa. The following are some of the private companies that they have so far invested in.

FANISI Venture Capital Fund

PROPARCO invested USD 10million in Fanisi Venture Capital Fund in 2009 alongside other EDFIs namely Norfund and Finnfund.

Fanisi Venture Capital Fund is a Fund that aims to promote SME financing in East Africa by supporting financial intermediation. It aims to invest in roughly in 12 small and medium-sized enterprises in Kenya and the sub-region countries i.e. Rwanda, Uganda and Tanzania.

Fanisi made an initial investment of USD 2.5 million in Craft Silicon in 2009. Craft Silicon is a company based in Nairobi that produces financial software for the banking and microfinance sectors and has roughly a hundred clients in over 38 countries.

Geothermal Power Plant

PROPARCO allocated a 15 million dollar direct loan to finance Olkaria III project. It was initially built by Ormat Group as a 13MW geothermal power. It is the only privately built and operated geothermal power plant in Africa. In 2008, Ormat and Kenya's electricity utility KPLC agreed to raise the capacity of Olkaria III to 48 MW. It complies with World Bank environmental and social standards and is currently being registered under the Clean Development Mechanism (CDM). This is Kenya's first, and by extension Africa's first, private geothermal energy production project. The Olkaria III project aims to help create an accessible and reliable energy sector and in particular the electricity sector. Energy is essential for the country's future economic development and growth without which the industrialization dream

may not be achieved.[80] To Increase the capacity of the power plant financing from several European financial institutions was sought of which PROPARCO injected USD 15Million.

AFD in East Africa

PROPARCO assisted AFD's in Kenya where it has financed investments to improve water and sanitation services. Today AFD is working with the Water Service Boards of Kisumu, Nairobi and Mombasa. With a portfolio of ongoing and completed projects amounting to approx.USD 100million. AFD is one of the key development partners in the water sector and therefore plays a central role in the coordination of development partners in Kenya, supporting the establishment of a sector wide approach (SWAp). Furthermore, AFD is also financing programmes for the management of solid waste. It is also the Kenyan Government in all segments of the energy sector, providing financing to the Government and private companies through PROPARCO.

Since 1995, PROPARCO has commitments totaling USD 143Million in support of small and medium enterprises either through direct loans to companies, or credit lines to commercial banks. Some of the beneficiaries of the financing include Barclays Bank of Kenya, NIC Bank, and I&M Bank. PROPARCO is also financing the agro industry mainly tea and confectionaries, handling at the port of Mombasa and is currently preparing a project for financing an electricity co-generation plant.

4.4 DEG

DEG is a member of KfW Bankengruppe (KfW banking group) and was founded in 1962. Its mission is to finance investments of private companies in developing countries. As one of

[80] www.proparco.fr/jahia/Jahia/site/proparco/lang/en/pid/19304

Europe's largest development finance institutions, it promotes private business structures to contribute to sustainable growth and improved living conditions.

DEG aims to contribute to the attainment of the Millennium Development Goals by being a reliable finance partner for enterprises that undertake investments. It also focuses on these investments producing positive effects in the developing countries. In Kenya, DEG has funded the following investments:

DEG Finances Rose Grower in Kenya

DEG provided Panda Flowers Limited, a company which cultivates roses for export on 40 hectares of greenhouse space. It was given a long-term loan of approx. USD10 million for expansion of their investment.[81]

DEG had granted USD20 million for rose and lily projects in Kenya over a two years period ending 2009. Apart from Panda Flowers Ltd, five further lessees were using the Flower Business Park, among them Kreative Roses Kenya Limited had expanded its business and was granted a loan by DEG in 2005 for expansion.

DEG's investment in horticulture sector as a developmental impact as this is one of the major currency-generating enterprises of Kenya. It has also employed many people on the flower farms. Since these are mainly unskilled or little qualified workers from the neighbouring regions, the project contributes to poverty reduction. The financing of private investments with positive developmental effects in Africa is a strategic business field of DEG. In 2005, DEG invested 108 million Euros in Africa, the highest ever annual financing volume for this continent.

[81] http://www.deginvest.de/EN_Home/About_DEG/index.jsp

DEG Participates in a Kenyan Commercial Bank

In 2007, DEG and PROPARCO jointly invested USD 5.4Million in Investment and Mortgages Bank Ltd. (I&M). The investment was meant to strengthen the bank's equity base and thus enable its further growth. I&M Bank is one of the local Kenya Banks and it offers a broad range of corporate and retail banking products and services addressing primarily medium-sized corporations which play a key role in Kenya's economy. The participation DEG and PROPARCO in a local bank was viewed as a good signal for local and international investors.

DEG Finances Geothermal Power Plant

In 2009, DEG together with KfW Entwicklungsbank (KfW Development Bank) provided Orpower 4 Inc. (Orpower), the owner and operator of the Olkaria III geothermal power plant in Kenya, with a long-term loan to the amount of 40 million US-dollars. Furthermore, DEG structured and arranged the complete debt financing of 105 million US-dollars. With this project, DEG and KfW supports the utilisation of renewable energy in a focus country of the German development cooperation, thereby making a significant contribution to climate protection. Other investors in the same project include the European Finance Partners (EFP), a financing vehicle of 13 European Development Finance Institutions (EDFIs) and the European Investment Bank (EIB), Emerging Africa Infrastructure Fund (EAIF), PROPARCO as well as FMO.

Geothermal investment is in line with DEG's climate protection policy and an important business area of DEG.

Financing to Combat Malaria

Given the high mortality rate owing to malarial infection. Kenyan enterprise, Botanical Extracts EPZ Limited, cultivates the shrub *Artemisia annua* and processes it to artemisinin (Artemisinin is an essential basic substance for the production of antimalarial drugs). IN 2008, DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, provided the Enterprise with a subordinated long-term loan of 3.2 million Euros for the expansion of its production facilities. Further lenders were the World Bank Group member IFC, Acumen Fund and Industrial Promotion Services Kenya. The total investment volume was 30 million US-dollars.

The lenders involved, among them DEG, safeguarded further financing of the project given that private investments with positive developmental effects is its strategic business field. In 2007, DEG invested 187 million Euros in Africa, the highest ever annual financing volume for this continent.[82]

[82] http://www.deginvest.de/EN_Home/Press/Press_archive/2008/20080417.jsp

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

This chapter present summary of data findings, conclusions based on the findings and recommendations there-to. The chapter also presents recommendations on further studies.

5.2 Summary

From the data findings presented in the previous chapters, the following were significant. The study found that European DFI has contributed to development in Africa by providing funding to the Africa region and this has been growing over the years from 2000 to 2009. This has contributed to economic growth by providing finance to segments of the private sectors that have development impact, lifts skill levels and facilitate the transfer of technology and knowledge through participation in the management and development of the companies. According to the findings, investments within the country taking an example of Norfund alone amounted to USD 57 Million.

The study also established that European DFIs investment portfolio amounts since 2000 approximates USD 25 billion with Africa getting 28% of it. In addition to equity financing, EDFI members, multilaterals ADB, IADB, and EBRD and commercial banks in Africa have encouraged private investments by pooled funds which allows investors to cover their local currency risks called The Currency Exchange Fund (TCX).

The study also found out that European DFIs focus their investment strategies according to their areas of expertise, with varying degrees of sector and geographic diversification. In 2009, seven of the European DFIs held more than 50% of their portfolio in one sector and eight held more than 30% in one region. The DFIs diversify their portfolio to varying degrees, with a tendency to diversify more on one dimension than others.

Norfund focuses on Renewable energy sector while FMO on the other hand focus on financial sector. By the end of 2009, FMO they had 58% of their total investments in the financial services sectors while Norfund had 44% of their portfolio in renewable energy sector.

On the financial instruments, the trend among EDFI members is equity based financing. However, depending on the organization various EDFIs have different strategies on the instruments they will use to provide the funding. Both Norfund prefers using equity to structure their investments and by the end of 2009 they had 66% of their portfolio funded in the form of equity. FMO prefer loans where they had 66% of portfolio in Loans.

5.3 Conclusions

Based on the findings and research objectives, conclusions can be made on how effective EDFIs have been as intermediaries for targeting credit to priority groups, the study established that EDFIs do advance credits for private investments by way of loans and equity in four investment areas: financial institutions, SME funds, renewable energy and industrial partnerships. Starting up from scratch by entrepreneurs involves high risk. New project often face challenges in attracting private capital, but may have a greater chance of making huge profits and as a result

have a positive development impact. Start up enterprises is important to EDFIs and therefore would take up the risk to fund the projects and support the entrepreneurs.

On European DFIs investments in Africa and have investments in Kenya, the study established that EDFI's members have contributed a lot by extending reliable financial services to small and medium-sized enterprises (SMEs) and individuals who do not have access to these services today generally in Africa but more so in Kenya. Norfund for instance has benefitted groups such as Safepak, Primefuels, Seven Seas, Brookside Dairy, Athi River Steel Plant Ltd, Ovidian, Cable Holdings Ltd, Deacons, Porini (Game watchers Safaris & Porini Camps), Bank of Africa Kenya, Rabai Power, Olkaria III, GroFin Kenya, to name but a few. This has ensured sustainability as most of the services are meant for development purposes and others help those locked from reaching formal financial institutions access credit. It can also be concluded that DFIs, aid agencies and development banks do complement each other in addressing the breadth of challenges to financial access in Kenya. For example, EDFI uses country based DFIs like KIE, DFCK and ICDC to extend their financial tentacles to those not reached by financial infrastructure before and also finance private investments.

On whether European DFIs target financial institutions sector, the research found that each EDFI has a preferred sector to target depending on their specialization and skills available. In the case of Norfund, it has a strong focus on the renewable energy sector. They believe that prosperity is strongly linked to access to electricity thus a reliable power supply is a prerequisite for establishing and developing the manufacturing and commercial sectors. FMO on the other hand has placed a lot of emphasis on financial Services sectors. Other like PROPACO and DEG has their main focus as well depending on their objectives.

On European DFIs extending loans as a preferred instrument of financing, it's evident from the research that the different EDFIs have different ways of structuring the funding to meet their objective and give them the expected return. Norfund for instance have issued their finances in the form of Equity where as FMO have disbursed their funding in the form of loans.

These institutions have extensive experience operating across developing countries and emerging markets and share a joint interest in financing climate change and climate efficiency projects with the aim of creating a portfolio of climate friendly private sector investments in target countries. They have sought to demonstrate the financial attractiveness of climate-friendly projects to private sector investors in developing countries and emerging markets and have committed to act as catalyst lead investors to attract additional long-term investments. The institutions will further promote use of clean technology as an integral part of economic development and provide long term financing for renewable energy projects in countries facing acute energy shortages and restricted energy access, further contributing to economic development.

Many EDFI have place emphasis on private investment in African countries. The evidence collected in this study supports this view. One way in which EDFIs can have a positive impact on growth is by enhancing domestic capital accumulation. In particular, African countries have benefited from measures aimed at promoting domestic private investment given that a strong investment performance will serve as a sign of high returns to capital, which in turn will attract more EDFI investments.

5.4 Recommendations

The study recommends that since DFIs have been instrumental in economic growth, the government should encourage more DFIs' activities within the country. The government should also ensure that DFIs such as KIE, DFCK and ICDC which are parastatals functions efficiently and that they are transparent in allocating resources to the most deserving investments for only by doing these will the DFIs within the country fulfill their mandates more effectively.

National policies should aim at harnessing complementarities between domestic private investment and DFI rather than regarding them as substitutes.

The analysis in this study has not taken cognizance of the importance of resource endowment as a driver of EDFI. The results suggest that governments should make deliberate efforts to attract EDFIs to their markets within the African countries. There are various factors that are important to attract the presence of investors in resource intensive relative to non-resource-intensive countries. In particular, infrastructure is critical for attracting EDFI in non-resource rich countries but not in those with resources. This suggests that non-resource rich countries have to work harder to entice EDFIs. At the same time, this also implies that there are alternatives to resource endowments as a means of attracting development investor. Thus, by designing the right policy frameworks, African countries can make progress in overcoming marginalisation in the global economy.

5.5 Areas for Further Studies

The study recommends that further studies be conducted on the relevance of private investment to economic growth. This is because while DFIs mostly finance private investment, there is no study that has significantly researched on cost benefit analysis of private investment in an economic thus suggests whether DFIs should focus more on public or private investments.

While the literature has provided much evidence on the investments of EDFI, much less is still known in the case of African countries and the effects of EDFI on growth. Further studies should be conducted on their effects on domestic factor markets. Understanding the linkages between EDFI and factor markets is key to uncovering the channels through which EDFI affects economic performance. This will help policy makers to identify the policy levers that may be activated to maximize both EDFI inflows and the gains from DFI for the host economy.

Micro finance has been an avenue for DFIs to provide funding to entrepreneurs for a long time. However, micro-borrowers have reached their plateau, the high administrative cost of these programs, the competition among capital providers driving down the performance of many micro-finance institutions, the urban-biased impact of these institutions, and the limitations of providing capital unaccompanied by technical assistance. For these reasons, many EDFIs see the need to broaden their portfolios beyond microfinance and have been supporting SMEs through technical assistance. This has gone a long way in improving the performance of their investments. Further research needs to be conducted on the impact of the technical assistance provided by EDFIs to the companies they have invested in.

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APPENDICES

Appendix 1: Questionnaire

1. What size is your fund by the end of 2009?
    a. Which regions does your organisation favour?
    b. Why?
2. What percentage of your investments is in the following regions?
    a. Africa, Caribbean and Pacific (ACP).
    b. Asia.
    c. Central & Latin America.
    d. Others.
3. Which counties in Africa are you focusing on and why?

4. Do you have a sector specific strategy?
    a. If yes, which sectors have you targeted?
    b. If no, why not?

5. Which instruments does your organisation prefer? (roughly provide percentages)
    a. Equity/Quasi- Equity?
    b. Loans?
    c. Guarantees?
    d. Why does your organisation prefer the selected instrument?

6. Have you ever invested in the Kenya in any way (i.e. debt / equity /Guarantees)?

   a. If yes, please provide the sectors of companies invested in.

   b. If not, Why not and have you ever considered any such investment?

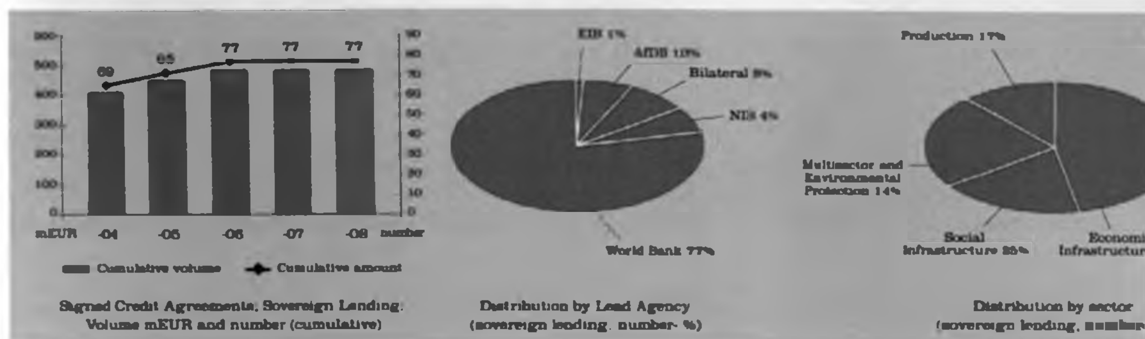
7. Are there any impediments to you making investments in Kenya? Please specify

   a. Are there any circumstances under which you would make such investments?

   b. What needs be done to make investing in Kenya attractive (Recommendations)?

Appendix 2: Nordic Investments Portfolio Schedule in Africa.

Portfolio **Africa**



Signed Credit Agreements, Sovereign Lending: Volume mEUR and number (cumulative)

Distribution by Lead Agency (sovereign lending, number- %)

Distribution by sector (sovereign lending, number

Country/Project	Sector	Lead agency	Investment million, NDF	Total*)	Year of signing
Public sector projects					
Benin					
Transport Sector Investment	Economic Infrastructure	IDA	4,7 SDR	35,0	1997
Energy Services Delivery	Economic Infrastructure	IDA	13.8 EUR	80,0	2005
Burkina Faso					
Power Sector Development	Economic Infrastructure	IDA	10,5 EUR	102,0	2005
Botswana					
Mochudi-Molepolole Groundwater Exploitation	Social Infrastructure	NIB	1,1 SDR	4,2	1990
Trans-Kgalagadi Road	Economic Infrastructure	AfDB/NIB	0,5 EUR	121,9	1992
Transmission Line Francistown-Maun	Economic Infrastructure	NIB	5,0 EUR	21,4	1993

Cape Verde					
Integrated Fisheries Development	Production	ICEIDA	2,1 SDR	4.8	1994
Ethiopia					
Addis Ababa Airport Improvement	Economic Infrastructure	EIB	5,0 SDR	83,0	1998
Energy II	Economic Infrastructure	IDA	7,0 SDR	90,0	1998
Road Sector Development	Economic Infrastructure	IDA	4,8 SDR	538,0	1998
Road Sector Development II	Economic Infrastructure	IDA	10,0 EUR	219,0	2003
Ghana					
Urban II	Social Infrastructure	IDA	4,5 SDR	73,0	1994
National Electricity	Economic Infrastructure	IDA	5,3 SDR	115,0	1994
Accra Tema Water Supply Rehabilitation	Social Infrastructure	AfDB	4,5 SDR	17,0	1994
Urban Environment Sanitation	Social Infrastructure	IDA	2,2 SDR	60,0	1996
Mining Sector Development and Environment	Production	IDA	4,0 SDR	12,9	1996
Health Sector Support	Social Infrastructure	IDA	5,0 SDR	144,0	1998
Urban V	Multisector and Environmental Protection	IDA	2,6 SDR	18,0	2000
Health Services Rehabilitation III	Social Infrastructure	AfDF	8,3 EUR	37,0	2003
Land Administration	Multisector and Environmental	IDA	7,0 EUR	55,1	2004

	Protection				
Urban Water Project	Multisector and Environmental Protection	IDA	6,0 EUR	98,2	2004
Urban Environment Sanitation II	Social Infrastructure	IDA	9,0 EUR	67,6	2004
Kenya					
Northern Transport Corridor Improvement	Economic Infrastructure	IDA	16,0 EUR	233,0	2004
Energy Sector Recovery	Economic Infrastructure	IDA	10,0 EUR	184,0	2004
Malawi					
Fisheries Development	Production	IDA	2,4 SDR	11,0	1991
National Water Development	Social Infrastructure	IDA	5,3 SDR	57,0	1995
Power V	Economic Infrastructure	IDA	5,0 SDR	195,0	1997
Preparatory Programme to Support the Telecommunications Sector	Economic Infrastructure	Danida	4,3 SDR	15,5	1998
Road Maintenance and Rehabilitation (ROMARP)	Economic Infrastructure	IDA	5,0 SDR	150,0	1999
Mauritius					
Environmental Investment for Sustainable Development	Multisector and Environmental Protection	IBRD	3,0 SDR	49,0	1990
Mozambique					
Urban Household Energy	Economic Infrastructure	IDA	4,4 SDR	74,4	1989

Cahora Bassa Interconnection	Economic Infrastructure	NORAD	3,7 SDR	125,0	1994
Semi Industrial Fisheries	Production	Danida/IC	3,6 SDR	9,4	1996
National Water Development	Social Infrastructure	IDA	5,3 SDR	86,3	1997
Municipal Development	Social Infrastructure	IDA	4,0 SDR	33,0	2001
Mineral Resources Management Capacity Building	Production	IDA	12,6 EUR	25,0	2001
The Roads and Bridges Management and Maintenance	Economic Infrastructure	IDA	13,4 EUR	800,0	2001
Agricultural Sector Public Expenditure (PROAGRI)	Protection	IDA	7,4 EUR	246,0	2002
Energy Reform and Access (ERAP)	Economic Infrastructure	IDA	10,2 EUR	69,7	2003
Namibia					
Seaflower - Whitefish Corporation	Production	NIB	1,5 SDR	12,1	1994
Rwanda					
Urgent Electricity Rehabilitation	Economic Infrastructure	IDA	7,5 EUR	24,1	2005
Urban Infrastructure and City Management	Social Infrastructure	IDA	5,0 EUR	39,9	2005
Senegal					
Women's Groups Support	Multisector and Environmental Protection	AfDB	3,7 SDR	7,6	1992
Water Sector	Social Infrastructure	IDA	5,3 SDR	197,0	1995
Integrated Health Sector Development	Social Infrastructure	IDA	5,0 SDR	294,0	1997

Second Transport Sector	Economic Infrastructure	IDA	2,1 SDR	405,0	1999
Long Term Water Sector Project Water Resources Management	Social -Infrastructure	IDA	5,6 SDR	74,0	1999
Poverty Alleviation	Multisector and Environmental Protection	AfDB	7,5 SDR	18,6	1999
Quality Education for All	Social Infrastructure	IDA	5,0 SDR	48,0	2000
Long Term Water Sector Project Urban Sanitation, Thiès	Social -Infrastructure	IDA	11,5 SDR	186,0	2000
Urban Mobility Improvement	Economic Infrastructure	IDA	5,7 SDR	76,0	2002
Tanzania					
Electricity IV	Economic Infrastructure	AfDB	5,0 SDR	77,0	1993
Power VI	Economic Infrastructure	IDA	5,0 SDR	291,0	1995
Mineral Sector Development Technical Assistance	Production	IDA	6,7 SDR	20,9	1999
Songwe River Stabilisation Study	Social Infrastructure	IDA	1,1 SDR	2,0	1999
Central Transport Corridor Roads	Economic Infrastructure	IDA	5,0 EUR	114,0	2004
The Lake Tanganyika Integrated Regional Development (PRODAP)	Production	AfDF	6,0 EUR	34,2	2005
Electrical System Extension and Rehabilitation Works	Economic Infrastructure	IDA	8.0 EUR	52,5	2006

Tunisia					
Second Forestry Development	Production	IBRD	3,6 SDR	105,0	1994
Water Supply and Sewerage	Social Infrastructure	IBRD	1,5 SDR	90,0	1996
Uganda					
Second Power - Installation of SCADA System	Economic Infrastructure	IDA	4,0 SDR	76,0	1990
First Urban	Social Infrastructure	IDA	4,7 SDR	25,0	1991
Third Power - Owen Falls Extension	Economic Infrastructure	IDA	4,7 SDR	150,0	1994
Transport Rehabilitation	Economic Infrastructure	IDA	3,6 SDR	34,0	1994
Northern Reconstruction - Telecommunications component	Multisector and Environmental Protection	IDA	5,0 SDR	75,0	1998
Second Economic and Financial Management (EFMP2)	Social Infrastructure	IDA	3,2 SDR	16,8	2000
Roads Development Program, Phase II (RDPPII)	Economic Infrastructure	IDA	7,0 SDR	72,0	2001
Fourth Power	Economic Infrastructure	IDA	12,7 EUR	104,0	2002
Sustainable Management of Mineral Resources (SMMRP)	Production	IDA	6,0 EUR	33,5	2005
Farm income Enhancement and Forest Conservation Project	Production	AfDF	5,0 EUR	37,9	2006
Zambia					
Environment Support	Multisector and Environmental	IDA	0,8 SDR	28,0	1997

	Protection				
Power Rehabilitation	Economic Infrastructure	IDA	5,0 SDR	165,5	1999
Copperbelt Environment	Production	IDA	10,0 EUR	48,9	2003
Road and Rehabilitation and Maintenance Project - In Support of ROADSIP II (Phase I)	Economic Infrastructure	IDA	8,0 EUR	320,1	2004
Zimbabwe					
Urban Sector and Regional Development	Social Infrastructure	IBRD	4,4 SDR	440,0	1990
Cahora Bassa Interconnection	Economic Infrastructure	NORAD	3,5 SDR	125,0	1994
Pungwe Mutare Water Transfer	Social Infrastructure	Sida	5,9 SDR	37,0	1996
Private sector projects / Loans with equity features					
Benin					
Cimbenin S.A.	Production	Swedfund	0,7 SDR	11.8	1996
Ghana					
Paper Conversion Company Ltd.	Production	Swedfund	0.5 SDR	2,9	1995
Ghana Emulsion Company Ltd.	Production	IFU	0,4 SDR	3,0	1996
Danafco Ltd.	Production	IFU	0,2 SDR	2,0	1998
Mozambique					
Maputo Port Privatisation and Rehabilitation	Economic Infrastructure	Swedfund	0.9 SDR	45,1	2003
Namibia					
Seaflower Whitefish	Production	NBVF	0,7 SDR	7,0	1999

Corporation Ltd.					
South Africa					
Nielsen Tap (Pty) Ltd.	Production	IFU	0,1 SDR	0,2	1995
Princeton Computing Training Solutions (Pty) Ltd.	Social Infrastructure	IFU	0,0 SDR	0,3	1996
New Africa Signs and Graphics (Pty) Ltd.	Production	IFU	0,0 SDR	0,5	1997
Danforge Engineering (Pty) Ltd.	Production	IFU	0,0 SDR	0,3	1998
Tanzania					
Sao Hill Timber Ltd.	Production	NORAD	0,3 SDR	2,1	1997
Uganda					
MTN (Uganda) Ltd.	Economic Infrastructure	Swedfund	1,5 SDR	52,0	1999
Zimbabwe					
Imperial Derby Refrigeration Ltd.	Production	IFU	1,0 SDR	7,0	1995
Oscars Fine Foods	Production	IFU	0,1 SDR	0,7	1995
Frese (Zimbabwe) (Pvt) Ltd.	Production	IFU	0,3 SDR	2,0	1996
Powervision (Pvt) Ltd.	Production	IFU	0,1 SDR	0,4	1997
Regional					
African Infrastructure Fund	Multisector and Environmental Protection	Swedfund	1,5 SDR	375,0	1999
Aureos Southern Africa Fund (ASAF)	Economic Infrastructure	Norfund	3,4 EUR	51,0	2003
Aureos West Africa Fund	Economic Infrastructure	Norfund	3,0 EUR	40,0	2004

Credit lines

Fifth Line of Credit and Technical Assistance to the East African Development Bank	Economic Infrastructure	AfDB	5,6 SDR	30,0	1995
DBSA Credit Line (Development Bank of Southern Africa)	Economic Infrastructure	NIB	8,5 EUR	17,0	2001
Second NDF Credit Line to the East African - Develpment Bank (EADB)	Economic Infrastructure	n/a LA	7,0 EUR	7,0	2003

*) The total project costs at the time of NDF's credit decision

Source: Nordic Development Fund (NDF) (2001)