

FINAL REPORT

Evaluation of the Finnish Fund for Industrial Cooperation Ltd.

Evaluation on Finland's Development Policy and Cooperation

November 2018

Evaluation of the Finnish Fund for Industrial Cooperation Ltd.

Final Report

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Acronyms and Abbreviations

BIO	Belgian Investment Company for Developing Countries
CDC	Commonwealth Development Corporation
CO2	Carbon Dioxide
DEAT	Development Effects Assessment Tool
DEG	Deutsche Investitions- und Entwicklungsgesellschaft MBH
DFIs	Development Finance Institution
E&S	Environmental and Social
EBITDA	Earnings before interest, tax, depreciation and amortization
EDFI	European Development Finance Institute
EMS	Evaluation Management Services
ENEE	Empresa Nacional de Energia Electrica
ESAP	Environmental and Social Action Plan
EU	European Union
EUR	Euro
FDT	Forestry Development Trust
FF	Finnfund
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.
FRCA	Fragile and Conflict Affected
FSC	Forests Stewardship Council
FTE	Full-time Equivalent
GAP	Good Agricultural Practice
GRAS	Green Resources AS
GwH	Gigawatt Hours
HIPSO	Harmonised Indicators for Private Sector Organisation
HRBA	
IFC	International Finance Corporation
IFCPS	International Finance Corporation Performance Indicators
ILO	International Labour Organisation
ISO	International Organisation for Standardisation
KVTC	Kilomberto Valley Teak Company
KwH	Kilowatt Hours
LIC	Lower Income Countries
M&E	Measurement and Evaluation
MENA	Middle East and North Africa
MFA	Ministry of Foreign Affairs
MFA	Ministry for Foreign Affairs (Finland)
MSME	Micro, Small and Medium-sized Enterprise
Mw	Megawatt
NFC	New Forests Company
NGO	Non-governmental Organisations
NIB	Nordic Investment Bank
NORAD	Norwegian Agency for Development Cooperation
ODI	Overseas Development Institute
OECD	Organisation for Economic Cooperation and Development
OECD-DAC	OECD Development Assistance Committee
OPIC	Overseas Private Investment Corporation

OSM	Ownership Steering Memoranda
PFP	Private Forestry Programme
PPA	Power Purchasing Agreements
PS	Performance Standard
RSPO	Roundtable on Sustainable Palm Oil
SDG	Sustainable Development Goals
SDG	Sustainable Development Goals
SECO	State Secretariat for Economic Affairs
SIFEM	Swiss Investment Fund for Emerging Markets
SME	Small and Medium-sized Enterprise
SRI	Special Risk Instrument
TA	Technical Assistance
ToC	Theory of Change
ToR	Terms of Reference
UN	United Nations
US	United States
USD	United States Dollar
WBG	World Bank Group
\$	United States Dollar
€	Euro

Abstract

The goals of this evaluation are to assess Finnfund's historical performance, the extent to which it has followed its mandate and annual guidance, and the likelihood that the 2018-2025 strategy will achieve its objectives. This was conducted over two phases. This first reviewed Finnfund's record on development impact, and alignment with its mandate. The second appraised the future strategy based on fieldwork in three countries in Latin America and Africa. These covered 11 businesses in the strategic sectors of finance, renewable energy, forestry and agriculture. Additional research questions related to adherence to annual guidance, best practice in risk management and additionality.

In the ex-post study, the evaluation found that Finnfund was broadly consistent with annual guidance and best practice in both commercial and environmental/social risk management, and often exceeded these. While it is not possible to assess causality, we find evidence of job creation on the part of investees, as well as improved business performance. Findings on taxation are inconclusive. Finnfund's country and sector allocations also suggest that impacts are being achieved, if not always captured. On additionality, we find that Finnfund's investments are most likely to be additional in forestry and agriculture.

The fieldwork found some evidence for positive outcomes in areas such as capacity development, business performance, the scale and quality of employment, and community and environmental impacts. We cannot generalise from this to the portfolio, however, due to the small sample size.

The evaluation finds that the goal of tripling impact is only possible if the trend towards high impact countries and sectors continues, but that this is likely to increase risks and lower returns. Ensuring that Finnfund expands in a way that is compatible with this is essential. We set out a number of ways this could be done, which entail different combinations of public and private investment, and potential changes in key areas such as Finnfund's return requirements.

Finally, to increase impact on the scale required, Finnfund needs a greater on-the-ground presence in the countries in which it operates, and to engage closely with investees to better performance. Just as importantly, impacts need to be robustly measured and reported. Finnfund needs the support of public opinion in Finland, providing credible evidence of impact, and engaging actively in development policy circles, is key to this.

Summary

Established in 1980, Finnfund is a bilateral development finance institution (DFI), which provides loans, equity, mezzanine financing or guarantees to firms in developing countries, with the goal of promoting social, environmental and economic development. Finnfund's investment decisions are informed by the requirement to achieve the following objectives: social and environmental responsibility; development impact; financial self-sufficiency; and Finnish interest.

In April 2018, Finnfund's portfolio was around €600 million. While this represents a significant increase over recent years, it is nonetheless one of the smallest DFIs in Europe. Finnfund's increased funding mirrors similar trends in other bilateral DFIs. With this increased investment has come increased scrutiny, and many DFIs have been evaluated to assess their development impacts. The current evaluation of Finnfund is, therefore, timely and in line with these trends.

The Ministry of Foreign Affairs (MFA) is considering a further increase in Finnfund's financing, with a convertible loan of €130 million. A key goal of this evaluation is to assess whether this is justified on the basis of historical performance, and, if so, how the investment could best be used to support Finnfund's 2018-2025 strategy. This further increases the timeliness and importance of the evaluation.

Objective and methodology

The overall objective of the assignment as stated in the ToR was to evaluate how well Finnfund has implemented its' mandate during the period 2008-2017, as defined by the Finnfund Act and the annual guidance from the MFA. A second objective was to assess the likelihood that Finnfund can achieve the objectives set out in the 2018-25 strategy, with recommendations for change as appropriate. The central tenet of Finnfund's strategy is to: 'double its size and triple its impact.'

The evaluation was conducted in two phases: ex-post and appraisal. The former was retrospective covering the work of Finnfund between 2008 and 2017. The 10-year period includes periods before and after 2012, from which time Finnfund has been directed by annual MFA guidance (i.e. OSMs). The second part of the evaluation was forward looking; focusing on Finnfund's 2018-25 strategy. The evidence to support both phases was drawn from a document review, interviews with stakeholders and Finnfund staff, and fieldwork in three countries: Ethiopia, Tanzania and Honduras.

Nine research questions were developed during the inception phase. The following sections present the answers to these questions (findings, conclusions and recommendations) clustered by evaluation phase.

Answers to the ex-post questions

Have Finnfund's activities been aligned with its mandate and annual guidance?

Finnfund receives annual guidance from the MFA in the form of Operational Steering Memoranda (OSM). This consists of 5 targets relating to development impact, economic development, and collaboration with Finnish companies, cost effectiveness and self-sufficiency. Finnfund has generally achieved its targets in each year, with some exceptions. In some cases, this is because targets have been reduced, but generally this is not the case. In recent years, Finnfund reports a sharp increase in new jobs created, following a change to the method of calculation.

A different question is what impact targets have had on Finnfund's activities, and what the implications of this are. Finnfund is strongly incentivized to achieve its targets, and makes every effort to do so. This has important impacts on asset allocation and other activities. Any nominal target risks distorting behaviour, and it is therefore positive that OSM guidance is moving away from this in some areas. It is important to think through the potential unintended consequences of targets.

Conclusion 1:

Annual guidance has been very effective at shaping Finnfund's activities, and it is therefore important that targets are only used when appropriate, and unintended consequences are assessed.

Finnfund is strongly incentivised to meet the targets in its annual guidance, making it important that these are carefully constructed to achieve the desired result, and that unintended consequences are taken account of. Headline targets for employment and tax can encourage claims to be made without evidence of attribution. Lack of gender related targets disincentivises a focus on this issue, and it is therefore welcome that this has been addressed in 2018. Financial sustainability targets have had a major impact upon its activities and the composition of its portfolio.

Recommendations:

- Review the profitability criterion which as an important element of the OSM requires consideration as part of wider strategic choices.
- Review the targets (and the use of targets) in the OSM, as they may have created pressure to be achieved at the expense of other considerations. The trend away from specific targets is welcomed and we would encourage this to be continued.
- Review Finnish interest criterion as it is often misunderstood by the development and NGO community as 'Finnish economic interests'. Given the various interpretations, loose application and controversy generated, the value of Finnish interest should also be questioned.

Has Finnfund followed DFI and international best practice on environmental and social risk management?

Finnfund follows international best practice E&S standards developed by the IFC and European Development Finance Institutions (EDFI). Following the EDFI harmonized approach, Finnfund assesses the E&S risks of all investments and based on the results carries out E&S Due Diligence. In this process the project is evaluated against the IFC PS and other relevant international best practices. Compliance gaps are identified, and corrective measures specified in Environmental and Social Action Plans (ESAP) and in contractual clauses in the investment agreements.

Projects are contractually bound to E&S commitments and clients are required to reach compliance within a reasonable timeframe. Our analysis found an increase in ESAP coverage over the period of analysis, which may be partly explained by an increase in the risk profile of the portfolio, evolution of the international best practices such as the EDFI Harmonized Standards and the new edition of the IFC PS (2012), but also by an increase in the priority and resources given to E&S monitoring within Finnfund.

The document review found consistent compliance with EDFI and IFC performance measurement, as well as examples of where these standards had been exceeded. An important caveat is that adherence to these standards is not always a safeguard against major E&S problems arising, as highlighted in some high-profile cases discussed in this report. While these may be isolated examples, they do serve as a reminder of the need for deep country knowledge, and strong due diligence and oversight, regardless of adherence to formal standards.

Some gaps in process were also identified during the fieldwork. For low risk projects, we found quite lenient E&S monitoring. Under EDFI Harmonized Standards low risk category C projects are only required to comply with local law regarding E&S matters. This should not mean that extra steps are not taken where deemed necessary. As per international standards Finnfund applies risk-based approach to E&S monitoring. For high risk projects, Finnfund was sometimes slow to initiate sanctions when ESAP terms were not complied with. This may reflect the mission Finnfund has as a DFI to help and instruct the clients reach compliance over time, rather than issue sanctions, but clearly a balance needs to be struck between positive and negative incentives on a case-by-case basis.

In recent years Finnfund has developed its E&S capacity and widened the use of ESAPs. There is also evidence that lessons have been learned in Honduras, where investees valued the E&S monitoring introduced by Finnfund. Some projects reported very light touch oversight from Finnfund and a lack of ‘on the ground’ presence. Although monitoring was not universally welcomed, there was a general recognition that it was an inevitable requirement of DFI finance. There was also a positive endorsement of the quality of E&S staff. However, E&S capacity is limited by human and financial resources.

The additionality of Finnfund’s E&S monitoring varied with the level of risk the project posed. Low risk E&S projects reduce costs and potential reputational damage to Finnfund. They are also less likely to be contributing towards the objective of improving the E&S performance of investees in priority sectors.

Conclusion 2:

Finnfund has followed DFI and international best practice, but the limitations of international good practice E&S standards in ensuring that high E&S standards are being achieved was also found. This could be improved by increased E&S resources.

Managing and minimising E&S risks is crucial if Finnfund is to achieve its impact goals. Although Finnfund is broadly compliant for high risk projects and thorough in its process, E&S risks may still remain. More resourcing and engagement with relevant sectors will be required, especially as Finnfund moves to higher risk projects and locations. In terms of impacts on E&S performance, although there are examples of where this is effective, there are questions about how additional it is. To move beyond its current performance level, Finnfund will require dedicated TA budgets to support clients to make investments in this area.

Recommendations:

- Build on the ground presence in countries to increase depth of knowledge of local issues. This will help to better understand, and be responsive to, a complex and relatively high-risk business environment as well as to provide guidance on E&S matters to projects. Working closely with local actors (communities, experts, civil society etc.) is an important element of this.
- Create and deploy TA budgets to support partners with E&S improvements, data collection and community engagement.
- Monitor and strictly enforce ESAP compliance for high risk projects and ensure compliance with minimum standards for low-risk projects.

Has Finnfund followed DFI and international best practice on commercial risk management?

As with E&S issues, the IFC provides guidance on the management of commercial risk and is again an industry benchmark. Much of this guidance is not relevant to Finnfund as it is a very different and much smaller institution, but our assessment is that its approach to risk is broadly compliant in comparable areas.

We also identify an interesting balance in Finnfund’s approach. In many areas it takes a conservative stance to commercial risk, such as liquidity management. This is balanced by the assumption of significant credit risks, which is an inevitable consequence of seeking to achieve high impacts in difficult markets. It does leave Finnfund quite vulnerable to a coordinated shock across a major section of the portfolio, however. To date this has been avoided, largely due to good judgement it would appear, as well as perhaps an element of luck. It would be prudent now to seek to diversify the portfolio more systematically following a detailed analysis of correlations between different aspects of strategic sectors, both geographically and in terms of the types of business supported.

Conclusion 3:

Finnfund has followed DFI and international best practice on commercial risk management. Although conservative in some areas, this is balanced by the assumption of significant credit risks, which are likely to rise further. This may leave Finnfund vulnerable to a coordinated shock across a major section of the portfolio.

Achieving high impact is impossible without assuming significant risk. Finnfund's already faces considerable credit and market risk. If the goal of tripling impact is to be delivered this will have to rise further. As well as increasing investments in high risk countries and sectors, Finnfund intends to focus on fewer, strategic sectors. Less diversification raises risks further, particularly where a strategic sector – agriculture – is inherently more risky than the more diversified set of sectors it will displace.

Recommendations:

- Finnfund currently uses the due diligence process to increase the likelihood that selected project are viable, and also assists with the creation of robust business plans. Maintaining and strengthening this focus is essential, and the availability of a TA budget to support this would be helpful.
- Diversification should be increased, geographically and particularly across value chain based on estimated covariance of risk.
- Investments should be regularly stress tested, including extreme scenarios.
- Geographical diversification is essential to minimise the portfolio effects of country risk.
- Engage with governments, and other Finnish and non-Finnish development actors that do, to prevent major shocks, or receive prior warning of unavoidable shocks.

Have Finnfund's investments positively contributed to development effects?

Generating positive development effects is core to Finnfund's mission and making an effective assessment of this is crucial for this evaluation. The scope of what could be considered as 'impact' varied due to data limitations in the ex post data, and limitations of the generalisability of the fieldwork findings. In the ex-post study our analysis was limited to three core areas: business performance, employment and taxation. In each case, we began by looking for evidence that Finnfund's investees showed improvements over time.

Three indicators were used to measure business performance: EBITDA, turnover and annual profits. While the last of these was the only one that had a discernible improvement, it is also the best proxy for business performance, and suggests a small improvement in overall business performance over the period of analysis.

For employment, it is important to note that the data relate to total employment of investees in each year, rather than new job creation. To assess this, we looked at annual change, and found high annual volatility in terms of total employment, which appears to be driven by movements of particular investments into and out of the portfolio. At the level of individual investees, however, we found evidence of positive employment growth, both for direct and financial investments, as well as for funds. It is important to note that this does not establish causation, but there is positive growth in each year and for all instruments. For indirect employment effects, median results – which are the most reliable – are either negative or zero in each year.

Tax data also exhibits high volatility from year to year in terms of total tax paid. Once again, observable changes are largely driven by entries and exits from the portfolio. At the investee level, there is no reliable evidence of a positive or negative trend, with growth in some years offset by declines in others.

During the appraisal a wider set of outcomes, such as capacity development, environmental impact and community impacts were considered. In general, all interviewees spoke positively about the impact of Finnfund on business performance. However, differences between sectors were also found. All businesses reported increases in the numbers employed, and in many instances in the quality of employment. As would be expected, this varied by sector with the biggest effects in agriculture. There was also some evidence of better salaries and working conditions than the sector average. In general, female employment was not given particular priority, and the findings support the view that the renewables sector is not a major employer of women, whereas the agricultural sector is.

Findings from the fieldwork suggest that Finnfund uses its expertise, and political capital effectively to benefit investees, but there was also evidence that the involvement of Finnfund can be light touch, and the full potential of its expertise in areas like forestry and renewables is not yet being realised. Capacity

development to date has not been core to Finnfund's offer and unlike other DFIs it does not have a technical assistance (TA) budget to support this. Significantly more value could be added if this was addressed.

All projects were found to be impacting on local communities, mostly positively but with some negative effects. Farms and forest farms were engaged in outgrowing schemes with local farmers, for examples, albeit with mixed success. There were also reports of improved diets and better nutrition in communities connected to the farms. The main community benefit from renewables is the provision of cheap electricity and new connections, including to remote and rural locations.

All investees were conscious of the need for good community relations, especially in Honduras. Most were engaged in community development projects of some kind. While it was out of scope to analyse the impacts of these projects, it is our observation that these may work best where they are linked to the core business activity, ensuring buy-in from the company. In general, there was evidence of positive community relations, apart from a major forestry project in Tanzania.

Conclusion 4:

While data availability prevents us from reaching conclusions on causality, there is good evidence of increased employment and some evidence of improved business performance among investees. This is supported by qualitative findings, but stronger evidence is needed.

Given the sectors and countries where Finnfund invests, it is likely that significant impacts are being achieved in many cases. Although we cannot directly address questions of attribution and causality, there is some evidence that business performance and employment of investees has improved over time. This is supported by qualitative findings, but stronger evidence is needed. Finnfund will require more robust M&E infrastructure if it is to credibly demonstrate development impacts.

Recommendations:

- Choose countries on the basis of need and potential impact and commit for the long-term.
- Strengthen the evaluation policy to provide a clearer rationale for evaluation with focused measurement around a set of core indicators.
- Augment with regular external evaluations, combining quantitative studies of statistically discernible effects where appropriate, with deep-dive case studies using contribution analysis and process tracing.
- Expand direct equity investments, as these provide greater scope for impact
- Seek greater collaboration with DFIs, other development actors and Finnish bilateral programmes
- Develop streamlined common reporting standards and promote peer-to-peer learning among investees

Have Finnfund's investments been additional?

As well as looking at change in indicators, there is also the key question of Finnfund's additionality. In simple terms, if an investee could have obtained financing from elsewhere, then the only impacts that can be claimed by Finnfund are those that result from its influence over the investee. On the other hand, if Finnfund's investment could not have been obtained from elsewhere, and it was crucial to the launch or survival of an investee, then potentially all employment or tax paid could be attributable to Finnfund's investment. We can then potentially think about 'stronger' and 'weaker' forms of additionality.

We cannot measure this directly, but Finnfund's focus on lower-income countries and challenging sectors – where finance is likely to be very scarce – supports the view that much of their investments are additional. While there will obviously be exception, we find that additionality is most likely in forestry, agriculture, and to a lesser extent renewable energy. Financial investments can be additional, but only where investment could not have been obtained on similar terms elsewhere, or Finnfund is able to positively influence lending and investment behaviour to improve development outcomes. More evidence is needed on these questions.

Conclusion 5:

Finnfund can be additional in two ways. While we believe both forms of additionality are being achieved to a certain extent, they are unlikely to be being maximised at the present time. There is a need for further research to understand this better, to inform future strategic choices.

Additionality should not be thought of in binary terms, but as a spectrum. The strongest forms are where Finnfund's investment is crucial for the creation or survival of an investee. Less strong, but still additional, is where investment could potentially have been obtained, but was not of a suitable form, thus enabling an investee to expand, for example. In a weaker sense, investments may not be financially additional, but they may allow Finnfund to influence investee behaviour positively, improving outcomes. These distinctions relate to the credit that Finnfund could potentially claim. For the strongest forms of additionality, it may be reasonable to claim credit for all employment generated or tax paid by an investee, as it would not exist without Finnfund. For weaker forms, it is only possible to claim credit for changes in these outcomes, and only then when attribution to Finnfund's influence can be robustly demonstrated.

Recommendations:

- The question of additionality is crucial for DFIs, and we recommend a more systematic approach to measuring different forms of additionality, and seeking to maximise additionality in the light of this. Analyse (internally and through external studies) the different ways that Finnfund can be additional, perhaps developing a spectrum from strong to weak additionality based on the criteria discussed in this report.
- Estimate the total level of additionality in the portfolio, and inform investment decisions with the requirement to progressively increase this over time.

Answers to the forward-looking appraisal questions

What evidence is there that the 2018-25 Strategy is likely to achieve its objectives?

This evaluation finds that Finnfund's ambitious strategy is achievable, but only if certain key choices are made. The goal of tripling impact is only possible if the trend towards high impact countries and sectors continues. This will increase risk, and potentially reduce Finnfund's returns. Accepting this, and ensuring that Finnfund expands in a way that is compatible with this, will be central to whether the strategy is achieved or not.

Conclusion 6:

In terms of choice of sector and countries, Finnfund is broadly on track to achieve the Theory of Change that underpins its future strategy.

As the appraisal findings show, there are positive self-reports on a range of outcomes from the projects visited. These include capacity development, the quantity and quality of employment, business performance, E&S performance, community and environmental impacts. Although we cannot generalise from these findings to the whole portfolio, we can conclude that small sample evidence finds Finnfund has achieved positive impacts in the projects we visited across this wide range of important outcomes.

Recommendations:

Most strategic sectors are high risk, however, and recommendations have been developed for each strategic sector to mitigate these (see section 7.3 for sector-specific recommendations).

What evidence is there that Finnfund is institutionally set up to achieve this?

Central to Finnfund's work is managing trade-offs between profitability, impact, commercial and ESG risks and Finnish interest. We found Finnfund to be unusual amongst DFIs, in that impact and financial concerns are well balanced. In our view, however, this is largely the result of the current balance of staff, and particularly that of senior management. The board has a high degree of discretion to overrule guidelines. This is positive in that flexibility is important, but also places great emphasis on the composition of the

Board. This currently works but were the composition of senior management and the Board to change, there is every chance this could change.

Conclusion 7:

Finnfund has many institutional strengths but also areas of weakness. Its strengths are largely the result of the current balance of staff and could be threatened by staff changes.

Finnfund's policies could be described as generally good but with room for improvement. They could benefit, for example, from wider stakeholder inputs. Organisationally, whilst Finnfund has managed the trade-offs that it faces well until now, this could be at risk in the future, especially as the organisation grows. Hardwiring key strategic factors into Finnfund's mandate, and potentially modifying the composition and discretion of the board, may be a useful way to protect against this.

Recommendations:

- In general, to ensure the current balance is maintained through the strategy period and beyond, key elements (see section 7.3 for details) should be 'hardwired' more explicitly into Finnfund's mandate and governance structures.
- Consider strengthening the E&S and development impact specialism of the Board so that it can absorb and interpret the information it receives in this area.
- Finalise and apply human rights policy robustly.
- Strengthen M&E capacity to robustly measure and report development impacts.

To what extent are changes needed to increase the likelihood that the theory of change is realized?

To achieve its strategy, Finnfund needs to work in challenging environments hence taking on more risk, but too much risk will threaten its viability. This is not compatible with the current funding structure and return requirements. The way that Finnfund 'doubles in size', coupled with a more effective approach to impact assessment, will be central to whether it is able to increase its impact, and to what degree. We identify 6 scenarios which are explained in detail in section 7.

Additionally, we have identified the (potential) loss of support from Finnish public opinion as a significant threat to the strategy.

Conclusion 8:

Given its existing portfolio and funding structure and its requirement to achieve a certain level of returns, it is unlikely that Finnfund will be able to triple its impact under the current conditions.

More impact means more risk, and this is not compatible with the current funding structure and return requirements. The way that Finnfund 'doubles in size', coupled with a more effective approach to impact assessment, will be central to whether it is able to increase its impact, and to what degree.

Recommendations:

- Changes to the balance between private and public investors will be necessary to cover for the additional risks attached to increasing Finnfund's size and impact. 6 options have been identified in that regard and are presented with specific recommendations in section 7.
- The unique contributions that Finnfund makes in the international community should be communicated better so that it can be understood, valued, and enhanced. To achieve this Finnfund should engage in more dialogue with civil society.
- More effort should be made to communicate the importance of private sector development in general, and the role that Finnfund plays in this. Finnfund has many supporters and allies in Finnish civil society, who could be encouraged to take on a more vocal role in this regard.

- Become more integrated into Finnish development policy, including membership of the Development Policy Committee.
- All of the above would be enabled if Finnfund is better able to credibly demonstrate impact, and is seen as a development rather than a commercial actor.
- Finally, transparency should include a greater openness about mistakes, which can be an opportunity to explain better the challenges and trade-offs that Finnfund faces.

How should the planned additional €130 million MFA loan be spent?

Finnfund cannot achieve its strategic objectives without more financing. How this is spent will be crucial to whether the 2018-25 strategy is achieved, but it is highly likely that further public investment will be needed.

Conclusion 9:

How this investment is used is central to the goal of increasing impact.

As the balance between public and private finance will shape the impact Finnfund can achieve, it may be that more public finance is needed in the future if Finnfund is to achieve its goal of doubling in size while also tripling impact.

Recommendations:

We recommend five areas where new finance should be used:

1. Increase ability to understand and manage country and E&S risk
2. Increase ability to positively influence investees on business and E&S performance
3. Expand M&E capacity
4. Analyse and systematically manage commercial risk
5. Expand portfolio financing

As the €130 million is a loan, it will initially all need to go into an expansion of portfolio financing (recommendation 5). We recommend that the increased returns generated by increased portfolio activities should be devoted to support the higher operational costs implied by expanded activities in this area. As well as higher running costs, however, there are also significant one-off expenditures needed to expand capacity and improve systems in these areas. These could also be funded internally (e.g. drawing on the anticipated increases in earnings described), or by the new TA budget recommended elsewhere, or by some combination of the two. The types of one-off investments we envisage are: commissioning of research into E&S and commercial risk; development of in-house systems informed by this research; training of Finnfund staff; development and implementation of complementary systems for investees; and training of investee staff.

Recommendation 5 relates to straight capital expenditure to support investment activities. All the recommendations contained in this report, designed to support the delivery of the 2018-25 strategy, entail the assumption of greater risk by the public element of Finnfund's financial structure. While more public investment will be needed in the future if Finnfund is to double in size while also 'tripling its impact', the most sensible use of this loan would be to increase Finnfund's capacity to take on more risk in its investments. Given current structures, the simplest way of doing this would be to expand the SRI mechanism further. As discussed elsewhere, there are other options which could achieve this end, though in these cases a restructure of financing arrangements, and possibly changes to Finnfund's mandate, would also be needed.

Summary table of key findings, conclusions and recommendations

Findings	Conclusions	Recommendations
Have Finnfund's activities been aligned with its mandate and annual guidance?		
<p>Finnfund has generally achieved its targets in each year, with some exceptions, and has often exceeded them considerably.</p>	<p>C1 – Annual guidance has been very effective at shaping Finnfund's activities, and it is therefore important that targets are only used when appropriate, and unintended consequences are assessed.</p>	<ul style="list-style-type: none"> • Review the profitability criterion which as an important element of the OSM requires consideration as part of wider strategic choices. • Review the targets (and the use of targets) in the OSM, as they may have created pressure to be achieved at the expense of other considerations. The trend away from specific targets is welcomed and we would encourage this to be continued. • Review Finnish interest criterion as it is often misunderstood by the development and NGO community as 'Finnish economic interests'. Given the various interpretations, loose application and controversy generated, the value of Finnish interest should also be questioned.
Has Finnfund followed DFI and international best practice on environmental and social risk management?		
<p>Our document review and appraisal study found that Finnfund broadly followed relevant EDFI and IFC best practice guidance, and often go beyond these.</p>	<p>C2 – Yes, but the the limitations of international good practice E&S standards in ensuring that high E&S standards are being achieved was also found. This could be improved by increased E&S resources.</p>	<ul style="list-style-type: none"> • Build on the ground presence in countries to increase depth of knowledge of local issues. This will help to better understand, and be responsive to, a complex and relatively high-risk business environment as well as to provide guidance on E&S matters to projects. Working closely with local actors (communities, experts, civil society etc.) is an important element of this. • Create and deploy TA budgets to support partners with E&S improvements, data collection and community engagement. • Monitor and strictly enforce ESAP compliance for high risk projects and ensure compliance with minimum standards for low-risk projects.
Has Finnfund followed DFI and international best practice on commercial risk management?		
<p>Our assessment is that its approach to risk is broadly compliant with IFC guidance on commercial risk management</p>	<p>C3 – Yes. Although conservative in some areas, this is balanced by the assumption of significant credit risks, which are likely to rise further. This may leave Finnfund</p>	<ul style="list-style-type: none"> • Finnfund currently uses the due diligence process to increase the likelihood that selected project are viable, and also assists with the creation of robust business plans. Maintaining and strengthening this focus is essential, and the availability of a TA budget to support

Findings	Conclusions	Recommendations
	vulnerable to a coordinated shock across a major section of the portfolio.	<p>this would be helpful.</p> <ul style="list-style-type: none"> • Diversification should be increased, geographically and particularly across value chain based on estimated covariance of risk. • Investments should be regularly stress tested, including extreme scenarios. • Geographical diversification is essential to minimise the portfolio effects of country risk. • Engage with governments, and other Finnish and non-Finnish development actors that do, to prevent major shocks, or receive prior warning of unavoidable shocks.
Have Finnfund’s investments positively contributed to development effects?		
The quality of historical data is limited but we see good evidence of a positive trend in employment generation for Finnfund investments, and some evidence of improved business performance. We are not able to assess causality with respect to these trends.	C4 – While data availability prevents us from reaching conclusions on causality, there is good evidence of increased employment and some evidence of improved business performance among investees. This is supported by qualitative findings, but stronger evidence is needed.	<ul style="list-style-type: none"> • Choose countries on the basis of need and potential impact and commit for the long-term. • Strengthen the evaluation policy to provide a clearer rationale for evaluation with focused measurement around a set of core indicators. • Augment with regular external evaluations, combining quantitative studies of statistically discernible effects where appropriate, with deep-dive case studies using contribution analysis and process tracing. • Expand direct equity investments, as these provide greater scope for impact • Seek greater collaboration with DFIs, other development actors and Finnish bilateral programmes • Develop streamlined common reporting standards and promote peer-to-peer learning among investees
Have Finnfund’s investments been additional?		
Our research suggests that additionality is likely to be higher in some sectors than others. For Finnfund’s strategic sectors, these are forestry and agriculture, and to a	C5 – Finnfund can be additional in two ways. While we believe both forms of additionality are being achieved to a certain extent, they are unlikely to be being	<ul style="list-style-type: none"> • The question of additionality is crucial for DFIs, and we recommend a more systematic approach to measuring different forms of additionality, and seeking to maximise additionality in the light of this. Analyse (internally and through external studies) the different

Findings	Conclusions	Recommendations
<p>lesser extent renewable energy. Financial investments can also be additional in many cases, but only where finance could not have been obtained on similar terms elsewhere, or Finnfund is able to successfully influence lending or investment patterns to boost development outcomes.</p>	<p>maximised at the present time. There is a need for further research to understand this better, to inform future strategic choices.</p>	<p>ways that Finnfund can be additional, perhaps developing a spectrum from strong to weak additionality based on the criteria discussed in this report.</p> <ul style="list-style-type: none"> • Estimate the total level of additionality in the portfolio, and inform investment decisions with the requirement to progressively increase this over time.
<p>What evidence is there that the 2018-25 Strategy is likely to achieve its objectives?</p>		
<p>There was evidence from the qualitative study of positive development effects relating to the quantity and quality of employment, capacity development, community impacts, environmental impacts and E&S performance.</p>	<p>C6 – In terms of choice of sector and countries, Finnfund is broadly on track to achieve the Theory of Change that underpins its future strategy.</p>	<p>Most strategic sectors are high risk, however, and recommendations have been developed for each strategic sector to mitigate these (see section 7.3 for sector-specific recommendations).</p>
<p>What evidence is there that Finnfund is institutionally set up to achieve this?</p>		
<p>Finnfund has developed a range of new policies. There are opportunities to strengthen these, and remove ambiguities especially on disclosure and tax.</p> <p>Finnfund has largely managed the balance between impact and returns by hiring individuals that can work across it, and through effective strategic guidance by the board and senior management. This may be at risk in the future strategy if this composition changes.</p>	<p>C7 – Finnfund has many institutional strengths but also areas of weakness. Its strengths are largely the result of the current balance of staff and could be threatened by staff changes.</p>	<ul style="list-style-type: none"> • In general, to ensure the current balance is maintained through the strategy period and beyond, key elements (see section 7.3 for details) should be ‘hardwired’ more explicitly into Finnfund’s mandate and governance structures. • Consider strengthening the E&S and development impact specialism of the Board so that it can absorb and interpret the information it receives in this area. • Finalise and apply human rights policy robustly. • Strengthen M&E capacity to robustly measure and report development impacts.
<p>To what extent are changes needed to increase the likelihood that the theory of change is realized?</p>		
<p>Central to Finnfund’s work is managing</p>	<p>C8 – Given its existing portfolio and</p>	<ul style="list-style-type: none"> • Changes to the balance between private and public investors will be

Findings	Conclusions	Recommendations
<p>trade-offs between profitability, impact, commercial and ESG risks and Finnish interest. This is a challenging set of conditions which strongly affect what Finnfund does and therefore the impact it can achieve. ‘Tripling impact’ has implications for all these elements, and is likely to require changes in key areas, including to Finnfund’s funding structure. The way that Finnfund ‘doubles in size’ will determine whether it can sharply increase impacts or not.</p>	<p>funding structure and its requirement to achieve a certain level of returns, it is unlikely that Finnfund will be able to triple its impact under the current conditions. Improved project selection and management should enable Finnfund to increase its impact, but in our view there are hard limits to this. Tripling impact would require a 50 % increase in impact per unit of investment across the portfolio. While more can be achieved with investments similar to those taken on today, a change of this magnitude only seems possible if significantly more risk is taken on, in terms of challenging – but developmentally impactful – countries and sectors We believe it is unrealistic to think that this can be achieved consistently without having a negative effect on average returns, and that it is therefore strategically important to accept this and respond accordingly.</p>	<p>necessary to cover for the additional risks attached to increasing Finnfund’s size and impact. 6 options have been identified in that regard and are presented with specific recommendations in section 7.</p> <ul style="list-style-type: none"> • The unique contributions that Finnfund makes in the international community should be communicated better so that it can be understood, valued, and enhanced. To achieve this Finnfund should engage in more dialogue with civil society. • More effort should be made to communicate the importance of private sector development in general, and the role that Finnfund plays in this. Finnfund has many supporters and allies in Finnish civil society, who could be encouraged to take on a more vocal role in this regard. • Become more integrated into Finnish development policy, including membership of the Development Policy Committee. • All of the above would be enabled if Finnfund is better able to credibly demonstrate impact, and is seen as a development rather than a commercial actor. • Finally, transparency should include a greater openness about mistakes, which can be an opportunity to explain better the challenges and trade-offs that Finnfund faces.
<p>How should the planned additional €130 million MFA loan be spent?</p>		
<p>Finnfund cannot achieve its strategic objectives without more financing. How this is spent will be crucial to whether the 2018-25 strategy is achieved, but it is highly likely that further public investment will be needed.</p>	<p>C9 – How this investment is used is central to the goal of increasing impact.</p>	<p>We recommend five areas where this new finance should be used:</p> <ol style="list-style-type: none"> 1. Increase ability to understand and manage country and E&S risk 2. Increase ability to positively influence investees on business and E&S performance 3. Expand M&E capacity 4. Analyse and systematically manage commercial risk 5. Expand portfolio financing

1 Introduction

1.1 About Finnfund

Finnfund is a bilateral development finance institution (DFI), which provides loans, equity, mezzanine financing or guarantees to firms in developing countries, with the goal of promoting social, environmental and economic development. The Finnish Government established The Finnish Fund for Industrial Cooperation Ltd (Finnfund) as a development finance company in 1980. Broadly, its mission is to provide financing for private companies in developing countries in order to improve peoples' lives and foster sustainable development. More specifically, its core mandate is as follows:

“The Company shall promote the economic and social development of countries which the OECD has classified as developing countries by directing human and material resources to the development of the industrial and other economic corporate activity of these countries.” (Finnfund, 1979)

It is also important to note that Finnfund is required to be profitable. In this regard, the 2018-2025 Finnfund strategy defines the mission as:

“to build a better world by investing in responsible and profitable businesses in developing countries”. (Finnfund, 2018)

The State of Finland is the major shareholder owning a 93.8% stake. Additional shareholders are Finnvera Plc (6.1%) and the Confederation of Finnish Industries (0.1%). Finnfund's investment decisions are informed by four criteria:

- Social and environmental responsibility
- Development impact
- Finnish interest
- Profitability

Core to Finnfund's operations is to balance these criteria by identifying investments that will be responsible, profitable and impactful, whilst also furthering Finnish interests.

In contrast to other Nordic DFIs, Finnfund is also able to borrow in the capital markets to fund its activities. FMO, DEG and Proparco also utilise borrowed money, but they raise this based on a government guarantee rather than the strength of their own balance sheet. In October 2017, before the convertible loan from the Government had been drawn down, private borrowing accounted for 46% of its total financing, which exceeded the 40% it has received from public funds. The remainder of its activities are funded from reinvested earnings.

In April 2018, Finnfund's portfolio and undisbursed commitments were around €719 million. This represents a significant increase over recent years, reflecting a convertible loan of €130 million from the Government. Despite the increase in capital, Finnfund remains one of the smaller DFIs. Countries with similar sized DFIs are Belgium, Denmark, Switzerland and Sweden, though it should be noted that Finnfund is only of comparable size because of its borrowing from capital markets. In terms of capital supplied by government, Finnfund has received substantially less than these DFIs. Globally, the largest bilateral DFI is OPIC in the United States, which is roughly thirty times the size of Finnfund. DFI size is not simply a function of country size, however, but also dependent on policy decisions. The largest European DFI is FMO from the Netherlands, which had assets of €8.3 billion in 2017. The Dutch economy is a quarter the size of the UK and France and a fifth the size of Germany, but FMO is considerably larger than the CDC Group, Proparco and DEG respectively.

Finnfund's increased funding mirrors similar trends in other bilateral DFIs. Collectively, European DFIs saw their assets more than triple between 2010 and 2016, from €10.9 billion to €38.9 billion (EDFI, 2016). This shift seems to reflect the fact that donor countries see DFIs as particularly well placed to contribute toward achieving the Sustainable Development Goals (SDGs). The SDG funding gap has been estimated at around US\$2.4 trillion per year, of which roughly half is expected to come from the private sector. As well as achieving direct development impacts through their investments, therefore, DFIs are seen as having a crucial role to play in mobilising private investment into their target countries.

With this increased investment has come increased scrutiny, and many DFIs have been evaluated to assess their development impacts. *Inter alia*, BIO of Belgium was evaluated in 2012 (Carnegie Consult, 2012), SIFEM in 2013 (SECO, 2013), FMO in 2014 (Carnegie Consult and ODI, 2014), Norfund in 2015 (NORAD, 2015) and Swedfund in 2018 (Spratt et al., 2018). IFU of Denmark is currently being evaluated, and a 10-year longitudinal evaluation of CDC's ability to mobilise private capital is just getting under way. As well as independent evaluations of development impact, numerous internal or commissioned evaluations have taken place to assess impacts in particular areas, or the effectiveness of specific programmes or instruments. The current evaluation of Finnfund is, therefore, timely and in line with these trends.

Finnfund seeks to invest in projects with high potential development impacts, which also meet – or have the potential to meet – social and environmental standards. Projects should also be profitable, as the goal is to support and promote financially viable firms and should contain some element of 'Finnish interest'. As well as the involvement of Finnish firms or technology, this is interpreted broadly and may also relate to projects that are supportive of Finnish development policy.

Around 500 investment proposals are received each year, of which 50-60 enter the investment decision-making process. This does not mean the other proposals do not have merit, but rather that Finnfund has to prioritise projects based on its overall capacity and fit with objectives and areas of specialisation. The investment decision-making process lasts around 8 months and includes a due diligence process, as well as a screening of projects on the above criteria. 20-30 proposals are ultimately approved for investment per year, or around 5% of the original applications.

Geographically, just under half (46%) of the portfolio is in sub-Saharan Africa, with 24% in Asia and 16% in Latin America, and the remainder of the portfolio divided quite equally amongst the other developing regions. This is distinct from the average geographical allocation of European DFIs, where just 31% of investments are in sub-Saharan Africa, 20% in Latin America, and around 12% each in East Asia, South Asia, and Eastern Europe and Central Asia (EDFI, 2016).

Finnfund's three largest sectors are renewable energy (20% of portfolio and more than 50% of all projects approved in 2017), forestry (15%) and financial institutions (15%). The remaining significant sectors are basic industries (10%), manufacturing (4%), and transportation and storage (3%). While still less than 1% of the portfolio, agriculture is likely to increase in importance in the coming years due to the potential development impacts (e.g. employment intensity) in that sector. Again, this is different to the aggregated sector allocations for European DFIs as a group. By far the largest sector across this group is financial institutions (32.8%), followed by the power sector (18.3%), industry and manufacturing (15.2%), infrastructure (9.3%), agribusiness (8.5%), and services (4.7%) (ibid.).

Geographically, therefore, Finnfund is considerably more invested in sub-Saharan Africa than most other DFIs, while its sector allocations see a much greater weighting given to renewable energy and forestry, and a much lower weighting to financial institutions than European counterparts. The focus on forestry is particularly unusual, if not unique, among DFIs. A thorough analysis of the Finnfund portfolio is provided in Chapter 3.2 of this report.

In 2012, the Ministry of Foreign Affairs agreed to support a Special Risk Instrument (SRI), which partially guarantees losses in selected high-risk/high-impact projects. The aim of the SRI is to enable Finnfund to increase its risk tolerance for projects of this kind, and therefore development impacts, while not threatening its ability to maintain financial self-sufficiency. The instrument expanded from 2012-2015. Government authorisation to accept new projects to the SRI expired at the end of 2015 and was renewed in 2018 (when the maximum Government risk under the SRI also was expanded to EUR 75 million from EUR 50 million). The SRI now accounts for around 15% of Finnfund's portfolio.

The shifts in country allocations, as well as the increased use of the SRI, are in line with Finnfund's 2018-2025 strategy, which commits to increasing its weighting to low-income countries and fragile states, and to reaching a level of 80% of its portfolio in core sectors: agriculture, financial services, forestry and renewable energy. Finnfund also aims to double in size over the period, and to triple its development impact.

1.2 Evaluation aims, objectives and scope

The Unit for Development Finance and Private Sector Cooperation of the Ministry for Foreign Affairs (MFA) of Finland is the commissioner of the Finnfund evaluation. The assignment was channelled through the Evaluation Management Services (EMS) mechanism, a framework contract managed by the Development Evaluation Unit of the MFA.

The overall objective of the assignment as stated in the ToR was to "evaluate how well Finnfund has implemented its' mandate during the period 2008-2017, as defined by the Finnfund Act and the annual OSMs by the MFA." The core objectives of the evaluation were subsequently modified and focused in the light of discussions with the MFA, as described below.

The evaluation was conducted in two phases: an ex-post phase and an appraisal phase (MFA, Evaluation Guidance). The former was retrospective covering the work of Finnfund between 2008 and 2017. The 10-year period includes periods before and after 2012, from which time Finnfund has been directed by annual MFA guidance (OSMs). The second part of the evaluation was forward looking; focusing on Finnfund's 2018-25 strategy. The evidence to support the appraisal was drawn from a document review, interviews with stakeholders and Finnfund staff, and fieldwork in three countries. A workshop with Finnfund and MFA took place to discuss the initial findings, conclusions and recommendations prior to finalising the report.

The original TOR listed the following evaluation issues to address:

1. Relevance and additionality.
2. Commercial risk management.
3. Environmental, social and human rights related risk management.
4. The effectiveness in delivering desired outputs.
5. The effectiveness in delivering desired outcomes.
6. The effectiveness in leveraging other funds.
7. Efficiency of the organization.
8. Results measurement.
9. Communication.
10. Sustainability of investments.

As noted above, however, the scope of the evaluation is narrower than described in the original TOR. Given the need to deliver the evaluation in a short period, a revised ToR was agreed where the scope was narrowed to focus on 1-4, addressing other issues from the original TOR where possible. A

further caveat is that, as Finnfund does not yet have an operational human rights policy, this is not systematically addressed. Neither does the evaluation include MFA governance oversight specifically, as governance within Finnfund, including board oversight, is included

The evaluation also includes a benchmarking exercise, comparing Finnfund with Investment Fund for Developing Countries (IFU) in Denmark and Swedfund in Sweden. This is contained as a separate document in Annex 5.

It was agreed that the evaluation should assess Finnfund's 2018-25 strategy, particularly whether it is likely to achieve its stated impact objectives. The MFA will take a decision later in 2018 on whether to supply a new loan of €130 million. The evaluation team were asked to make recommendations on how these funds could be deployed to support the 2018-25 strategy. As well as development impacts, Finnfund's commitment to greater public transparency is an important aspect of this strategy to be assessed.

The analysis includes, but is not limited to, the investment policy and its' implementation, the structure and organizational capacity of the company, the functioning of the board as well as corporate strategies and their implementation. The evaluation also includes the special risk instrument, in spite of its' separate evaluation in 2018, as it is an essential element influencing the investment decisions of Finnfund.

The business partnership programme Finnpartnership, to which Finnfund provides administrative support under contract with the MFA, is out of scope. Finnpartnership's strategy and operational guidance is set directly by the MFA separately from the OSMs and, as a grant programme, its' immediate objectives differ from those of Finnfund.

This assignment will not consider the link between broader development and trade policy objectives of the MFA and the OSMs. The evaluation will, however, analyse positive and negative effects stemming from the OSM targets on the activities and results of Finnfund, as well as their relevance, realism and appropriateness.

1.3 Report outline

The report begins with an overview of methodology. This is divided into the ex-post and appraisal phases with research questions provided for each. This section also discusses research limitations.

Chapter 3 presents ex-post findings. We begin with an analysis of Finnfund's adherence to OSM guidance and compliance with international best practice on Environmental and Social (E&S) risk management and commercial risk management. We then go on to assess development effects based on Finnfund's own datasets. The chapter concludes with a focused analysis of the Special Risk Instrument.

Chapter 4 presents appraisal findings. This is structured around the Theory of Change (ToC) for Finnfund's 2018-25 strategy. It begins by mapping stakeholders and describing how the ToC has been used in the evaluation. Subsequent sections describe evidence from the fieldwork based around the interrogation of key assumptions in the ToCs.

Chapter 5 continues the focus on the future strategy, drawing on the findings to identify the factors likely to determine whether the stated goals are met.

Chapter 6 presents the conclusions of the study, while chapter 7 relates to our recommendations.

A short benchmarking study comparing Finnfund, Swedfund and IFU is contained in Annex 5.

2 Research questions, Methodology and Limitations

This section provides an overview of the research. It explains the two phases in detail, sets out the research questions and methodology, including justification for the methods used, and how they were applied.

As requested in the ToR, the evaluation was guided by OECD-DAC and EU evaluation criteria as interpreted by the MFA (MFA, 2018): a) relevance, b) efficiency, c) effectiveness, d) impact e) sustainability, f) aid effectiveness and g) coherence (see Annex 6 for a description of how these synergies were achieved).

2.1 Research overview

The research was conducted in two phases: ex-post and appraisal. The ex-post phase covered the investment period 2009-2017 and is based on historical investments and activities. It drew on data collected by Finnfund, as well as any complementary studies that were available. It assessed the following:

- Finnfund’s adherence to DFI best practice with respect to social, environmental and commercial risk management (evaluation issues 2 and 3);
- The alignment of Finnfund’s activities with its annual guidance (evaluation issue 1 – relevance);
- The development effects of Finnfund’s investments from 2009 to 2017 (evaluation issue 4); and,
- Finnfund’s additionality, both in a financial sense, and in terms of other forms of additionality such as ESG issues and business development (evaluation issue 1).

The appraisal phase was forward-looking and formative. According to MFA guidance, an appraisal is a “second opinion” on a proposed activity. It is “an overall assessment of the relevance, feasibility and potential sustainability of a programme prior to a decision of funding”. The MFA describes feasibility as the potential for the programme to be implemented efficiently, effectively and with impact”. It is distinct from ex-ante evaluation as it does not gather baseline data but may advise on this. In the appraisal study we:

- Further develop sectoral ToCs for the 2018-25 Finnfund strategy;
- Assess the probability that expected development impacts will be achieved based on the coherence and logic of the strategy, and Finnfund’s record in similar areas;
- Assess whether Finnfund is institutionally equipped to achieve these impacts;
- Recommend changes, as necessary, to the strategic approach or Finnfund’s institutional framework to increase the chances that the expected development impacts are achieved.

Across both phases of the research, there are three main research activities: i) primary research with Finnfund and other stakeholders to understand the strategy and develop theories of change; ii) secondary research using relevant Finnfund data and documents; and iii) fieldwork to gather case study information on investees. The research tasks were broadly carried out sequentially, with the data and document analysis taking place in July and August 2018 and the fieldwork taking place during

August 2018. Interviews and workshops with Finnfund and other stakeholders took place throughout the research.

2.2 Research questions

The evaluation addresses the following nine questions.

Ex-post

1. Have Finnfund's activities been aligned with its mandate and annual guidance?
2. Has Finnfund followed DFI and international best practice on environmental and social risk management?
3. Has Finnfund followed DFI and international best practice on commercial risk management?
4. Have Finnfund's investments positively contributed to development effects?
5. Have Finnfund's investments been additional?

Appraisal

1. What is the theory of change for Finnfund's strategy 2018-2025
2. What evidence is there that the programme design is likely to achieve this?
3. What evidence is there that Finnfund is institutionally set up to achieve this?
4. To what extent does the future programme/Finnfund institutional structure need to be revised to increase the likelihood that the theory of change is realized?

2.3 Methodology

2.3.1 Ex-post phase

The ex-post phase of the evaluation addresses the five questions set out above, using a combination of primary and secondary data. Secondary analysis was based on Finnfund's own documents and data.

Approximately 150 documents (or document types) were received from Finnfund. The documents were securely uploaded to Egnyte, an encrypted storage system. Of the documents published only in Finnish, 40 were marked for translation. Throughout the report, we reference the sources consulted in the relevant sections. These figures relate to organisation-wide documents only. A further set of documents were consulted as part of the fieldwork. The full list of documents consulted is listed in Annex 3.

Finnfund collects data on financial performance and development effects on an annual basis. The financial indicators are organised according to the nature of the investment: company, financial institution, or equity fund. Development indicators are collected in areas such as employment, taxes, lending patterns, as well as environmental effects.

Finnfund's portfolio currently consists of 176 investments. In some cases, investees have received more than one investment. The total number of investees (including funds) is therefore 140.

2.3.2 Have Finnfund's activities been aligned with its annual guidance?

To assess this question, annual OSMs were analysed and collated into a chronological table (see Annex 8). The table captures performance goals under each of its target areas. Finnfund's

performance was then assessed against its annual targets. Recognising that Finnfund invests for 7-10 years, we compared new investment decisions with prevailing guidance on an annual basis to assess the extent to which Finnfund adjusts its approach in response to changes in this guidance.

This section concludes with an assessment of how OSM guidance has affected Finnfund's activities and performance. How this might be improved is addressed in the Chapter 7 with sets out our recommendations vis-à-vis the 2018-25 strategy.

2.3.3 Has Finnfund followed DFI best practice on social, environmental and commercial risk management?

This question was answered in two parts. First by assessing the extent to which Finnfund itself is adhering to DFI best practice and requiring its investees to do likewise. Second, we assess the extent to which it is adhering to IFC best practice on commercial risk management. We approached this in the following way:

1. Identified best practice policies and processes
2. Reviewed Finnfund documents to assess whether these were consistent with best practice
3. Developed a matrix to document how Finnfund was approaching the issue and any evidence of compliance, or divergence

The output was then shared with Finnfund for feedback and discussed in follow-up emails and phone calls. E&S issues are also addressed as part of the development impact and appraisal sections.

2.3.4 Have Finnfund's investments contributed to development effects?

To assess Finnfund's development effects, we have been dependent upon the data that Finnfund collects, augmented from our findings from fieldwork. Given data availability, we focused on three core areas: business performance, employment, and taxation. Finnfund also collects data on Environmental and Social (E&S) effects, but this is at an early stage of development. The dataset is very much a work in progress, being the result of an intern's work in the summer of 2017 to collate the E&S data that Finnfund has. Although the dataset is not currently of sufficient quality to allow substantive findings to be reported, we have drawn some conclusions where there is sufficient evidence to support these.

We refer to development 'effects' rather than 'impacts' deliberately. As mentioned, we are dependent upon the data that is available, and this is at the level of output rather than outcome. This is reflected in the ToR, which suggests prioritising outputs as outcomes are much more difficult to assess. The question of attribution is also key. While Finnfund – as is the case with all DFIs – reports on the performance of its investees in a variety of ways, this does not mean Finnfund's investments necessarily caused these effects. We do not have sufficient data to try and establish causation statistically. Given this, the question of attribution is addressed more qualitatively, drawing on the other elements of the evaluation described in this Chapter.

2.3.4 Have Finnfund's investments been additional?

Attribution is a subset of additionality. To have the potential to cause an effect, Finnfund's activities must first be additional. If investments would have happened even if Finnfund did not exist, then it is

logically impossible to claim attribution for any effects. Additionality does not guarantee attribution, but creates the space for it to be possible. On the other hand, if there is no additionality, attribution is impossible.

There are two discreet elements to the question of additionality: financial and non-financial. Financial additionality refers to the extent to which the funding fills a gap left by the private sector, or alternatively is crowding out private investment. This asks whether the investment could have been acquired through other means. Non-financial additionality refers to whether engagement with Finnfund leads to improvements in development outcomes, business or E&S performance e.g. through compliance with performance standards or via capacity-development support. In this instance, even if the finance is additional, improvements in other areas may have happened anyway as part of a process of normal change (deadweight), may have been as a result of other actors (attribution) or may have displaced other equally valuable activities (displacement).

While it is a critical question, it is not possible to assess additionality directly. In the ex post phase of the evaluation we have identified the elements of the portfolio that there is good reason to think are additional. By comparing the effects generated in this part of the portfolio with the total effects, we can get a sense of what proportion of the reported effects may be the result of Finnfund’s activities.

2.3.5 Appraisal

Appraisal refers to the forward-looking formative phase of the evaluation. There are several elements to this part of the analysis, which are described below.

Theory of change, indicator development and stakeholder engagement

A ToC was developed for the 2018-25 strategy in collaboration with Finnfund. As part of the inception phase, we held a series of interviews and a workshop with Finnfund staff to understand the strategy and identify assumptions underpinning it. The aim was to systematically identify indicators to inform the interview schedules used in the fieldwork – i.e. the questions to be asked. These in turn informed the reporting template and the structure of the appraisal section of this report.

Table 1 List of stakeholders engaged

Stakeholder group	Number of representatives
Finnfund	18
The MFA	3
The Prime Minister’s Office	2
Indufor	2
Finnish investors	1
The Development Policy Committee	1
Independent consultants	3
NGOS (Finnwatch, KEPA, and Forests Development Trust, Friends of Earth...)	11
Other DFIs	1
Academics	3

Total	46
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Following this a series of stakeholder interviews and workshops were held to interrogate aspects of the ToC that were either not relevant to the fieldwork, or to shed further light on those findings. Table 1 lists the stakeholders engaged. As well as the 46 people interviewed as part of this process, a further 53 interviews took place in the field (38 in Africa and 15 in Honduras). This brings the total number of people engaged as part of the research to 98 (see Annex 2 for a list of all participants).

Overview of Fieldwork

There were three priorities for the fieldwork:

1. To gain an understanding of investee firms experience with Finnfund: what has worked well; what less so; where the most value has been created; what could be done in the future to enhance this.
2. To interrogate the sectoral and institutional level ToCs. By “interrogate” we mean test the implicit assumptions and come to a view, on the basis of the projects visited, how likely it is that the objectives set out in the 2018-25 strategy will be achieved.
3. To inform our recommendations for adjustments to the way that Finnfund operates to enhance development impacts and additionality and increase the chances that strategic goals are achieved.

In line with MFA guidance, the appraisal is an objective “second opinion” on the strategy that is proposed. The findings could be used to inform course correction and support continuous improvement by highlighting areas where the programme could be strengthened and weaknesses of the strategy and its implementation.

Country selection and implementation for fieldwork

The first task was to select the most appropriate countries for fieldwork. The selection criteria, based on the ToR, MFA guidance and practical considerations, included the following elements: a reasonable number of investments, Finnfund operational for at least five years, two African countries with good transport links, cases cover spectrum of Finnfund’s activities, one Latin American country. The ToR also indicated that the evaluation should cover no less than 10 investments in total.

A total of 11 projects were visited, which was in line with the MFA’s requirement. In each country, the evaluation team member was accompanied by a senior country expert. Table 2 describes the countries and projects that were visited and a rationale for the choice.

Table 2 Country selection and rationale

Country	Project	Rationale
Tanzania	Kilomberto Valley Teak Company (KVTC)	Forestry sector central to Finnfund’s current and future portfolio. Three projects, including varied and long-standing investments allowed us to explore this in depth. The three projects also located relatively near to each other in the area of Southern Highlands.
	New Forests Company (NFC)	
	Green Resources AS (GRAS)	
	Africado	Agricultural sector earmarked for growth in 2018-25 strategy
Ethiopia	M-Birr mobile money	Finance is a strategic sector
	Ethiopia Growth and Transformation Fund (EGTF;	

	Schultze equity fund)	
	EthioChicken	Agricultural sector earmarked for growth in 2018-25 strategy
Honduras	Valle Solar (solar)	Renewable energy is a strategic sector. With a mix of solar and hydropower, these four projects make up Finnfund’s current renewables portfolio in Honduras (with the exception of La Vegona, which Finnfund recently exited). Honduras is also important because of the controversy surrounding Finnfund’s financing of the Agua Zarca project.
	La Vegona (exited 2017) (hydro)	
	Los Laureles (hydro)	
	Mezapa (hydro)	

Preparation for the fieldwork drew on the document review, ToC work and interviews with MFA and Finnfund staff. These informed the interview schedules and were mapped systematically to the evaluation questions and indicators identified above.

The documentary sources of evidence for the country-level assessment included: (1) documents generated by Finnfund, such as investment memoranda for the relevant projects, contracts between Finnfund and the investees, and E&S reviews and action plans; (2) documents generated by the investees, such as E&S and development impact reports, technical reports, human resources manuals, publications, and various other project-specific files; and (3) publications prepared by external stakeholders.

The main stakeholder group consulted in the field were business owners and managers. We conducted Skype interviews with managers based outside the country of investment (e.g. Norway and South Africa), and country-level as well as the operational staff of the investee firms (such as workers’ union representatives, when available). We also consulted key informants, mainly of international experts from relevant institutions or independent consultants, as well as a representative of the Embassy of Finland in Dar Es Salaam. In Honduras, site visits to all power plants were made, and renewable energy experts consulted.

It was beyond the scope of the evaluation to engage a representative sample of beneficiaries (e.g. junior cadre level employees) or local stakeholders (such as inhabitants of affected nearby communities). However, whenever possible we interviewed workers’ union representatives and village chiefs.

Information was gathered systematically using the interview schedule and field report template, both of which are linked with the main report structure. This ensured that key assumptions in the ToC were investigated systematically and that all data gathering was geared towards answering the relevant research questions. Finally, field report findings were formulated based on a triangulation of evidence from complementary sources of evidence described above.

2.3.6 Limitations

There three main limitations to this study. These relate to the overall research design and scope of the research, and to the quality of existing data that Finnfund hold. Here we describe the implications of each and ways we sought to overcome them.

Research design limitations

The key limitations in design result from time available for the evaluation. Due to the short timescale (which also coincided with public summer holidays in Finland) some research activities were not possible. The ex-post research was based on existing data, with associated data limitations. The primary research was also time-constrained and was thus limited to three countries and 12 projects. While we could only cover four sectors, these were priorities for Finnfund's strategy. To overcome limitations with design, additional stakeholder engagement with NGOs, investors and policy makers was conducted to gain a broader perspective on Finnfund's work. In addition, the scope of the fieldwork was broadened to comprehensively cover as many of the research questions as possible and all aspects of the theory of change.

Scope of primary research

An important limitation of the field work was lack of access to projects located in remote and rural areas. As a result, in many cases, we could not explore the sites beyond the offices of the investee firms. This also limited out exposure to workers, suppliers and communities. However, this varied with the type of investment. For the agriculture projects, it was possible to visit the farms and for one (Africado), we also invited village chiefs from nearby communities to join the meeting at the company premises. For the forestry companies, we carried out the interviews in provincial offices often connected to a sawmill or electricity pole treatment plant, allowing the evaluation team to witness the overall functioning of the production activities. In the case of M-Birr, the mobile money company, interviews were conducted only among staff based in the capital. For the Ethiopia Growth and Transformation Fund (EGTF), only telephone interviews were conducted, and it was not possible to visit any of the investees of the EGTF.

In Honduras, all four power plants were visited, but the schedule did not permit visits to beneficiary communities. The conclusions reached here have been drawn from interviews conducted with teams from the four case study projects. We were also able to draw upon a Steward Redqueen study commissioned by Finnfund, which estimated the macroeconomic impacts of Finnfund's energy investments in Honduras. It should be noted that consultations with wider civil society, including vocal critics of renewable energy projects in Honduras, were beyond the scope of the study. Also, beyond the scope of the research was an in-depth financial or economic analysis of the energy market, and particularly the current position, and likely future, of ENEE – perhaps the biggest risk to the private generation market at present.

Data limitations

The secondary data analysis was based on the data made available by Finnfund and has not been independently verified by the research team. We have no reason to doubt its veracity, however, there are several weaknesses with the dataset that are important to highlight. There are three types of development effects that are potentially of interest to Finnfund:

1. The effectiveness in delivering desired outputs (e.g. ability to select and support successful ventures that generate jobs, taxes etc.)
2. The effectiveness in delivering desired outcomes (the ability to support positive development outcomes in the investee communities and countries)
3. The effectiveness in leveraging other funds (the ability to crowd in other funds through demonstration effects, building investor confidence etc.)

To make an assessment of impact, each area would require before and after measurements from a representative sample of projects. As well as that, some measures of additionality (attribution, deadweight and displacement) would be required to assess the link between any observed outcomes and Finnfund finance and activities. However, the data we have received is limited both in its scope (the number of outcomes being measured) and the quality of the datasets provided. For example, many areas of potential interest have only recently begun to be tracked by Finnfund, making impact evaluation impossible.

The findings presented in this report are therefore only a partial indication of the effects we may see in the future, both because Finnfund is implementing a new strategy that explicitly aims to increase impact, and because it is putting in place monitoring systems to better measure these impacts. We discuss these systems in Chapter 4, and make recommendation with respect to future additionality in Chapter 7.

3 Ex-post Findings

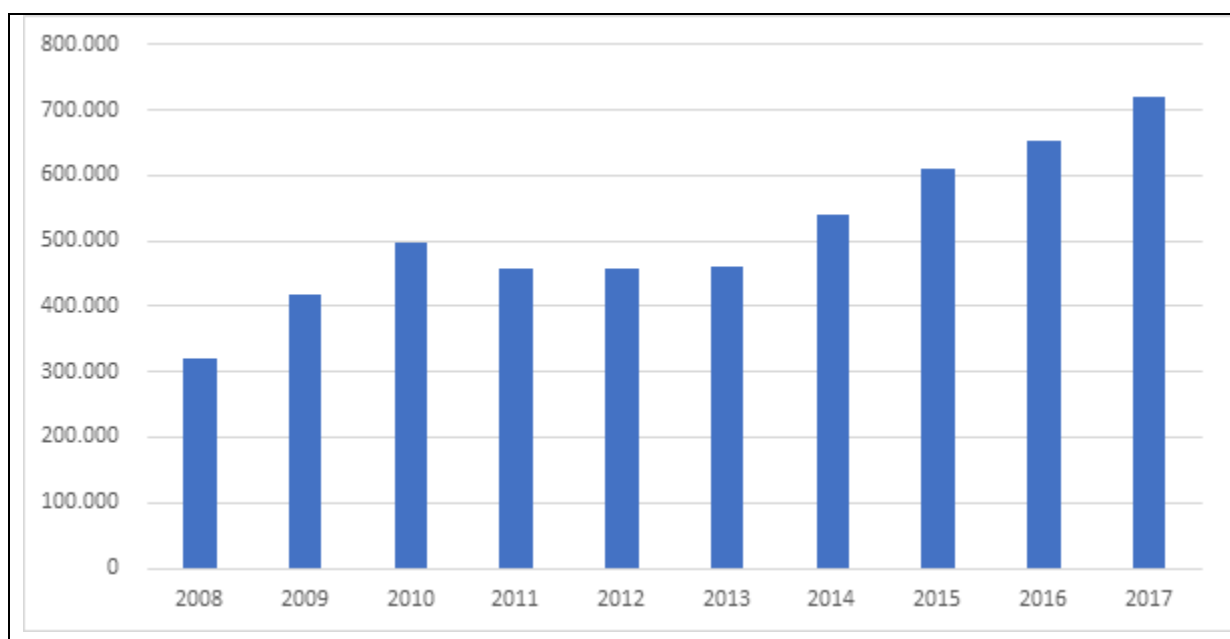
3.1 Introduction

After providing an overview of Finnfund’s portfolio, this chapter presents the findings from the ex-post study. First, we assess the extent to which Finnfund’s activities have been aligned with its annual guidance in the form OSMs. Second, we assess whether Finnfund has followed international best practice on E&S and commercial risk management. Questions of development effects and additionality conclude the chapter.

3.2 Portfolio overview and financial performance

In this section the main features of Finnfund’s investment portfolio are described, in terms of regional and sectoral allocations, instruments used, and changes over time in each of these areas. Where contemporary figures are provided, these relate to the portfolio as of March 2018.

Figure 1 Evolution of Finnfund portfolio and undisbursed commitments, 2008-17

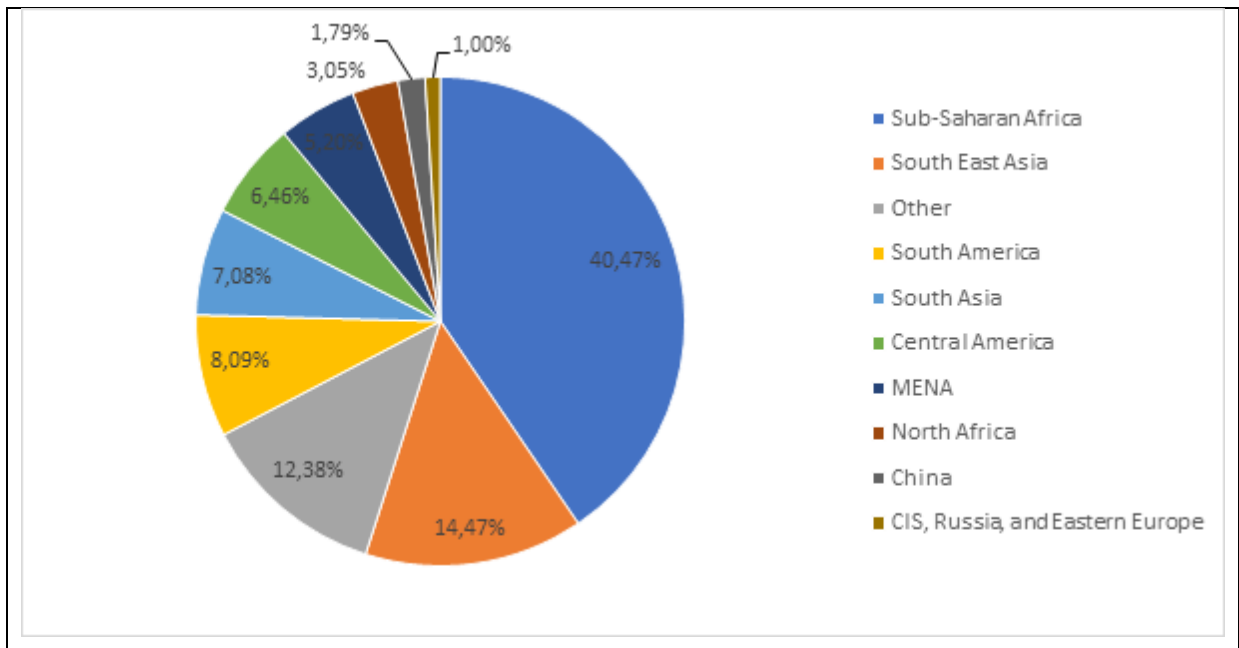


As we can see from Figure 1, Finnfund’s portfolio more than doubled in size between 2008 and 2017, from a little over €300,000,000 to more than €700,000,000 today.

3.2.1 Geographical allocation

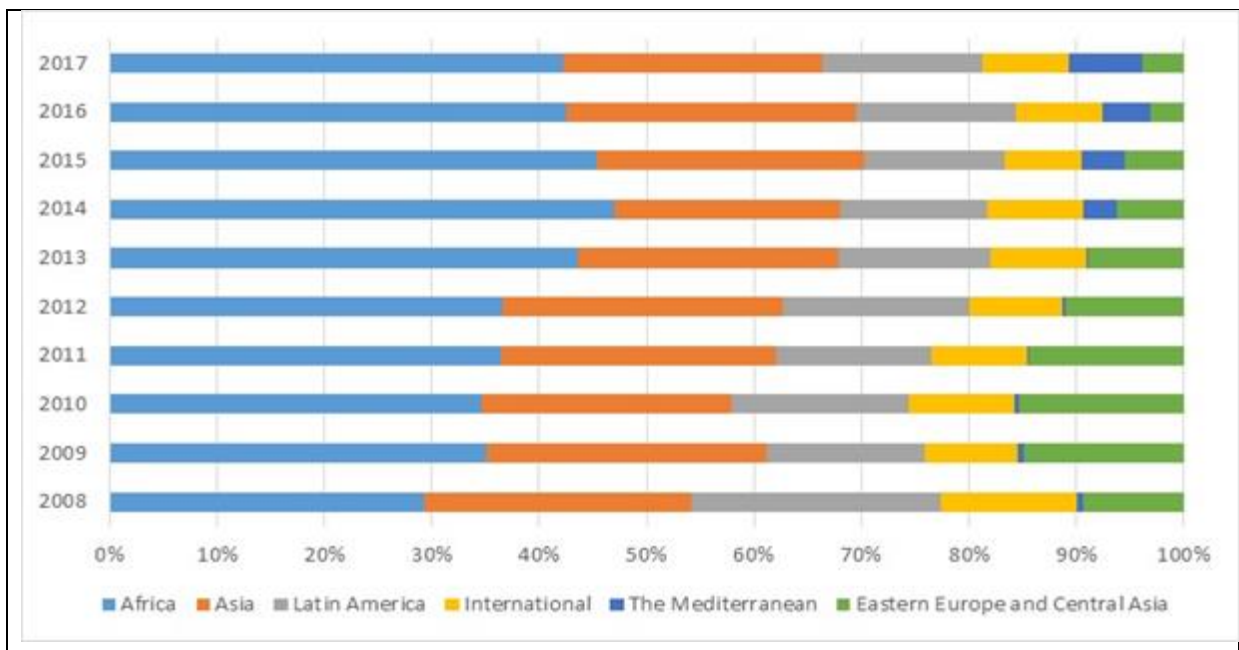
Data presented in this chapter that relates to the current portfolio is drawn from an original dataset provided by Finnfund, subsequent further information provided, and a review of historic annual reports.

Figure 2 Geographical Distribution of Finnfund’s Portfolio (Disbursed and undisbursed, Euros)



By far the largest region is sub-Saharan Africa with 40 % of the total. The next largest is South East Asia with 14.5 %, followed by South America (8), South Asia (7), Central America (6.5) and China (4.2). ‘Other’ refers to investments in funds or companies with an international focus.

Figure 3 Geographical evolution of portfolio and undisbursed commitments, 2008-2017 (Source: annual reports)



The geographical evolution of the portfolio is illustrated in Figure 3 above. As we see, the sub-Saharan African weighting has increased steadily over the period, and the Asian allocation remained relatively constant. The Latin America weighting has fallen significantly, while that for Eastern Europe and Central Asia also ended the period much lower than it began, after having expanded in 2009 and 2010.

Table 3 Regional Distribution of Finfund portfolio

	<i># Deals</i>	<i>Proportion of portfolio %</i>	<i>Total (Portfolio and Undisbursed) in Euros</i>	<i>Average Deal Size (Euros)</i>
Sub Saharan Africa	76	40.47%	290,890,688	3,827,509
South East Asia	26	14.47%	104,016,041	4,000,617
Other	19	12.38%	88,976,999	4,683,000
South America	7	8.09%	58,180,483	8,311,498
South Asia	13	7.08%	50,868,926	3,912,994
Central America	12	6.46%	46,424,403	3,868,700
MENA	5	5.47%	39,334,632	7,866,926
Mediterranean Countries	5	2.78%	19,947,615	3,989,523
China	11	1.79%	12,881,541	1,171,049
CIS, Russia, and Eastern Europe	7	1.00%	7,210,567	1,030,081

Table 3 summarises the geographical characteristics of the current portfolio. In addition to being the largest region in terms of volume, sub-Saharan Africa has almost three times the quantity of deals of any other region. Average deal sizes are between €3-4mn for most regions. Exceptions are South America and MENA, where average deal sizes are double this, and China and the former Soviet Union, where they are much smaller at around €1mn., largely as these are older loans which have been substantially repaid

Table 4 Top country exposures (portfolio + undisbursed commitments including only direct investments) 2018

Country	Portfolio Value 2018 (Euros)	Proportion of portfolio 2018
Kenya	38,643,934	5.38%
India	28,003,508	3.90%
Tanzania	23,580,500	3.28%
Egypt	21,913,806	3.05%
Ghana	20,696,372	2.88%
Paraguay	19,884,750	2.77%
Ethiopia	18,980,988	2.64%
Jordan	18,959,219	2.64%
Rwanda	18,261,505	2.54%

Table 4 identifies the ten largest individual countries in the portfolio as of March 2018. The largest is Kenya, which accounts for over 5 % of the portfolio. India, Tanzania and Egypt each account for between 3 and 4 %, with Ghana, Paraguay, Ethiopia, Jordan and Rwanda comprising between 2 and 3 %. Of this list, three countries are categorized as low-income by the World Bank: Ethiopia, Rwanda, and Tanzania. Three are lower-middle income, all of which have graduated from low-income status in

the past ten years: Ghana, India, and Kenya. The remaining countries are classified as upper middle-income: Egypt, Paraguay, and Jordan.

Figure 4 Financial instruments, 2008-2017 (source: annual reports – mezzanine finance not isolated)



As of 2017, more than half of the portfolio was in loans, with a quarter in direct equity, and the remainder invested through funds. Figure 4 shows how this composition has changed from 2008. The most notable shift we can see is the growth of the direct equity portfolio relative to loans.

Table 5 Instrument Distribution by region, (by Euro volumes, disbursed and undisbursed)

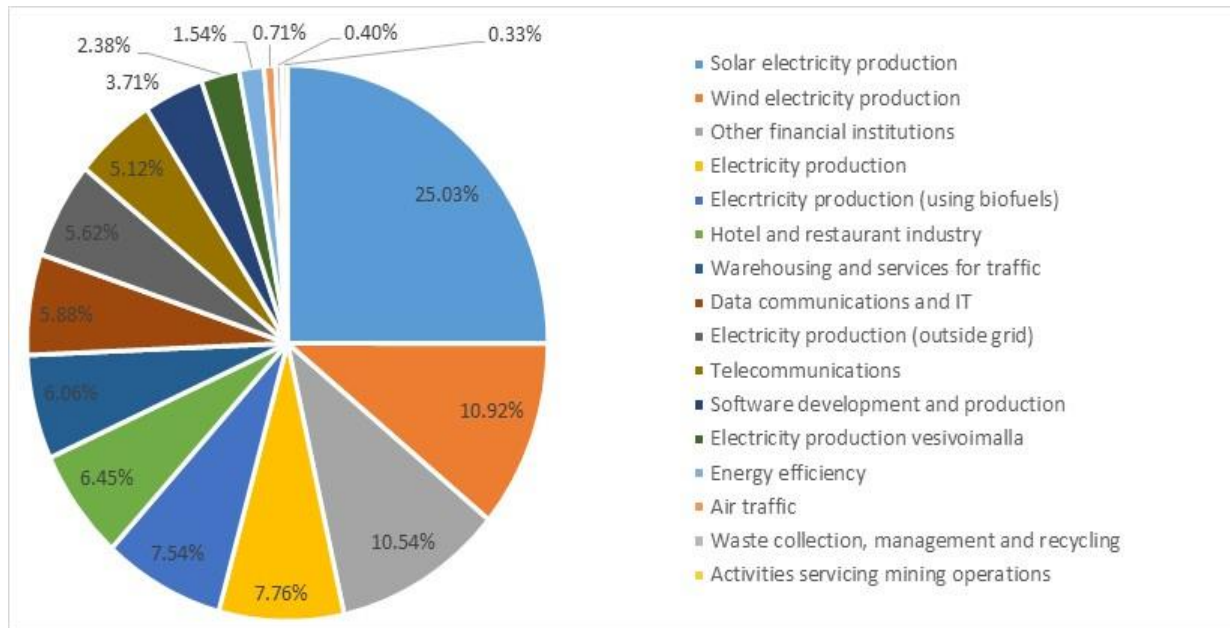
	<i>Equity</i>	<i>Fund</i>	<i>Loan</i>	<i>Mezzanine</i>
China	50%	0%	50%	0%
South America	51%	3%	40%	6%
Central America	28%	14%	45%	12%
Other	27%	36%	38%	0%
CIS, Russia, and Eastern Europe	28%	0%	72%	0%
South East Asia	32%	10%	51%	6%
Sub Saharan Africa	22%	24%	38%	16%
Mediterranean Countries	5%	0%	95%	0%
MENA	0%	0%	100%	0%
South Asia	0%	19%	81%	0%

Table 5 breaks this down by region. Notable features are: at a) the balanced use of instruments in sub-Saharan Africa, and – to a lesser extent – South East Asia; b) the importance of direct equity in China and South America (though the former has an almost equal proportion of loans); and c) the dominance of loans in the Mediterranean, MENA, the former Soviet Union, and South Asia. Reflecting the prominence of internationally focused funds, the largest investment form in the ‘other’ category is equity funds.

3.2.2 Sectoral characteristics of portfolio

The sector allocations of the current portfolio sees infrastructure as the largest sector, with just over 40 % of investments. The next largest is financial institutions and funds (33.5 %), followed by agribusiness (16.5) and industry and manufacturing (8). These top line categories obscure significant sub-sector variety, however. Figure 5 illustrates this for infrastructure.

Figure 5 Composition of infrastructure portfolio and undisbursed commitments, 2018



More than half of the infrastructure portfolio is comprised of electricity related projects. The largest is solar power generation, which accounts for a quarter of the total, followed by wind power (11). Other important elements are bioenergy production, and non-specified investments, which we understand relate co-financing arrangements with other European DFIs and financiers, primarily in the renewable energy sector. Outside energy, the largest component is infrastructure-related financial institutions (10.5), hotels and restaurants (6.5), warehousing and transport support (6), and communications and IT (6).

Breaking down the finance portfolio, more than half of investments are made through investment funds, with 28 % invested in banks, and 17.5 % in microfinance institutions. In agribusiness, most investments (85 %) are in forestry while industry/manufacturing investments are diversified across sub-sectors.

Figure 6 Evolution of sector allocations, 2008-2016 (Source: annual reports)

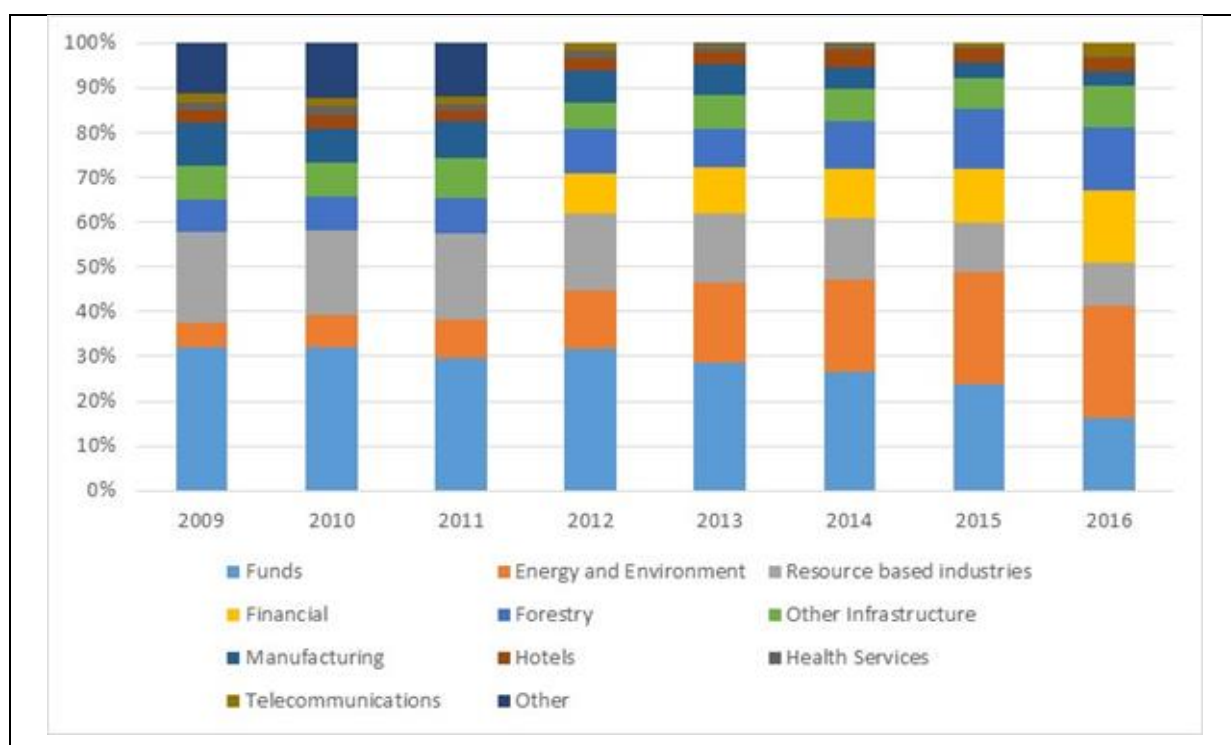


Figure 6 illustrates how sector allocations have changed over time. The main features are a steady rise in the importance of energy and environment related investments, the growth of the financial sector from 2012, and a reduction in fund investments from the same point, and reduced weighting to smaller sectors in recent years.

Table 6 Sectoral distribution of portfolio by region (Euro volumes, disbursed & undisbursed)

	<i>Infrastructure</i>	<i>Industry / Manufacturing</i>	<i>Agribusiness</i>	<i>Financial sector</i>	<i>Services</i>
Mediterranean Countries	95.05%	4.95%	0.00%	0.00%	0.00%
MENA	94.92%	5.08%	0.00%	0.00%	0.00%
Other	55.54%	0.00%	0.00%	44.46%	0.00%
Central America	54.89%	21.69%	0.00%	23.42%	0.00%
South America	45.83%	0.00%	47.11%	7.06%	0.00%
South East Asia	39.17%	4.77%	15.22%	40.84%	0.00%
China	37.26%	62.74%	0.00%	0.00%	0.00%
Sub Saharan Africa	31.09%	4.13%	25.53%	38.55%	0.70%
CIS, Russia, and Eastern Europe	27.81%	72.19%	0.00%	0.00%	0.00%
South Asia	10.70%	25.99%	0.00%	63.31%	0.00%

Table 6 breaks down the sectoral portfolio by region, highlighting some interesting differences. This is based on portfolio data rather than inferred from annual reports, so the sector classifications differ. Sub-Saharan Africa is reasonably diversified, with around a third of investments each in infrastructure, agribusiness and finance. South East Asia, Central and South America also show

reasonable diversification, while other regions are more concentrated. More than 60 % of investments in South Asia and China, for example, are in finance and industry respectively. Most investments in the former Soviet Union (more than 70 %) are also in industry and manufacturing. These regions are those where the 'Finnish interest' requirement is interpreted such that Finnish companies must be involved in transactions. The importance of industry and manufacturing thus reflects the engagement of Finnish businesses from these sectors.

Agribusiness investments are concentrated in South America, South East Asia, and sub-Saharan Africa. Other sectors are more diversified across regions, with infrastructure a major component (i.e. at least a quarter of all investments, and up to 95 % in some cases) in nearly all regions. The exception is South Asia, where investments of this kind account for only 10 % of Finnfund's investments.

3.2.3 Risk characteristics of portfolio

The figures presented in this section are based upon Finnfund's own classification of risk. This takes two forms. First, Finnfund's own internal classification of risk for projects, and second, the project risk rating, which takes account of project, portfolio and instrument elements, and thereby captures 'Finnfund risk' as well as project risk. In most cases, these are similar, though there are some differences, for example where the choice of instrument or availability of collateral affects risk levels.

Table 7 Risk distribution of portfolio and undisbursed commitments by instrument

FinnFund Internal Risk Categorisation	Equity	Fund	Loan	Mezzanine	Total
AA	0.00%	0.00%	0.00%	0.00%	0.00%
A	0.14%	0.00%	0.00%	0.00%	0.14%
BBB	0.00%	0.00%	6.31%	0.00%	6.31%
BB	0.00%	2.36%	7.50%	0.18%	10.04%
B	1.41%	7.45%	15.44%	0.62%	24.91%
CCC	6.78%	5.95%	11.71%	0.45%	24.90%
CC	9.50%	1.22%	5.86%	3.41%	20.00%
C	4.69%	0.71%	0.91%	2.53%	8.84%
D	1.75%	0.26%	1.29%	1.55%	4.85%
Total	24.28%	17.96%	49.02%	8.74%	100.00%

Table 7 breaks down the portfolio by risk classification and instrument. As the loan book accounts for half the total portfolio it is unsurprising that this is also where the greatest risk is found, with 18.48 % being loans rated CCC-C. Offsetting this, 29 % of the portfolio is BBB-B rated loans. The direct equity portfolio is heavily skewed towards CCC-C rated projects, with a similar proportion of total portfolio risk as for loans in these risk categories.

Table 8 Risk distribution of portfolio and undisbursed commitments by sector

Internal Risk Categorisation	Agribusiness	Financial sector	Industry/ Manufacturing	Infrastructure	Services
AA	0.00%	0.00%	0.00%	0.00%	0.00%
A	0.00%	0.00%	0.14%	0.00%	0.00%
BBB	0.00%	0.00%	0.28%	6.04%	0.00%
BB	0.00%	6.71%	1.30%	2.04%	0.00%
B	1.56%	16.32%	0.05%	6.99%	0.00%
CCC	6.07%	6.91%	2.09%	9.83%	0.00%
CC	3.84%	1.22%	0.98%	13.67%	0.28%
C	4.88%	0.94%	1.02%	2.01%	0.00%
D	0.00%	1.48%	2.03%	1.34%	0.00%
Total	16.35%	33.58%	7.87%	41.92%	0.28%

Looking at risk by sector in Table 8, we see the most common category for agribusiness and industry/manufacturing is CCC, for infrastructure, CC, and for financial sector investments B.

Figure 7 Risk profile of major regions

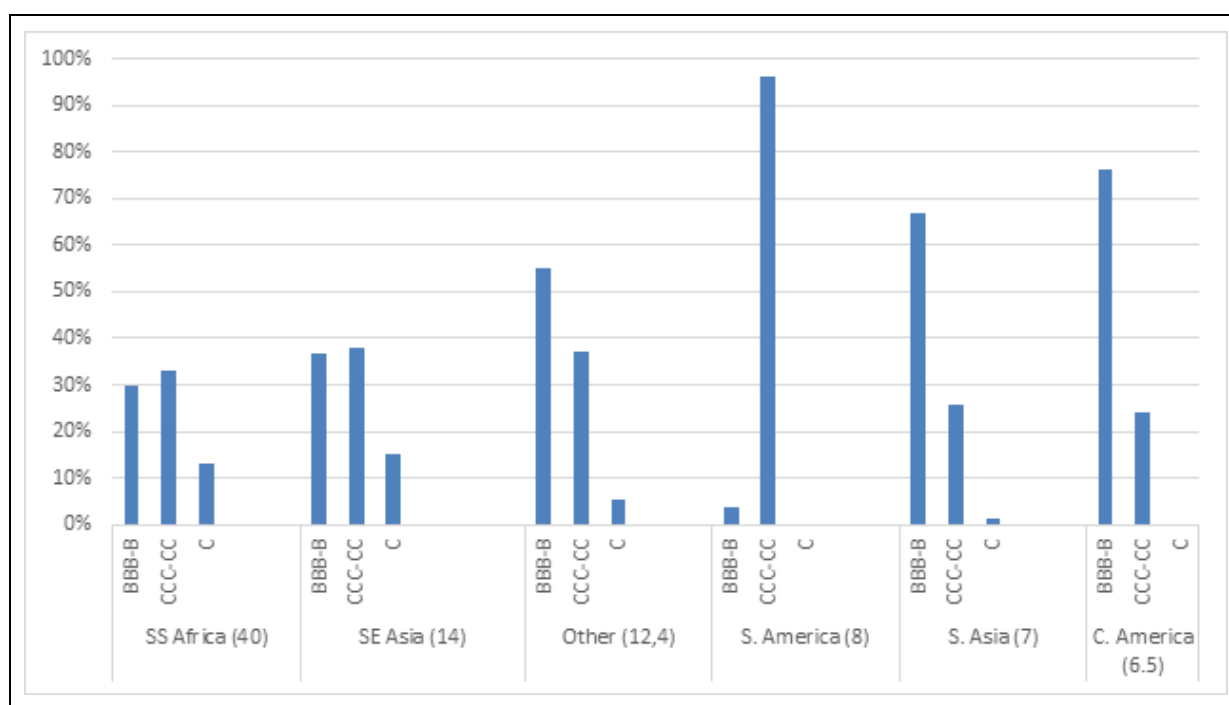


Figure 7 cuts the data somewhat differently, looking at the proportion of projects in the largest regions in the portfolio within each risk classification. These regions account for almost 90 % of the portfolio (regional weights given in parentheses). To aid comparison, risks are grouped into three categories representing low, medium, and high risk respectively: BBB-B; CCC-CC; and C.

The lowest risk categories are ‘other’, which is comprised of multinational funds, South Asian and Central America. In each case, BBB-B is the largest risk grouping, accounting for more than half of investments, and almost 80 % for Central America. Both sub-Saharan Africa and South East Asia, have similar risk profiles, with a relatively even split between BBB-B and CCC-CC, and a little under 15 % single C. South America has the highest risk profile, with more than 90 % of investments graded CCC-CC.

Performing the same exercise for the smaller regions, we can group these according to risk profile (these are relative to Finnfund’s portfolio not the market more generally – i.e. ‘low risk’ investments in this categorisation would be considered quite high risk by many commercial actors):

- **Low risk:** ‘other’; South Asia; Central America, MENA
- **Medium risk:** sub-Saharan Africa; South East Asia; CIS/Russia and Eastern Europe
- **High risk:** South America; China.

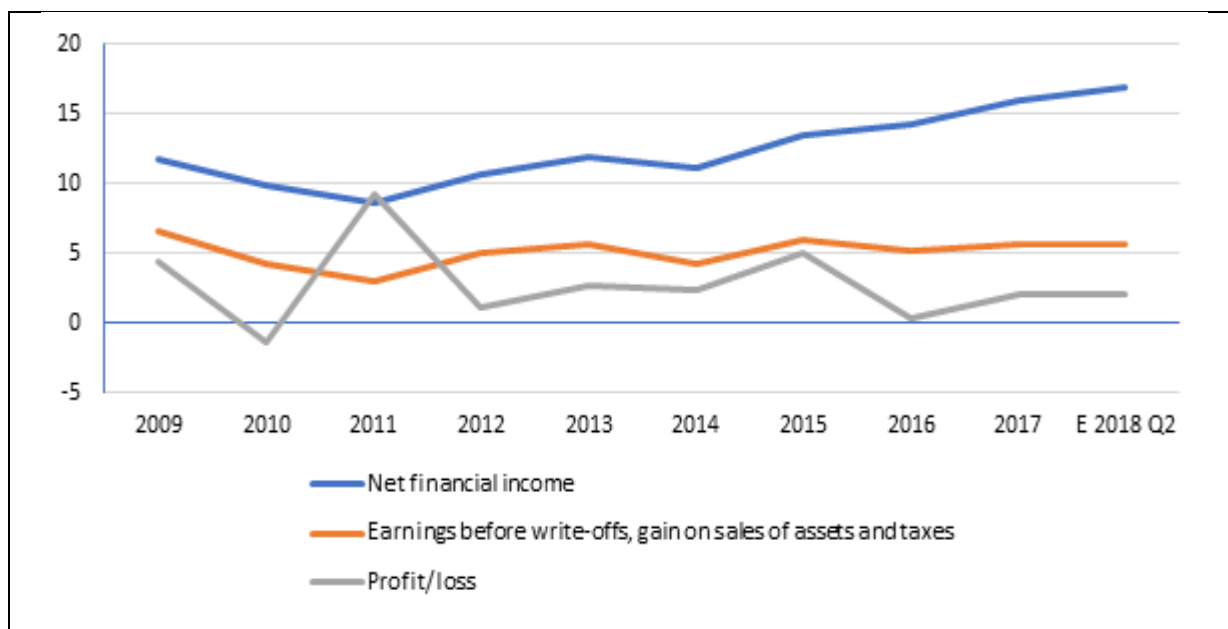
Broadly, this distribution finds higher risk investments in regions that are relatively small parts of the total portfolio. The two largest regions – South East Asia and sub-Saharan Africa – have somewhat lower risk profiles in terms of the internal risk classification of projects.

While the total level of risk in the portfolio is relatively stable, this is likely to change in coming years. The 2018-25 strategy aims to increase the weighting to high-risk countries, including FCAS. The intention is also to focus on fewer sectors, as discussed above. Both changes will increase risks, first by operating in riskier environments, and second, by being less diversified by sector. This latter point is compounded by the fact that some strategic sectors are also high risk. Forestry, renewable energy, and finance are already significant parts of the portfolio. Agriculture is not yet, however. As agriculture increases its weight in the portfolio, displacing a more diversified set of sectors, we would expect the risk profile of the portfolio to deteriorate.

3.2.4 Financial performance

Figure 8 charts Finnfund's financial performance from 2009 to date.

Figure 8 Finnfund financial performance, 2009-2018



As we can see, Finnfund was net profitable in every year with the exception of 2010. The subsequent year (2011) Finnfund recorded by far its largest annual profit, at almost EUR 10 million. In all other years, annual profits have been between EUR 0 and 5 million.

3.3 Have Finnfund's activities been aligned with its annual guidance?

3.3.1 Background

In addition to its mandate, Finnfund receives annual guidance from the MFA in the form of Operational Steering Memoranda (OSM). The details of OSM guidance from 2011 to 2018 are contained in Annex 8. While specific annual targets have changed regularly, OSMs focus on Finnfund activities in the following target areas (key areas of focus are listed under each target):

Target: The positive development impacts of Finnfund's investments grow and ability to assess development impact of investments and report on them improves.

- Proportion of projects deemed good or excellent in terms of impact
- Proportion of projects where Finnfund has created high value-added in terms of impact
- Jobs created; taxes paid; farmers reached; export earnings generated.

Target: Finnfund's investments help create broad based and poverty reducing economic development in those countries in which their own economic institutions are weak.

- Proportion of projects in low and lower-middle income countries and impactful sectors.
- Proportion of projects directly benefiting low income groups in countries.
- Financial additionality.

- Environmental impact measures.

Target: Finnfund strengthens collaboration with Finnish companies.

This target does not feature in OSM guidance from 2012 onwards.

Target: Finnfund works in a cost-effective way (+ from 2014: ‘and develops tools for defining cost-efficiency based on international comparisons’).

- Various measures of cost efficiency (i.e. administration costs as share of activities)

Target 4: Finnfund operates self-sufficiently.

- Return on equity etc.

3.3.2 Assessment

Figure 9 Share of the projects evaluated to be good or excellent by their development impacts from all of the investment decisions (%)

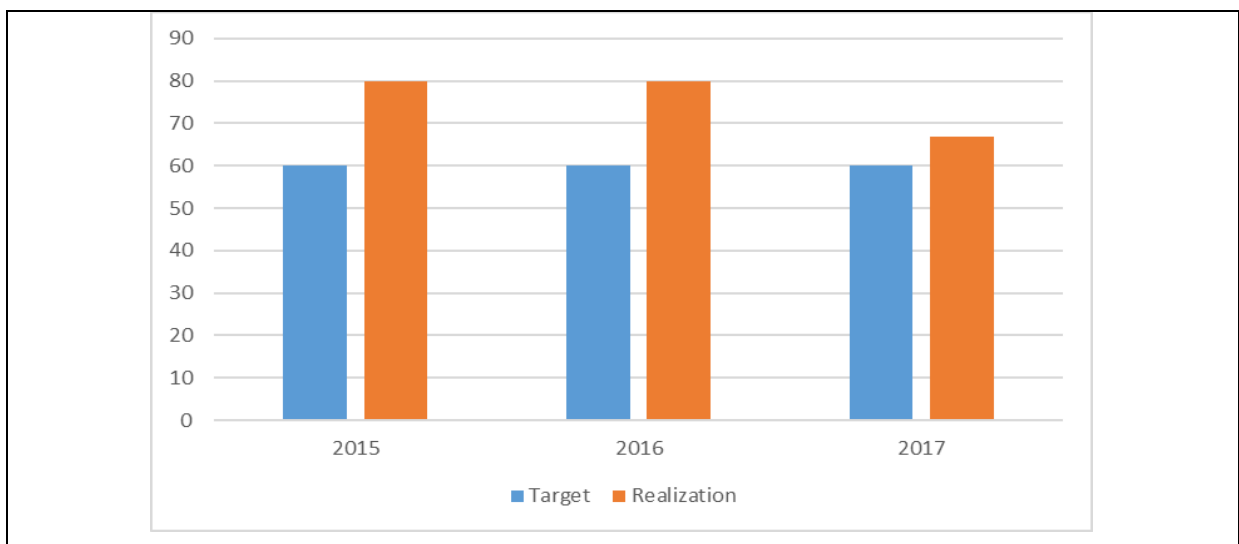


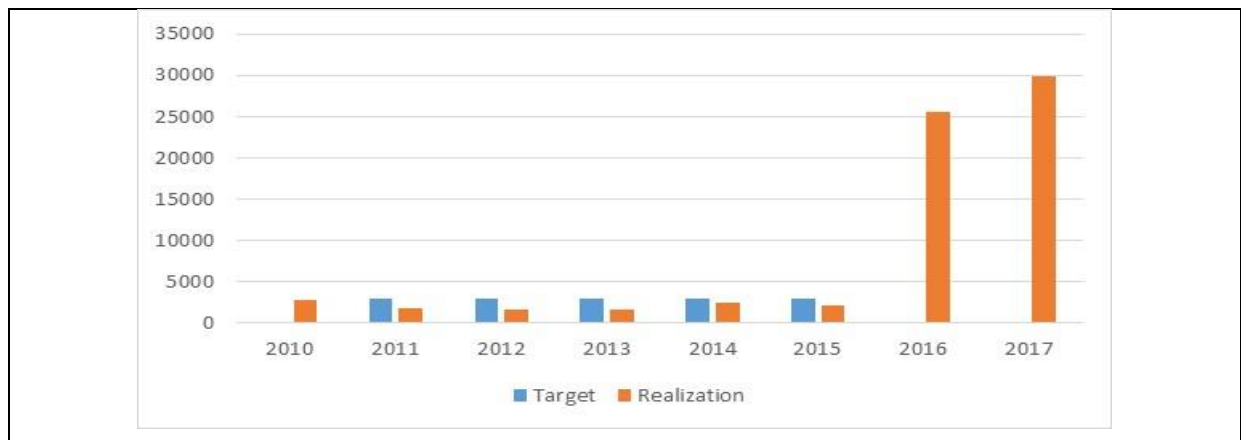
Figure 9 shows that this target has been achieved in all relevant years.

Figure 10 Proportion of projects where Finnfund's participation had a significant impact on the creation of the projects' development impact (significant value added) (%)



Figure 10 shows that this target has been achieved in all relevant years.

Figure 11 Jobs created by the financed projects (only new jobs)



As we can see from Figure 11, Finnfund did not achieve this target from 2011 to 2015. In 2016, the reporting changed, with target being dropped. In 2010-2015 expected jobs in the project where the financing decision was made that year were reported. From 2016 direct jobs in existing projects have been reported, in line with HIPS0 and EDFI standards, which explains the sharp increase in reported results.

Figure 12 Anticipated net tax revenue created by financed projects (only production and infrastructure)



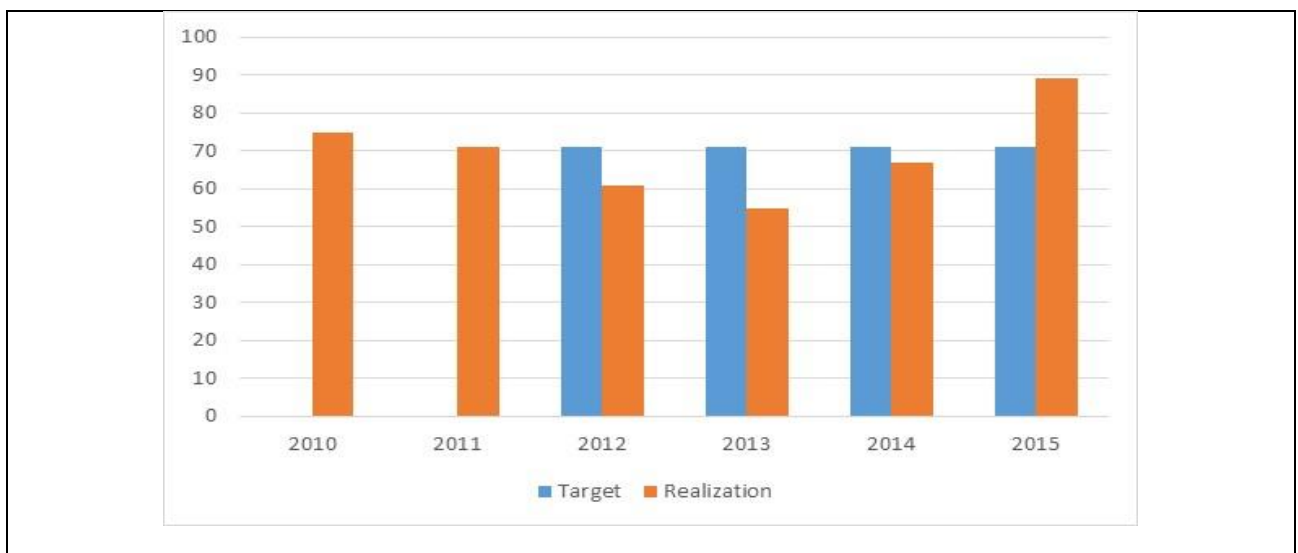
For tax revenues, we see that Finnfund did not achieve its targets in 2011 and 2012, but exceeded them in subsequent years, significantly so in 2014.

Figure 13 Anticipated current account impact of the projects financed (MEur)



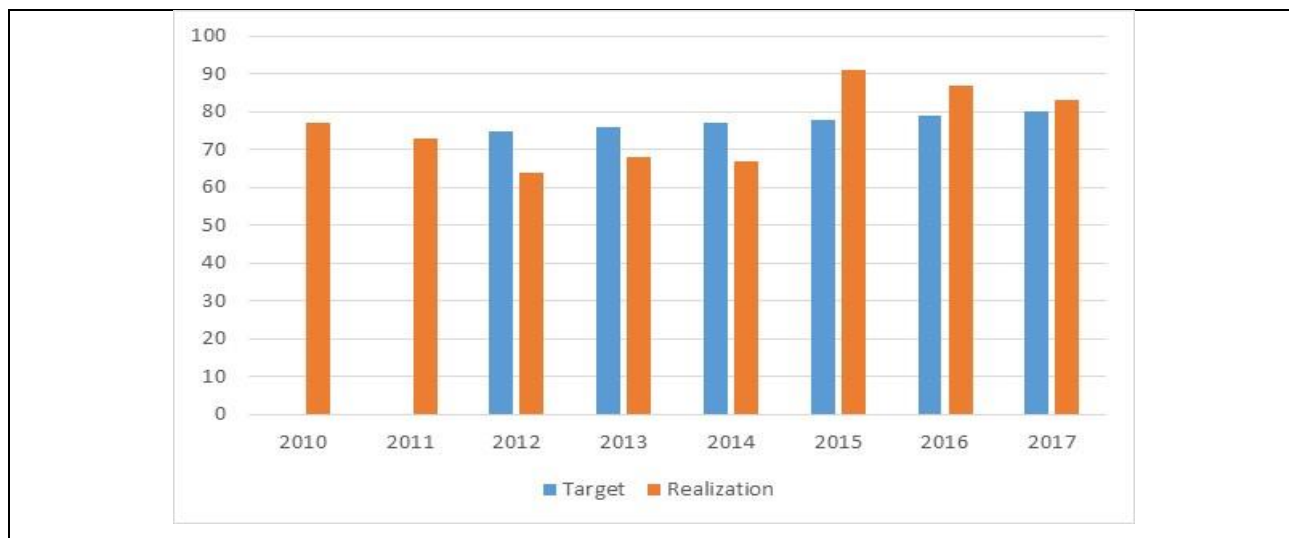
After failing to achieve its target in this area in 2011 and 2012, the target was reduced by half. At this point Finnfund’s performance improved dramatically, exceeding the new target by a factor of 5. In 2014 the same target was exceeded but by a smaller amount, while in 2015 the target was missed.

Figure 14 Investment in LICs/LMICS as a share of new investment decisions (in units %)



From 2012 to 2014, Finnfund did not achieve the target. In 2015 this was achieved, however.

Figure 15 Investment in LICs/LMICs as a share of Finnfund's new investment decisions. (in Euros %)



Expressed as Euros, Figure 15 follows the same pattern as that based on units. As we see, the 2015 achievement of the country allocation target continues in subsequent years, 2016 and 2017.

Figure 16 Proportion of projects directly serving the poorest sections of the population of new investment decisions %



Figure 16 shows that this target has been achieved in every year, often significantly.

Table 7 Share of operating expenses on investment assets (including unpaid investment decisions, excluding administrative costs of the Finnpartnership program) (%)

	<i>Target</i>	<i>Realisation</i>	<i>In Accordance with target?</i>
2011	<2.8	1.7	In accordance with target
2012	<2	1.5	In accordance with target
2013	<2	1.6	In accordance with target

2014	<2	1.6	In accordance with target
2015	<2	1.5	In accordance with target
2016	<2	1.6	In accordance with target
2017	<2	1.7	In accordance with target

As shown in Table 7, Finnfund has achieved its target in this area in every year of the period.

Table 8 Proportion of expenses in the income statement of the income statement's returns

	<i>Target</i>	<i>Realisation</i>	<i>In Accordance with target?</i>
2011	<50	51%	Not in accordance
2012	<50	92%	Not in accordance
2013	<75	62%	In accordance

Unlike the preceding table, Finnfund failed to achieve this target in its first two years of operation. When the target was subsequently increased in 2013, it was achieved.

Table 9 Operating costs as a share of the aggregate value of investment decisions %

	<i>Target</i>	<i>Realisation</i>	<i>In Accordance with target?</i>
2010		7.1	Na
2011	<7%	19.5	Not In accordance
2012	<7%	12	Not In accordance
2013	<10	8	In accordance with target
2014	<10	9	In accordance with target
2015	<10	11	Not in accordance

Table 9 looks at operating costs relative to the value of investments. After the target was missed in the first two years of operation it was increased. It was then achieved for two years, before being missed in 2015.

Table 10 Company's return on equity during review year

	<i>Target</i>	<i>Realisation</i>	<i>In Accordance with target?</i>
2010		-0.8	NA
2011	>0	5.3	In accordance with target
2012	>0	0.6	In accordance with target
2013	>0	1.3	In accordance with target

Turning to the profitability of Finnfund, Table 10 compares return on equity against target. As we can see, this target was achieved in each year that it was set.

Table 11 Finnfund's return on equity as a moving average for a five-year period %

	<i>Target</i>	<i>Realisation</i>	<i>In Accordance with target?</i>
--	---------------	--------------------	-----------------------------------

2010		5.8	
2011	>3.9	5.8	In accordance with target
2012	>3.9	2.2	Not in accordance
2013	>3.9	1.9	Not in accordance
2014	>2%	1.4	Not in accordance
2015	>2%	2.2	In accordance with target
2016	>2%	1	Not in accordance
2017	>2%	1.1	Not in accordance

Given the high risk nature of many of the environments in which Finnfund operates, a moving average measure of return on equity is perhaps a better measure than a target for a single year. Table 11 reports performance against target on this measure. As we can see, the target was achieved in only 2 out of 7 years, despite the fact that it was reduced by almost half in the middle of this period.

Table 12 Net write-offs as a moving average of a five-year period (% of investment assets)

	<i>Target</i>	<i>Realisation</i>	<i>In Accordance with target?</i>
2010		1.3	NA
2011	<2.8 % of portfolio	1.3	In accordance with target
2012	<2.8 % of portfolio	1.5	In accordance with target
2013	<2.8 % of portfolio	1.2	In accordance with target
2014	<2.8 % of portfolio	1.5	In accordance with target
2015	<2.8 % of portfolio	1.5	In accordance with target

Table 12 takes the same moving average figure and applies this to net write offs in the portfolio. On this measure, Finnfund comfortably achieves its target in every year it is set.

Table 13 Finnfund's equity ratio % (equity / total assets)

	<i>Target</i>	<i>Realisation</i>	<i>In Accordance with target?</i>
2010		58.6	NA
2011	50-70%	67	In accordance with target
2012	50-70%	65	In accordance with target
2013	50-70%	69	In accordance with target
2014	50-70%	65	In accordance with target
2015	50-70%	67	In accordance with target
2016		57	NA
2017		53	NA

The penultimate table looks at Finnfund's performance against its target equity ratio. In each year this target was operational it was achieved.

Table 14 New indicators added to the OSM Data Targets since 2016

	2016	2017
Farmers benefiting from the projects	15812	38046
Tax revenue and payments	285 mil. €	334 mil. €
Increase in financing; the share of risk financing of the investment decisions	0.67	0.73
Sectoral division of new investments (% of investments in renewable energy, sustainable forestry or food security)	0.48	0.53
Climate change mitigation	3 132 501 t avoided CO2	30 762 500 t avoided CO2 during investment period
Energy produced (kWh)	3 124 GWh	6 619 GWh
HRBA integrated in the project cycle. Principles written open and implemented as part of new project preparation.	Developing is ongoing and the process is in pilot use.	Process is used to analyse all the new investments

The final table above lists the new indicators that have been applied to Finnfund in 2016 and 2017. These show the direction of travel in terms of focus areas for the MFA, particularly a sharpened focus on environmental issues.

To conclude, Finnfund has generally achieved its targets in each year they have been set. In some cases, this is because targets have been reduced, but generally this is not the case. Two different questions are whether the targets are the right ones, and what impact they have on Finnfund's activities, and what the implications of this are. On the first of these, it is surprising that gender does not feature more prominently. Indeed, this is a general point with respect to Finnfund. Given the importance of this issue in Finland, which is seen as an international exemplar on promoting gender, women's and girls' rights, it is good that this gap has now been addressed in the 2018 OSM.

On the second question, Finnfund is strongly incentivized to achieve its targets, and makes every effort to do so. Beyond that we would make the following points:

- Targets need to take full account of additionality and attribution. If not, they risk encouraging Finnfund to invest in projects where they can report high numbers. The fact that specific targets have been dropped with respect to employment is welcome in this regard.
- A focus on smallholders/farmers may encourage the exertion of influence over existing projects to increase the number of farmers they work with (e.g. in forestry and agribusiness). This is not necessarily in the best interest of the projects themselves, nor necessarily in the best interest of smallholders. Discussions with Finnfund suggest that attempts to influence investees in this regard have come from other parts of Finnish development cooperation, and they are aware of this issue.
- Targets on financial self-sufficiency have clear impacts on Finnfund's activities, particularly on the balance of risk within the total portfolio.
- More generally, it is well established that targets have unintended consequences. More focus on understanding and addressing this issue systematically is important if MFA goals and Finnfund's activities are to be fully aligned. The trend towards removing specific targets is positive in this regard.

3.4 Has Finnfund followed DFI best practice on environmental and social risk management?

3.4.1 Introduction

All investments run the risk of producing negative social, economic and environmental externalities, which can be borne by individuals, governments, communities or the natural environment. Managing and minimising E&S risks is thus crucial if Finnfund is to achieve its development impact goals. It is important here to distinguish between the due diligence activities undertaken by Finnfund to ensure that harms are minimised and/or affected stakeholders are appropriately compensated, and performance by those companies against the standards, or indeed changes in that performance over time. This section deals with the latter and is focused on whether the policies and processes that are in place to screen and monitor projects in line with best practice. In the next section we look at the extent to which projects at portfolio level are meeting those standards. In Chapter 4 we explore the evidence that E&S performance has improved within the projects visited and whether these are attributable to Finnfund involvement.

3.4.2 What is best practice

“Best practice” is not defined on a normative basis, but rather on what is the industry standard among DFIs. Best practice standards for E&S have been developed by the European Development Finance Institution (EDFI), of which Finnfund is a member. The Declaration on Principles for Responsible Finance is now in its 10th year and contains seven principles covering investor behaviour and decision-making relating to labour rights, social and environmental impacts. These principles refer in turn to:

1. Harmonized Environmental and Social Standards, which cover social and environmental issues, due diligence, monitoring and exclusions.
2. Benchmarks developed by international institutions such as the UN Declaration on Human rights, The ILO Core Conventions and the IFC Performance Standards on Environmental and Social Sustainability and associated general and sector specific Environmental and Health and Safety Guidelines.

According to the EDFI, environmental and social categorisation reflects the preliminary assessment of the severity of potential environmental and social impacts and risks but does not take into account the clients’ capabilities to manage these potential impacts (projects are assessed based on the “inherent risk”). The activities to be included in the risk assessment depend on the nature and context of the investment, but a minimum scope should cover the legal entity financed or the site of the financed activity. Risks in the supply chain should also be included where the supply chain is integral to the financed business activities. In addition to this the IFC Performance Standards (IFC PS) set out scoping guidance when assessing the project against performance standards, for example associated facilities should be included in impact assessments. Finally, the categorisation should inform the approach to due diligence, any ES requirements to be incorporated into the terms of financing, performance monitoring and reporting. The Principles also state that clients should be “encouraged [to] work towards these international best practice norms and standards” and to promote them through their supply chains.

The intention of the EDFI policies is to facilitate the cooperation between clients and different DFIs. This is why the EDFI policies set out a series of procedures/norms that they expect members to

follow. Some policies such as those relating to due diligence have more guidance, and these have been detailed where available. However, it is the IFC PS and other applicable international best practice standards (e.g. World Bank Group general and sector specific environment, health and safety standards) that set out the explicit content of the E&S requirements for the clients environmental and social performance

3.4.3 Finnfund's approach to E&S risk management

The following is a mix of standards applicable to Finnfund and requirements to its clients

- Local legislation of target country, concerning the environment, occupational health and safety; terms, rights and conditions of employment, and other relevant areas (e.g. land ownership and acquisition, cultural heritage, etc...).
- IFC Performance Standards (2012) and their Guidance Notes
- The WBG General Environmental Health and Safety Guidelines and the sector specific EHS guidelines.
- Core Labour Standards, corresponding to the ILO Declaration of Fundamental Principles and Rights at Work (1998); and the ILO Basic Terms and Conditions of Employment
- Other industry-relevant guidelines and standards (e.g. ISO, FSC, RSPO, guidance notes for workers accommodation...)
- The EDFI harmonized E&S standards (2011) and EDFI exclusion list (2011)

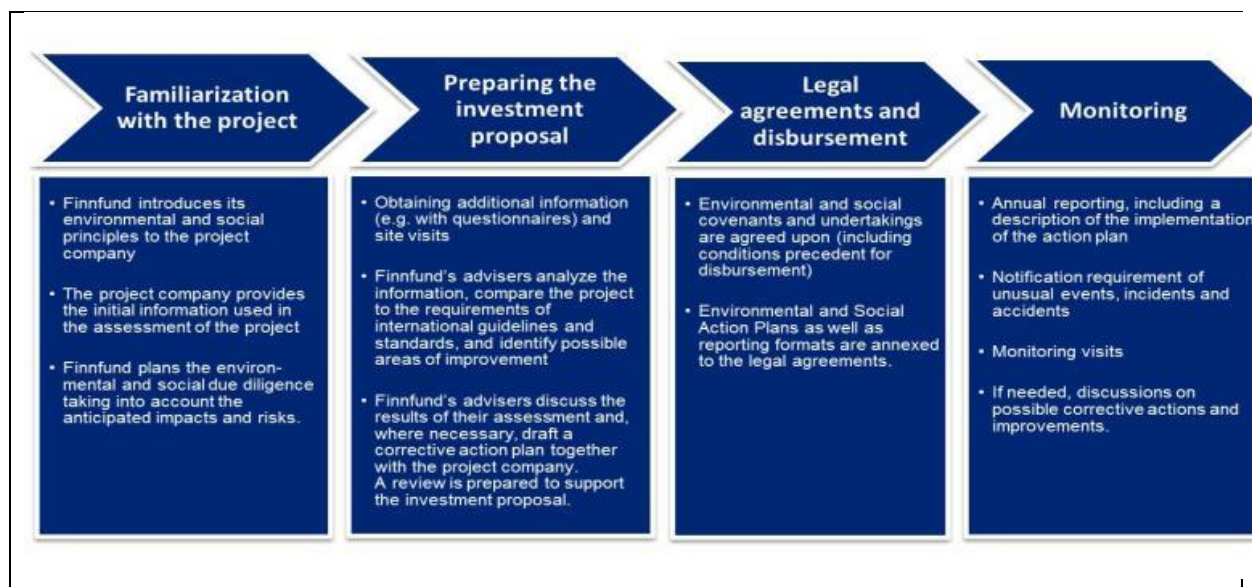
The process by which Finnfund approaches E&S risk management is set out in its E&S handbook. In line with the EDFI harmonized standards, the process varies by risk classification of the project i.e. whether it is A/B+/B and C projects but generally involves:

- a) Initial desk screening, resulting in the E&S categorisation of the project and the scoping of the E&S due diligence with consideration also regarding the type of human rights assessment
- b) E&S due diligence trip (esp. for high risk A and medium high-risk B+ projects)
- c) E&S appraisal, analysing the information gathered from documents (provided by the client or other financiers or consultants), public sources, meetings, site visits and observations.
- d) Preparation of the E&S review and the E&S summary, including an assessment of human rights impacts (using specific tools – for projects appraised after January 2017)
- e) Development of ESAPs, when compliance gaps are detected, based on IFC performance standards
- f) Contractual negotiations. These legal agreements contractually bind our clients to number of international standards and best practices and that we use our leverage to ensure compliance (e.g. through condition precedent clauses)
- g) Monitoring client compliance and adherence to best practice (may include reports or other monitoring methods such as external auditing, certification audits, visits, media tracking and/or teleconferences).

As we can see, the E&S process cuts across the entire investment decision from proposal to exit. In interviews with Finnfund staff, we were told that the initial E&S screening was crucial to whether an investment went ahead, and projects were often discarded at this stage on the advice of the E&S team. Once an investment has been approved for investment, IFC performance standards are applied for monitoring at the project level and are contractually agreed with the clients. Again, the requirements vary depending on the classification of the projects. Clients are requested to provide annual E&S reports but Finnfund is flexible with regards to reporting formats to reduce the administrative burden. If improvements don't occur, several tools are used to put pressure on the client, including holding on to disbursements, more frequent monitoring visits, hiring consultants at clients' cost, or (as a last resort) withdrawing from the investment. E&S specialists provide advice to investee companies on

and help them in procuring external services on E&S. Finnfund also aim to have the same ES experts through the investment life cycle (see Figure 17 for a visual description of this process).

Figure 17 E&S assessment in the investment cycle



3.3.4 Evidence that Finnfund is adhering to international standards

There are two elements to risk management to be evaluated: the process of assessing and monitoring risks and the standards that are used to measure performance. The following E&S documents were consulted to gauge compliance with best practice in both areas.

- E&S process as described in the E&S handbook (ympäristökäsikirja) and associated presentations,
- Staff resource on E&S compliance,
- E&S Policy (Yhteiskuntavastuupolitiikka)
- Project-specific E&S documents (see Table 15)
- Environmental and Social Action Plans ESAPs (EthioChicken, Africado and NFC), information on M-Birr, Schulze, GRAS and KVTC also reviewed.
- Finnfund's draft human rights statement paper

Table 15 Documents reviewed by project

Project	Document
EthioChicken	E&S review_Agflow; E&S summary_Agflow; Loan Agreement; Amendment and Restatement Agreement
M Birr	ES monitoring memo; Environmental review; ES summary; Loan agreement
Schulze	Environmental review; ES summary; Loan agreement
Africado	ES review; ES summary; Loan agreement
GRAS	ES reviews; ES summaries; Loan agreement; Amendment and Restatement Agreement
KVTC	ES review; Loan agreement; Shareholders

	agreement; Impact report
NFC	Sustainability report; ES summary; Loan agreement; Amendment and Restatement Agreement
Honduran projects	Board memos; Investment memos

Our analysis of these documents found consistent evidence of compliance both in terms of process and adherence to IFC performance standards (IFC PS). These are set out in detail in Annex 7 with examples and evidence drawn from Finnfund materials. As we can see, the level of E&S activity varies greatly by risk classification. For example, contractual oversight of one investee deemed to be low risk consisted of compliance with national laws, reporting changes in the project/activities of the company and notification of accidents. It did not reference IFC standards as the guidance suggests that these are not required for low risk projects. This raises several issues however. First, it requires that the initial classification is correct, especially C classifications as the associated requirements are very minimal. It also means that if the project is not considered risky, there is no minimum floor set, which may result in very basic standards not being in place. For example, MBirr in Ethiopia did not have a grievance procedure, which in and of itself would arguably generate risk.

There are also some examples of areas where Finnfund reports that it exceeds standards. For example, climate change mitigation is an area where Finnfund has expended additional efforts. This has included working with other DFIs to quantify the carbon footprint of portfolios, and the development and implementation of a project-level GHG accounting tool. Finnfund also consider their due diligence approach on land acquisition to be more robust than what is required in the IFC PSs. This includes considering land issues even if PS 5 on Land Acquisition and Involuntary Resettlement would not normally be triggered (based on email correspondence from Finnfund).

As will be discussed, human rights is an important policy priority for Finnish development policy and Finnfund has actively developed an approach to assessing human rights risks in its investment operations. This includes an explicit assessment of human rights risks and impacts and bringing these into the due diligence process. A series of recommendations on E&S will be provided later in the context of the findings from the primary research.

3.5 Has Finnfund followed DFI best practice on commercial risk management?

3.5.1 Background

As described in the TOR, “Finnfund invests in high risk environments, where norms and institutions are underdeveloped, investment information can be unreliable, good public governance has limitations and markets are small, susceptible to policy shocks and often volatile. The ability to take commercial risk and a long-term view in this difficult environment is one of the core reasons for the existence of Finnfund, but commercial risk has to be managed responsibly, so as to stay within the mandate as defined by the Government of Finland.”

As with ES issues, the IFC provides guidance on the management of commercial risk and is again something of an industry benchmark. The IFC approach to the risk management of private sector investments (IFC, 2013) requires risks to be continually identified, measured, monitored, analysed and controlled. The key principles of the framework are:

- The effective balancing of development impact, risk and reward;

- Ensuring business decisions are based on an understanding of risks;
- Being selective in undertaking activities which may result in adverse reputational impact; and
- Shared responsibility for risk management across the organisation.

Below we detail the risks that IFC identifies and seeks to manage.

i) Credit risk

Credit risk is defined as the risk that third parties that owe IFC money, securities or other assets will not fulfil their obligations. Credit risk management consists of policies, procedures and tools for managing credit risk in the loan portfolio, as well as the liquid asset and borrowing portfolios.

ii) Market risk

While credit risk addresses risks relating to individual borrowers, market risk arises because of the possibility of movement in key market variables, such as exchange rates, interest rates, or asset prices. For IFC, this has implications in three areas of their activities: investment operations; liquid asset portfolios; asset-liability management.

iii) Liquidity risk

DFI investments are generally illiquid due to the scarcity of capital flows, low trading volumes, and weak or absent price discovery mechanisms in many of the markets in which they operate. This can make it difficult or at times impossible to sell assets or do so in ways that do not affect the market price of the asset. For direct equity investments, it may mean an inability to find a buyer at exit, or to do so at a fair value price.

iv) Operational risk

IFC defines operational risk as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.” This is an important, and potentially existential, risk for DFIs, and therefore needs to be carefully assessed, monitored and managed.

Assessing Finnfund’s performance on commercial risk will follow a similar process to that set out for ESG risk, with matrices developed for best practice (based on IFC standards) and Finnfund’s approach in different areas. Again, areas of divergence will be identified and the reasons for this assessed.

3.5.2 Assessment

For our initial analysis, areas of alignment and divergence were identified in conjunction with Finnfund. Subsequently, interviews with Finnfund staff with responsibility in this area were held to discuss points of divergence and understand the rationale from Finnfund’s perspective. This section provides details of these points of difference, followed by our assessment of these.

Table 16 Finnfund vs IFC commercial risk management (1)

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
Minimum liquidity (at least 45% of IFC’s estimated net cash requirements for the next three years)	Finnfund’s policy to minimum liquidity is measured against 6 months (needs to be covered by committed liquidity) and 12 months	Treasury policy. Monthly treasury report	Finnfund’s approach is less conservative than IFC. IFC keeps reserves	Think it is sufficient for FF. They also have financing lines that cover their needs, based on forecasts. IFC’s liability structure is

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
	(covered by broad liquidity) forecasted disbursements.		to cover around 18 months, and Finnfund between 6 and 12 months depending on definition. What is the rationale for this?	more capital market financed. They have frequently expiring liabilities in different forms. FF funding is equity driven and does not have similar major liability events.

Assessment: the explanation for divergence is reasonable given Finnfund's circumstances and needs.

Table 16 Finnfund vs IFC commercial risk management (2)

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
Minimum level of total resources (including paid-in capital, total loss reserves and retained earnings, net of designations) equal to total potential losses for all on- and off-balance sheet exposures estimated at levels consistent with the maintenance of a AAA rating.	Losses are covered by equity (incl. retained earnings). We do not have public rating. (Our equity ratio is around 70 % (incl. government convertible loan calculated as equity.) This means that we could make losses of nearly 80 % of our portfolio before we would have eaten up our equity. This is really conservative. This does not even take into account that part of the exposure is covered by the special risk financing instrument.	Balance sheet	Why is such a conservative position taken? (i.e. why not expand loan portfolio?)	Don't think about this as they don't have a rating. They have sufficient financing in their view and therefore do not need to obtain a rating, the purpose of which would to aid private sector borrowing. Also unnecessary expense.

Assessment: the explanation given by Finnfund does not fully explain why such a conservative position is taken, particularly as a stated objective of Finnfund is to significantly expand. One way of doing this would be to expand private sector borrowing, for which an external rating would be required. There are other reasons for maintaining a conservative position (as discussed below), but they differ from those given.

Table 17 Finnfund vs IFC commercial risk management (3)

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
IFC does not	Finnfund normally	Investment	How frequent	Exceptions are rare. Less

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
normally finance for its own account more than 25% of a project's cost.	finances about 1/3 of project costs. In equity investments always minority investor. Exceptions are defined in financing policy.	policy	are the exceptions (% of portfolio), and what is the main reasons for these exceptions?	than 10% and falling. Two reasons: small projects FF are comfortable with risks; and difficult projects that they are trying to save.
Total exposure to a country based on the amount of economic capital required to support its investment portfolio in that country.	Total country exposure for calculated on nominal bases taking into account disbursed financing, signed agreements and Board decisions Finnfund total equity is used as benchmark for country exposures.	Financing policy	What determines country limits? How does FF's equity affect country limits?	Country limits maximum are 20% of FF total equity in any one country. FF use OECD country risk ratings to set country limits: 10, 15, 20 depending on the country risk level. Board can decide to exceed country limits on discretionary basis

Assessment: the rationale in both instances seems reasonable in general. One issue is that the discretionary power of the Board. While it is important to retain flexibility in this regard, risk management is quite vulnerable to the preferences of the current board. This places considerable weight on ensuring that Board is comprised by people with the right expertise, not just with respect to commercial risk management, but also the balance between this and development impact objectives. At present this seems to be well balanced, but a somewhat different balance between rules and discretion may have to be struck in the future to ensure that this balance is maintained even if the composition of the Board were to significantly change.

Table 18 Finnfund vs IFC commercial risk management (4)

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
Sublimits apply for certain sector exposures within a country	FF does not have specific sublimits inside the country limit. However, the Board (Audit committee) follows periodically the sector concentrations.	Audit committee material	How do you ensure that the whole portfolio is sufficiently diversified across sectors? What would you consider to be 'sufficient' in this respect, and why?	Where there is sector concentration in country (e.g. forestry in Tanzania) this is addressed by carefully managing risks. Concentration of full portfolio assessed with frequent monitoring and appears sufficiently diversified. FF do not see need for limits. Has been managed on a discretionary basis to date but may change. Sector specific risks

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
				assessed and investments stress tested against plausible scenarios (not finance).

Assessment: a more systematic approach is needed in this area, particularly given the strategic goal of focusing on fewer sectors. Finnfund partly achieves diversification within sector geographically (e.g. forestry projects in different regions). This is positive, but more could perhaps be done to mirror this by diversifying systematically following assessments of the correlations of risk. Concentration limits could be linked to these kinds of analysis. Financial sector investments are expressly designed to introduce a relatively low risk element of the portfolio. Previous experience of contagion in financial crises, including across developing regions, suggests that more thought should be given to the possibility that risks turn out to be higher, and more correlated, than is currently assumed.

Table 19 Finnfund vs IFC commercial risk management (5)

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
Exposures to individual counterparties are subject to concentration limits. For derivatives, exposure measured by replacement cost.	Finnfund's typical FX and interest rate derivatives are transacted with 4 Nordic Banks currently rated between AA- and A.	Treasury policy	What % of projects entail the use of derivatives, and why? Is % increasing over time?	Those involved with USD funding. USD funding comes from Nordic investment bank and is lent on. Plan to raise new loan from NIB in USD. Don't hedge equity projects, except for near exits. All USD loans are hedged. Derivative use will grow with portfolio.

Assessment: the use of derivatives and approach to counterparty risk, by Finnfund is good – i.e. necessary risks are hedged, but derivative instruments are not used when the costs (and risks) outweigh benefits.

Table 20 Finnfund vs IFC commercial risk management (6)

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
IFC expands its access to funding and decreases its overall funding cost by issuing debt securities in various capital markets in a variety of	Current debt capital market funding based on existing domestic 300 M€ commercial paper program and private placement of bonds (EUR150 mn. outstanding). FF also has bilateral financing arrangements and	Balance sheet, treasury report, agreements with financiers	Has this financing structure evolved naturally (if so, why?), or is it the result of strategic decisions (if so, on what basis?) How are FF's	Structure based on demand from borrowers. Main strategic decision was to use debt markets as well as equity for financing. This is unusual for DFIs. For FF, the issuance of bonds, which they

Risk Policy/ procedure	Finnfund policy (from Finnfund)	Finnfund Evidence	Questions to Finnfund	Responses
currencies.	committed/ uncommitted short- term limits. Bonds investors international as well as Finnish.		funding costs influenced by its current private financing structure (e.g. would more/less international investors/markets lower costs?)	reinvest, is a form of private finance mobilisation. Also raises awareness among private investors. Finnish commercial paper has been cheap compared with other countries for decades. Local companies issue commercial paper and place liquidity in market. The country is small and therefore people know each other and don't need to do lots of credit research. Despite this, it is only possible for Finnfund to use commercial paper when backstop financing is available, as with the undrawn component of the last government loan.

Assessment: given the very low cost of funding in the domestic market, Finnfund should clearly focus on raising finance largely domestically. The only question is the appropriate balance between different forms of funding, which currently seems reasonable. A significant shift in approach would need to be justified on a cost-benefit basis compared to the current arrangements.

A number of risk management areas addressed concerned the management of Finnfund's liquid asset portfolio. In all cases, Finnfund adopts a highly conservative position. The rationale is that Finnfund assumes significant credit risk, and that other aspects of commercial risk management should be treated very conservatively. This seems a very prudent and rationale stance to take.

Another area of divergence with IFC is with respect to political risk insurance. While IFC uses this relatively frequently, Finnfund does not do so. The rationale is political risk is unavoidable in the markets in which they operate, and that mitigating and managing this is part of DFIs value-added. Also, the cost of political insurance would be likely to make many projects commercially unviable.

The final area covered was operational risk. Here Finnfund relies on a comprehensive set of procedures, codified in relevant documentation. From the perspective of the valuation team, the approach seems thorough and well thought through.

To summarise, there is an interesting balance in Finnfund's approach to commercial risk management. In many areas they take a quite conservative approach, but as described above this is to offset the significant credit risks that they assume. This is an inevitable consequence of seeking high impacts in difficult markets, but it does also leave them vulnerable to a coordinated shock across a major section of the portfolio. To date this has been avoided, largely due to good judgement it would appear, as well as perhaps an element of luck. Luck tends to run out in the end, and it would be

prudent now to seek to diversify the portfolio more systematically following a detailed analysis of correlations between different aspects of strategic sector, both geographically and in terms of the types of business supported.

3.6 Have Finnfund’s investments generated development effects?

Generating positive development effects is core to Finnfund’s mission and making an effective assessment of this is crucial for this evaluation. In this section we analyse Finnfund’s historical portfolio to evidence of development effects. As discussed above, these are not at the level of outcomes, such as changes to the well-being of stakeholders, but are rather intermediate outputs that are indicative of such effects.

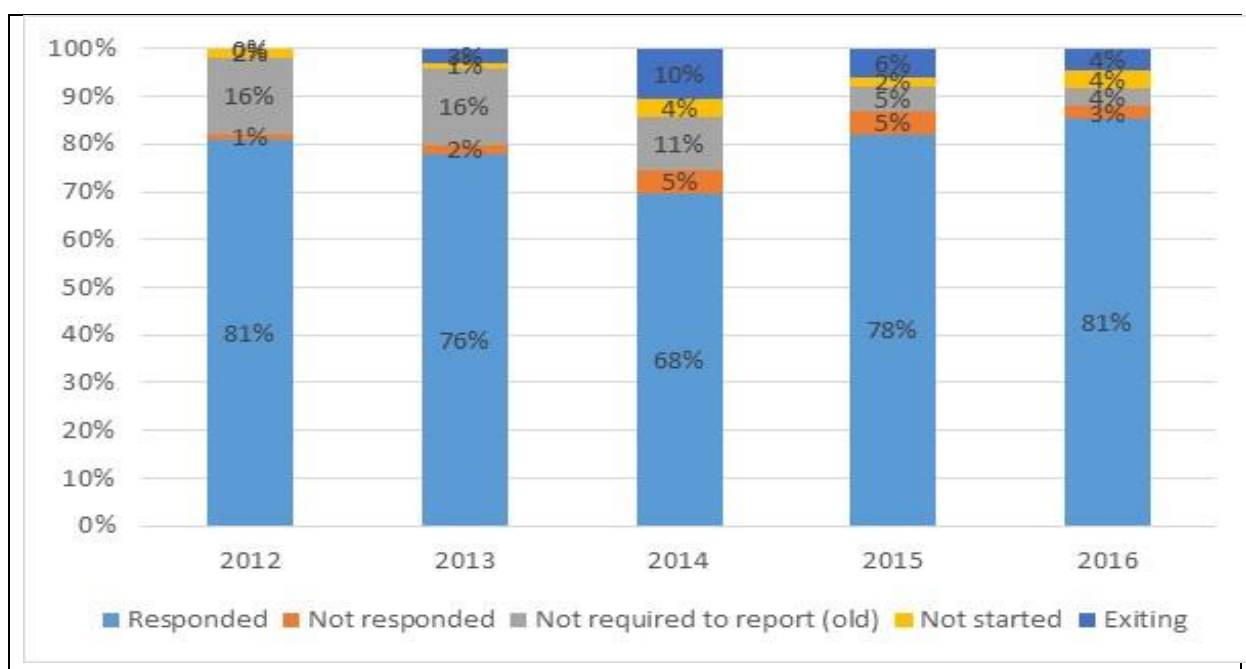
This section focuses on assessing development effects in the following areas:

1. Business performance of investees.
2. Employment effects.
3. Tax revenues generated.
4. E&S performance

There are two ways to think about impact. First, Finnfund may influence investees in various ways, leading to enhanced development outcomes. Second, Finnfund’s investments may be crucial to the existence or survival of the investee, such that any development impacts resulting from its activities are potentially attributable to Finnfund. The majority of this section focuses on the first of these elements. We also discuss the latter, however, in the context of financial additionality.

Our first analysis of the portfolio identified quite low response rates on some of the indicators discussed below. Discussions with Finnfund have clarified, however, that in many cases, this is because investees were not required to respond, or investments were too early for meaningful reporting to occur, or had reached the exit stage, again making reporting inapplicable.

Figure 18 Response rates across portfolio with rationale for non-responses



As shown in Figure 18, total responses across the portfolio were around 80 % in most years, with the majority of the difference being comprised of investees that were not required to respond, or were too early or late in the investment cycle to do so. A maximum of 5 % of investees that should have responded failed to do so in any year, with the figure considerably below this in some cases.

3.6.1 Business performance of investees.

Table 21 summarises the business performance of Finnfund investees from 2003 to 2018. The variables considered are changes in turnover, earnings (Earnings before interest, tax, depreciation and amortization EBITDA), and annual profits. In each case, we have looked at net annual percentage change in the reported figures.

Table 21 Summary business performance of Finnfund investees

Year	Responses	Average net % change in turnover	Responses EBITDA	Average net % change in EBITDA	Responses Net Profit (%)	Average net % change in Profit per Annum
2003			1	12.6	1	10.4
2004	1	5.5	3	3.6	3	-16.2
2005	3	254.1	6	1.7	6	-24.6
2006	6	132.1	13	14.3	13	1.8
2007	16	25.5	22	-14.0	22	-62.6
2008	24	115.3	28	0.8	27	-36.4
2009	27	1083.1	29	0.2	29	-27.1
2010	27	13.2	38	3.0	38	-17.5
2011	38	139.2	50	-30.4	49	-36.1
2012	53	243.6	54	-19.0	54	-42.2
2013	55	1075.4	56	-9.0	56	-17.9
2014	59	27.8	59	-24.8	55	-41.5
2015	62	22.1	59	-32.4	55	-69.7
2016	63	99.3	61	-36.1	58	-56.6
2017	31	7.9	28	-33.8	28	-44.2
2018	1	12.2	1	13.1	1	1.5

As we can see, each year shows significant declines in performance on average. This needs to be put into context, as the average figures are heavily distorted by a small number of major outliers. The following figures control for these outliers, and give a more balanced view of performance across the portfolio.

Figure 19 Net % change in turnover (controlling for extreme outliers)

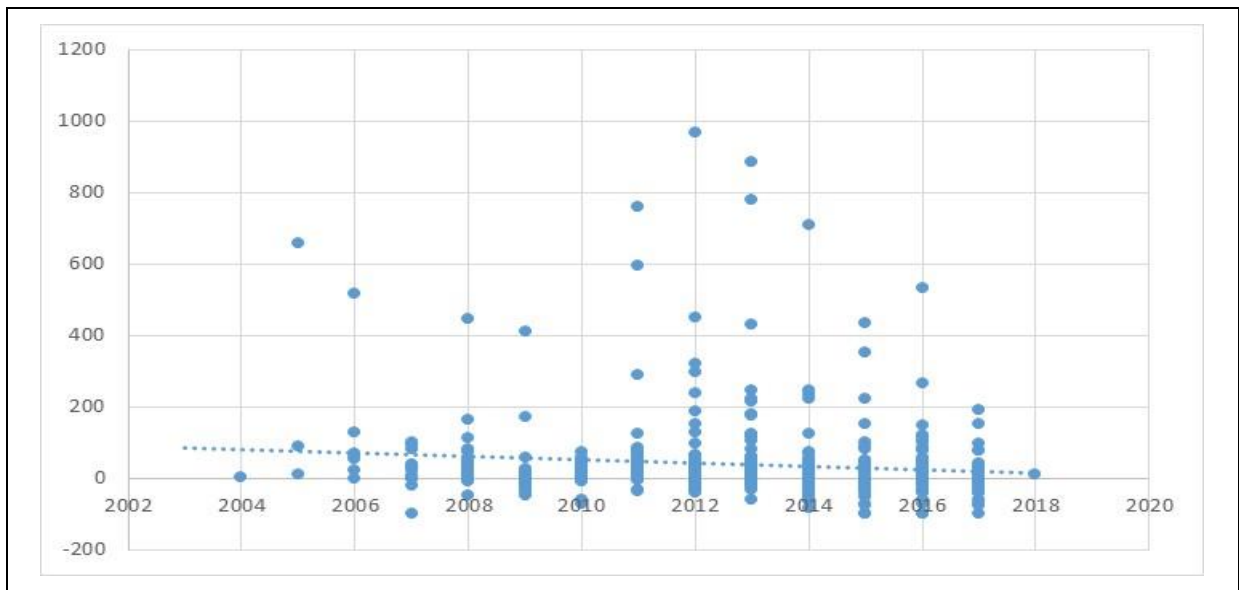


Figure 20 Net % change in EBITDA of investees (controlling for extreme outliers)

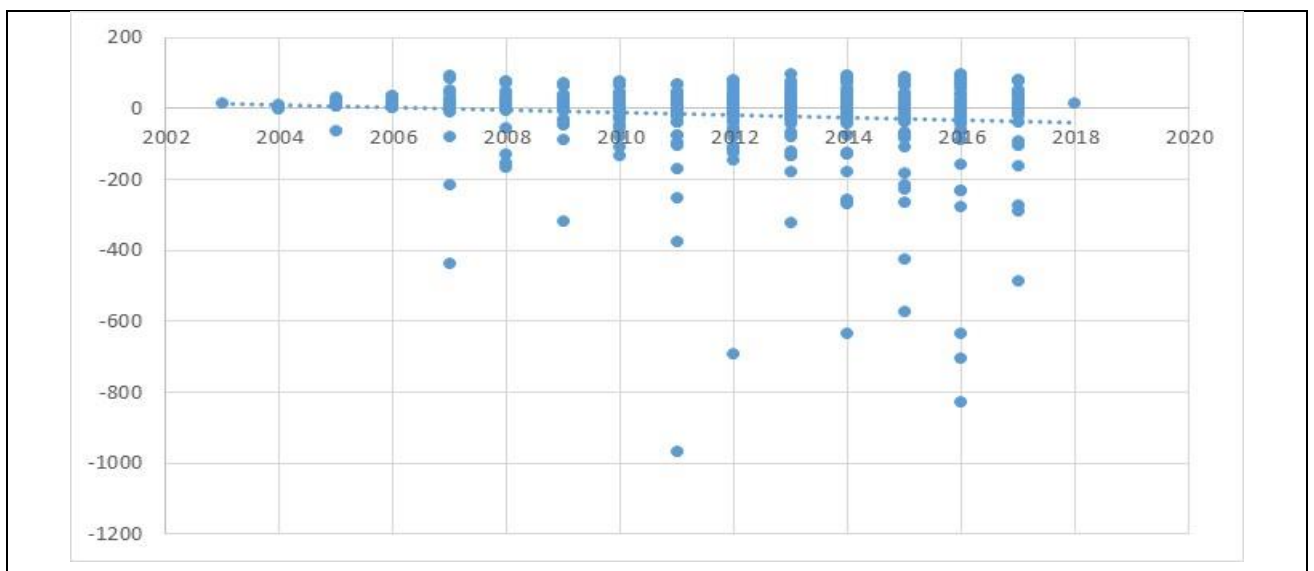
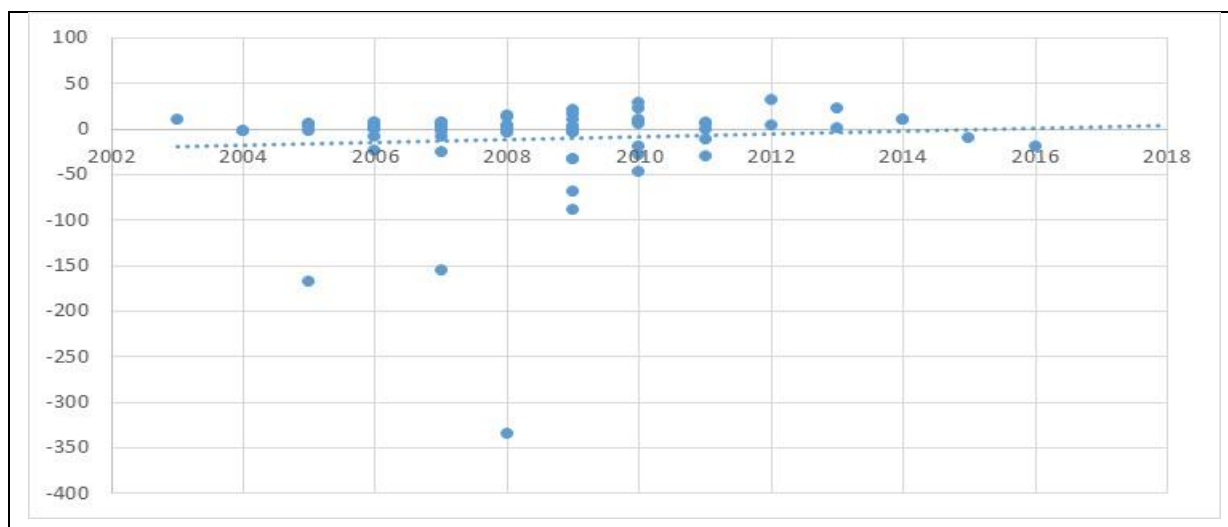


Figure 19 shows that turnover increased in each year of the period, though by a decreasing amount. While the majority of firms report growing EBITDA for the period, the average is pulled down a little by some large falls in a small number of companies (Figure 20).

Figure 21 Net % change in profits per annum (removing extreme outliers)



Annual profits are proportional to firm size and thus the best proxy for business performance. Controlling for outliers, we see a slight upward trend in profitability over the period for which we have data, moving from an average loss at the start of the period to a small average positive rate of profit at the end (Figure 21).

3.6.2 Employment effects (direct and indirect)

Direct employment

It should be noted that reported jobs refer to the total employees that investees have, rather than new jobs created by Finnfund's investment. Quoting headline figures thus risks over-stating Finnfund's contribution to employment outcomes. An exception is where Finnfund is responsible for an investee's existence, as discussed in the context of additionality below. Where this is not the case, we are interested in change in employment, and Finnfund's potential influence in this regard. It should be noted that we are not in the position to assess causality, but rather whether any discernable trends can be identified.

Table 22 Employment in Finnfund portfolio by investment type

	<i>Jobs 2012</i>	<i>Jobs 2013</i>	<i>Jobs 2014</i>	<i>Jobs 2015</i>	<i>Jobs 2016</i>
Direct	15,407	10,304	14,073.25	13,557.75	15,151.5
Financial	9,146	11,931	10,435	11,812	14,866
Fund	85,676	74,550	55,258	74,812	73,566
Grand Total	110,229	96,785	79,766.25	100,181.8	103,583.5

As shown in Table 22, Finnfund's investees employ around 100,000 people. Disaggregating by investment type shows that the vast majority of these jobs are related to investment funds, with a relatively small share connected to direct investments (equity/loans), and less to financial institutions.

While the total quantity of direct employment falls between 2012 and 2014, this is most likely due to fall in the number of investees reporting, rather than any significant trend. Table 23 breaks down the direct employment figures by region. The regions with the greatest direct employment effects are Asia

and sub-Saharan Africa, reflecting their weight in the portfolio. The third most important region is Latin America, however, this is a very small part of the total portfolio.

Table 23 Employment in Finnfund portfolio by region

	<i># Jobs 2012</i>	<i># Jobs 2013</i>	<i># Jobs 2014</i>	<i># Jobs 2015</i>	<i># Jobs 2016</i>
Asia	7,489	5,302	7,540	5,482	14,062
Africa	10,155	12,455	11,046	12,298	9,464
MENA	681	721	700	887	761
E. Europe & Central Asia	4,428	2,557	2,846	2,923	2,755
Latin America	2,062	1,718	2,710	4,028	3,695

Figure 20 Proportion (%) of women in reported direct employment figures

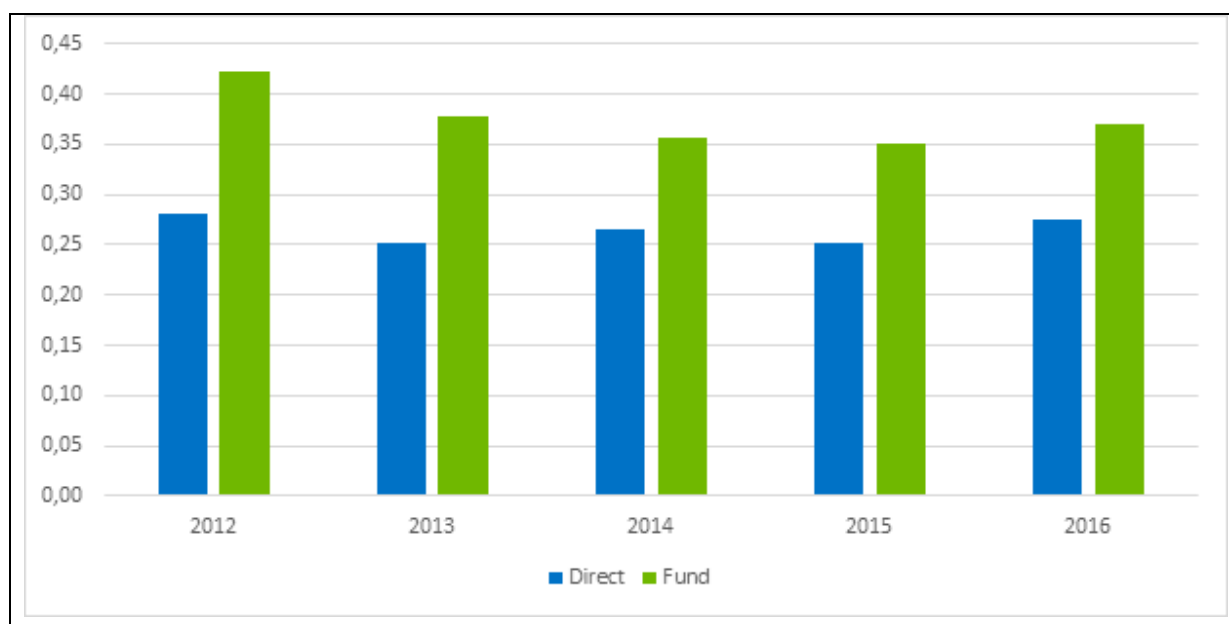


Figure 20 illustrates the proportion of women in employment over the period, distinguishing between direct/financial investments and funds. The proportions are relatively stable over time, with funds (excluding implausible outliers) having a higher proportion of female employments (35-42 %) than direct/financial investments (25-30 %).

Table 24 shows annual changes for individual investees and for funds. As funds invest in a large number of businesses, they have the potential to distort employment figures significantly if employment across the portfolio is reported this way, particularly as reported employment figures will change sharply as individual investments enter or exit their portfolio. This is why Finnfund do not report employment from direct investments and funds together. To address this issue, we have used the following methodology to calculate changes in fund employment in a comparable way, which mitigates distortion.

- Disaggregate reported employment for funds and direct/financial
- Take differences between years
- Calculate growth rates for investee companies reporting over consecutive years
- Create an average growth rate per year for the fund (as well as financial and direct investments)

- Average across the observations.

It should be noted that this form of analysis does not entirely control for extreme outliers. Given their distorting effect, we therefore only report mean growth rates controlling for these, as well as median rates. The results are shown in Table 24 below.

Table 24 Net employment effects annual and over reporting period

	Direct/Financial					Funds				
	2012-13	2013-14	2014-15	2015-16	2012-16	2012-13	2013-14	2014-15	2015-16	2012-16
Sample Size	36	32	38	51	23	27	21	22	26	21
Total	-1550	2699	925.5	477.7	-348	3742	3396	5595	329	3631
Average	43.06	77.11	23.73	9.37	15.13	26.92	27.84	45.12	2.65	47.16
Min	-1608	-206	-1749	-767	-1923	-2672	-751	-699	-2999	-2750
Max	156	1987	654	866	787	790	2214	1315	940	1710
Average Growth (ex. outliers)	5.9%	20.6%	15.8%	2.06%	16.4%	38.1%	9.4%	19.9%	4.6%	52.8%
Median Growth %	2.47%	9.11%	8.36%	2.00%	8.00%	8.46%	6.79%	4.25%	0.27%	50.8%

Over the full period, we see a net increase in employment through funds, and a fall in direct/financial investments. This latter result needs to be treated with scepticism, however, as the sample size shows wide variety in the number of reporting investees. In 2015-16, for example, 51 investees report, while only 23 report across the whole period. The two figures are thus not directly comparable. The sample of funds is more stable, and shows an increase in employment in each year. The largest increases or decreases in any year (i.e. min/max) highlight the point that annual changes are principally driven by new investments coming into Finnfund's portfolio (or that of the funds in which it invests).

The average and median growth figures are based on changes reported at the investee level, and are therefore the best measure of a potential as they are not influenced by sample size in the same way as the total figures. As we can see, this shows a positive picture, with positive growth in reported employment in all periods, for both direct/financial investments and funds. While this does not prove causality in any way, we can see that Finnfund's investees are likely to have seen an expansion in employment in all periods and for all categories of investment.

Indirect employment

There are various ways that indirect employment effects can be measured. One is to use a sector-based multiplier, adjusted for local supply chain features. Different sectors will generate different quantities (and ratios) of direct vs indirect employment. Infrastructure facilities, for example, employ relatively few employees directly, but may lead to significant job creation through the growth channel.

Manufacturing companies employ more people directly, but also generate employment indirectly through supply-chains. The strength of supply chain effects are location-specific, however, as they are dependent upon the extent to which inputs are sourced domestically or internationally. This can vary widely between countries, making it important to adjust any sector multipliers for local context.

Finnfund approaches this question differently, asking investees to report directly on likely indirect employment effects as follows: “[To] evaluate the number of jobs created in companies with activities related to the project company, such as transport companies, suppliers, service providers, guards, canteens, small or medium enterprises located nearby, and other, during the latest Financial Year. Indirect employment should be considered relevant where the assessed employee’s livelihood is dependent on the project company’s activity, so that at least half of its income is related to the project company. If this information is not available, please make plausible estimations and comments.” (from correspondence with Finnfund)

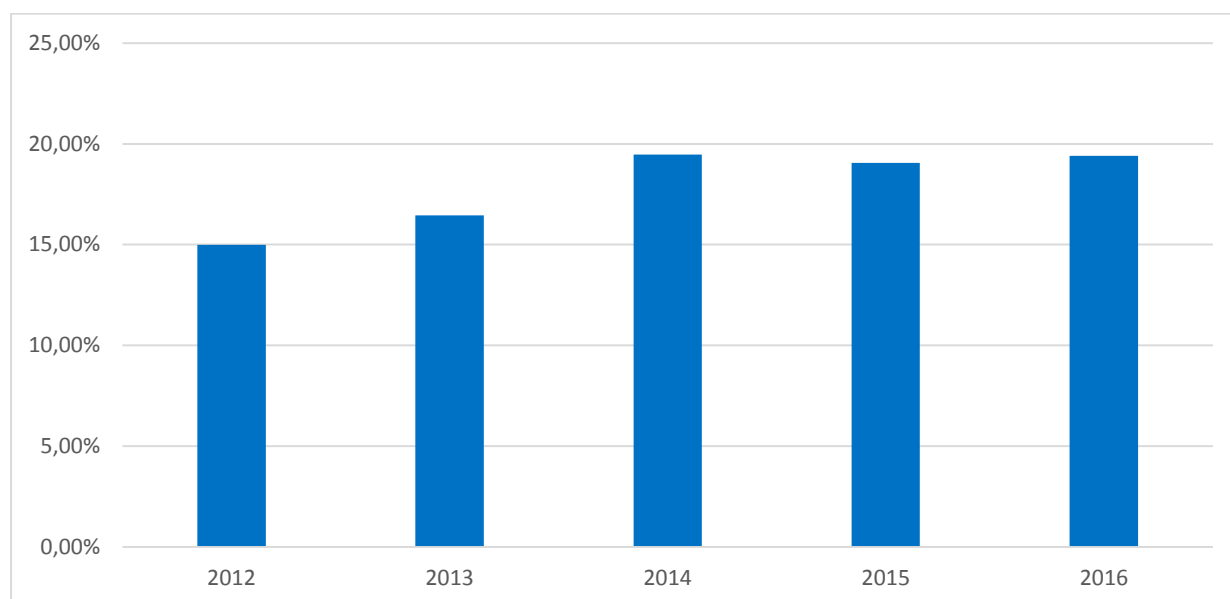
As with direct employment we see large changes from year to year in Table 25. Across the entire period, there is a 29 % increase in the mean growth rate, and 19 % for the median. For the reasons described above, the median figure is the more reliable, where we also see most year’s median figure is zero, showing neither an increase or reduction in indirect employment effects.

Table 25 Summary of net changes in estimated indirect employment

	2012-13	2013-14	2014-15	2015-16	2012-16
Sample Size	34	28	33	45	22
Total	17874	-19950	-7538	-1267	6322
Average	525.71	-712.50	-228.42	-28.16	287.36
Min	-3997	-21043	-5939	-1561	-864
Max	8880	4442	948	1389	4941
Average Growth (excluding largest outlier)	21.80%	14.16%	11.20%	19.90%	29.40%
Median growth	0	0	4.17%	0	19%

The proportion of women’s jobs in reported indirect employment is somewhat lower than for direct jobs for direct/financial investment. As shown in Figure 21, this averages at between 15 and 20 % in each year (compared with the 20-25 % for direct employment). We do not have fund data to replicate the exercise for these investments.

Figure 21 Proportion (%) of women in reported indirect employment figures, direct/financial



To summarise the findings from employment. We find high annual volatility, with major annual shifts driven by movements in and out of the portfolio. Looked at from the investee levels, we see consistent annual increases in employment, for all types of investment and in all periods. This is more convincing for direct than for indirect employment. Weaknesses in the way that indirect employment is measured, as recognised by Finnfund, reduce the reliability of these figures, however. There is some evidence therefore of a trend in terms of direct employment that could be attributed to Finnfund’s activities, though it is not possible to determine causality in this regard. On gender, the proportion of women employed is higher for funds than direct/financial investments for direct employment, and lower than either for indirect employment.

3.6.3 Tax revenues

Table 26 summarises the tax data we have for total taxes paid to government.

Table 26 Total taxes paid to government (annual change, millions of Euros)

	Direct/Financial					Funds				
	2012	2013	2014	2015	2012	2012	2013	2014	2015	2012
	-13	-14	-15	-16	-18	-13	-14	-15	-16	-18
Responses	50	60	59	66	22	28	28	22	25	28
Total MEur	-419	-19.8	14.99	23.34	298.9	84.92	15.83	41.03	39.85	75.26
Average Meur	-8.39	-0.33	0.25	0.35	13.59	0.38	0.09	0.24	0.19	0.48
Min	-461	-35.5	-3.61	-2.05	-0.42	-14.9	-16.3	-13.5	-18.7	-16.1
Max	35.48	7.83	9.60	13.21	217.6	64.01	21.41	20.27	32.68	57.21
Average annual % change (Ex. extreme outliers)	-5.5	84.7	-35.4	199.8	171.7	102.3	324.9	222.7	412.8	878.9
Median Growth %	-5.2	15.2	-20.6	-3	152.7	22.5	0	34.7	6.9	18.3

As we can see, most direct investments and funds report rising taxes paid to government in most years, and an increase over the full period. The exception is the first two years in the period for direct investments. As with employment data, however, a feature of the data is high annual volatility, with average annual results being heavily skewed by the appearance (or disappearance) of investees from the portfolio. Looked at from the investee level, there is no evidence of a trend for direct/financial investments, with some years showing high growth, and others large falls. For funds, there is consistent growth, but the magnitude of these effects for mean growth is not completely plausible. To separate out fund effects, we have replicated the methodology described above for employment. Despite controlling for extreme outliers, they are clearly still having a large effect.

The median growth rates are less subject to these effects, and may therefore provide a more reliable indicator. Here we see no pattern for direct/financial investments, and positive – but volatile – results for funds. Given the many factors that influence tax payments, there is less convincing evidence of a trend here than for employment.

3.6.4 E&S risk management performance

While we intended to evaluate Finnfund’s ability to generate improved E&S risk management performance in the ex-post study, current datasets are not sufficiently complete or validated to enable

this. They also exhibit large data gaps. Finnfund has started to develop a dataset to monitor E&S compliance at portfolio level. However, while project level data is available based on current monitoring approach, the process of setting E&S indicators for the portfolio is ongoing and indicators sets for the portfolio are incomplete. As a result, firm conclusions on the E&S performance of projects (individual and portfolio level) cannot be drawn. In this section, we present what we believe can provide value with these caveats in mind.

Looking at the full portfolio from 2007, the majority of the investments have classified as medium low (B~44%) and medium high (B+~35%) risks. Around 10 % of direct investments made were viewed as high risk (A) project, with a similar proportion classed as low risk (C).

Figure 22 IFC Performance standards triggered by active direct investments in the portfolio

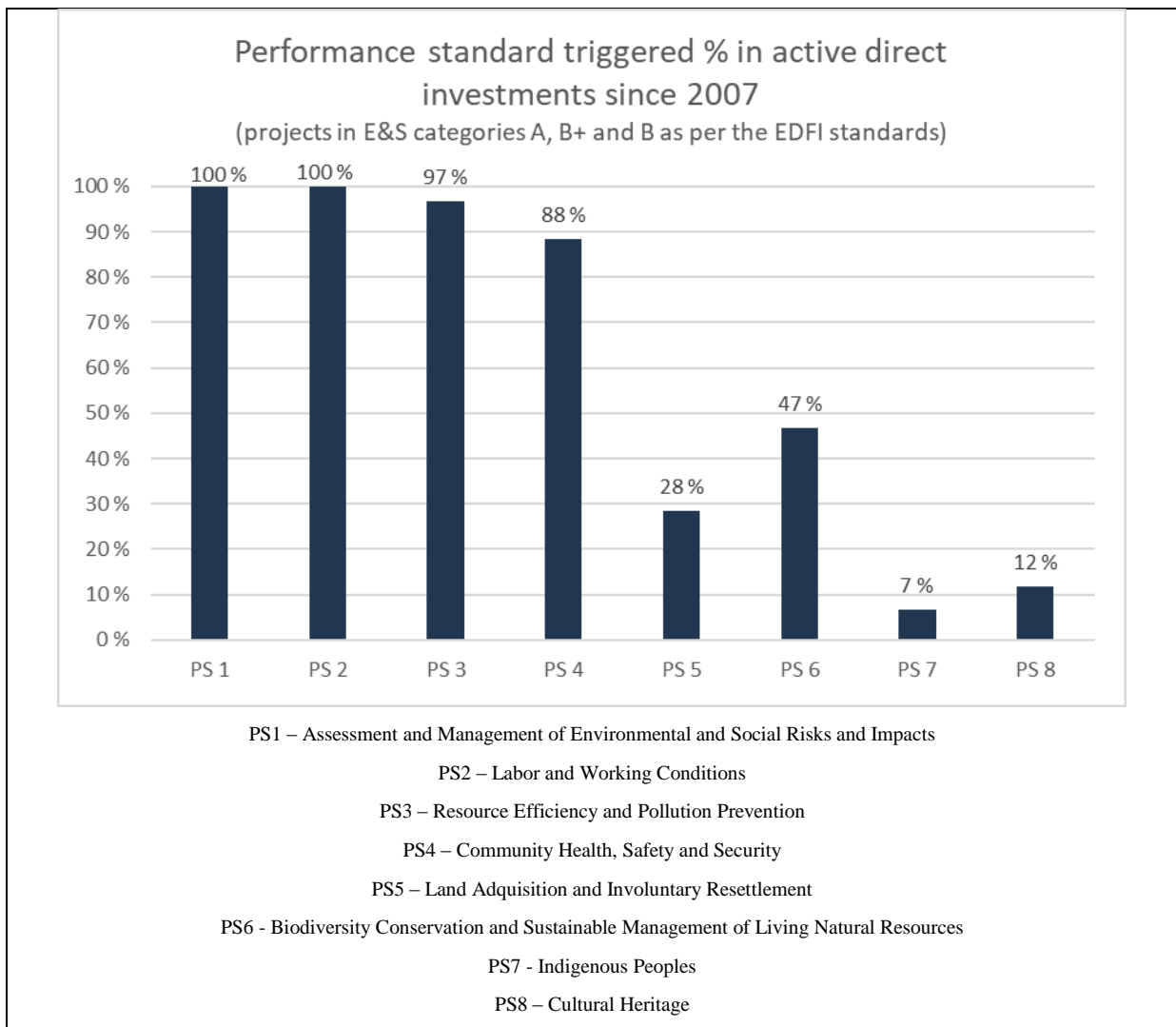


Figure 22 illustrates which IFC PS are applicable to the different direct investments in the portfolio (grouped under relevant headings). While this does not tell us about the impact that Finnfund is having, it does give a snapshot of which type of E&S risks are most common amongst Finnfund direct investments, hence triggering the respective environmental and social performance standards. As we can see the first two performance standards on E&S assessment and management and on working conditions are the most frequently applicable PS. In most (~88 %) investments also PS4 on community health, safety and security is applicable. PS3 on resource efficiency and pollution

prevention is applicable in 97 % of the projects. This is unsurprising, as virtually any commercial investee that employs staff, operates in a community and uses natural resources would be captured.

The frequency by which the other PS are triggered reflects Finnfund's sectoral focus. PS 6 on biodiversity and sustainable natural resource management, for example, would be particularly relevant in forestry projects, which are applicable in 47 % of investments. PS5 on land acquisition and involuntary resettlement has been triggered in 28 % of direct investments, and is likely to be relevant for renewable energy projects in particular.

Navigating these waters will always be challenging, but deep knowledge of a country's cultural and socio-economic history, and how this influences contemporary debates, is likely to be a precondition for doing this successfully. This will be discussed again in the appraisal section.

The remaining Performance Standards – PS7 on indigenous peoples in 7 % and PS 8 on cultural heritage – are triggered in relatively few cases. It should be noted that PS5, PS7 and PS8 are sometimes triggered due to a precautionary approach during due diligence.

Since 2007, a quarter of direct investments have been deemed to require an ESAP. Of the remainder 10 % have completed the process, with the rest being ongoing. There is evidence of an increased use of ESAPs in recent years. From 2004-2015, around a third of investments did not have ESAPs. From 2016-2018, this had halved to less than 15 %. This increase in the use of ESAPs may suggest greater oversight and scrutiny of projects, assuming that the use of ESAPs have this effect.

The corresponding data for financial institutions and funds is still under development. From what we can gather, however, many financial institutions are deemed relatively low-risk and therefore not seen as requiring ESAPs. For Finnfund acknowledges an important rationale for its financial sector investments is to balance its portfolio with lower risk investments, enabling it to make riskier investments elsewhere while also meeting its mandated requirement to maintain profitability. In addition, however, it is argued that financial sector investments enable Finnfund to reach sections of the markets in which they operate that they would otherwise be unable to. The most important aspects in this regard are micro small and medium enterprises (MSMEs), SMEs in general and female entrepreneurs. Finnfund targets financial institutions that are already engaged with these sectors, with financing tied to a commitment to expand lending operations in a strategically important area. We have limited data on the whether this is successful or not, for either microfinance or SME lending.

To conclude, some E&S issues are more likely to be triggered than others, and this is related to the types of investments that Finnfund makes. It is also the case, however, that potential development impacts – including the additionality of Finnfund – is likely to be higher in these sectors. Identifying, mitigating and managing E&S risks is therefore essential. This is much more likely to be possible in direct investments rather funds. Until recently, ESAPs were rare in fund investments. This may be because it is harder to exert an influence over project level activity when intermediated through a fund. It is also the case that Finnfund will be just one of a number of investors in any fund, further reducing the leverage they can exert.

Also, even if PS7 on indigenous peoples is directly applicable in only a fraction of Finnfunds portfolio, these matters are very sensitive and complex. The introduction of a human rights policy and its integration with the ESAPs is therefore crucial in this regard.

3.6.5 Additionality in the ex-post analysis

Financial sector investments are explicitly intended to improve the risk profile of Finnfund's portfolio. They are also designed to achieve specific development impacts that Finnfund could not do directly. In the case of smaller, microfinance institutions this is plausible. For larger institutions it

depends entirely on whether Finnfund is able to influence lending patterns, However, we do not have sufficient data to know whether this is the case. For investment funds, additionality will depend on whether a) the fund is providing finance to places or sectors that would otherwise not have received it, and b) Finnfund's investment was a crucial component in initiating the fund, enabling to close successfully, or positively influencing its ability to create development impacts (e.g. by affecting investments). Again, we do not have sufficient information to take a considered view on the extent to which fund investments meet one or more of these criteria.

An alternative way to think about additionality (and therefore potentially claimable impact) is to identify those parts of the portfolio that are *likely* to be additional. There are a number of ways this could be done, and the discussion here is designed to start a discussion on the best way to assess this, rather than come to a particular view. Possible criteria include:

- *Project risk considerations* – Given that it will generally be harder to raise finance for higher-risk projects, these are more likely to be additional.
- *Country risk considerations* – As with projects, investments are more likely to be additional in higher and lower risk countries.
- *Instrument considerations* – Fund investments that do not meet the criteria described above, are not likely to be additional.
- *Sectoral* – Similarly investments in financial institutions that could raise finance elsewhere, and where lending patterns (and therefore development impacts) are not positively influenced, would not be additional.

At this stage, it is not possible to determine clear thresholds in the areas described above. An open question is whether this would be possible in the future? A problem is that there will always be exceptions to any rule. It could be argued, for example, that only projects in low-income countries should be considered additional. While this might hold in many cases, it will also be true that some projects in middle-income countries are definitely additional, while others in LICs are probably not.

Rather than thinking about additionality in a binary way, a more productive way forward could be to develop a grading system to capture degrees of additionality. This could also be linked to the strengths of claims that could be made with respect to impact. As discussed previously, the strongest form of additionality is where the investee would not exist without the investment from Finnfund. Here it would be reasonable for Finnfund to claim responsibility – or partial responsibility with co-investors – for all employment generated, or taxes paid, by the firm. In contrast, where it is less clear that Finnfund can claim credit for the creation or survival of an investee, but has positively influenced business performance such that employment levels increase, then the appropriate claim would be for the change in jobs. Fund investments could be approached similarly. Where a fund would not have existed without Finnfund, it is reasonable to claim responsibility for all impacts generated by its investments. An added complication, however, is that this will depend on how additional the fund itself is with respect to the its own investments. Where Finnfund is one of a number of investors in a fund, and its financing could have been obtained from elsewhere, then the only type of claim that could be made is that the operations of the fund were positively influenced. The same points could be made with respect to financial sector investments.

The key point is that it might be better to think about maximising additionality, rather than taking a binary approach. In most cases, it will be possible to argue that Finnfund's investments have been additional in some way. This is not the same as these investments being as additional as possible though. A very important question in this regard is whether it is better to make more 'weakly' additional investments or fewer 'strongly' additional investments, and what the optimal balance of these should be. For example, investments in financial institutions in a lower middle-income country may be additional in some way, but less so than a direct equity investment in the agricultural sector of a post-conflict state. At the same time, the former is likely to generate higher and more stable returns,

returning funds to Finnfund for subsequent investments. The risk of loss in the agricultural project may be significantly higher, jeopardizing this recycling process.

Looked at from the portfolio level, the question is therefore which balance of 'weak' and 'strong' additionality will yield the greatest total additionality, and thus ensure that Finnfund is achieving the maximum possible development impact given its resources? It is beyond the scope of this evaluation to answer this, but it seems a very important question to address going forward.

4 Appraisal findings

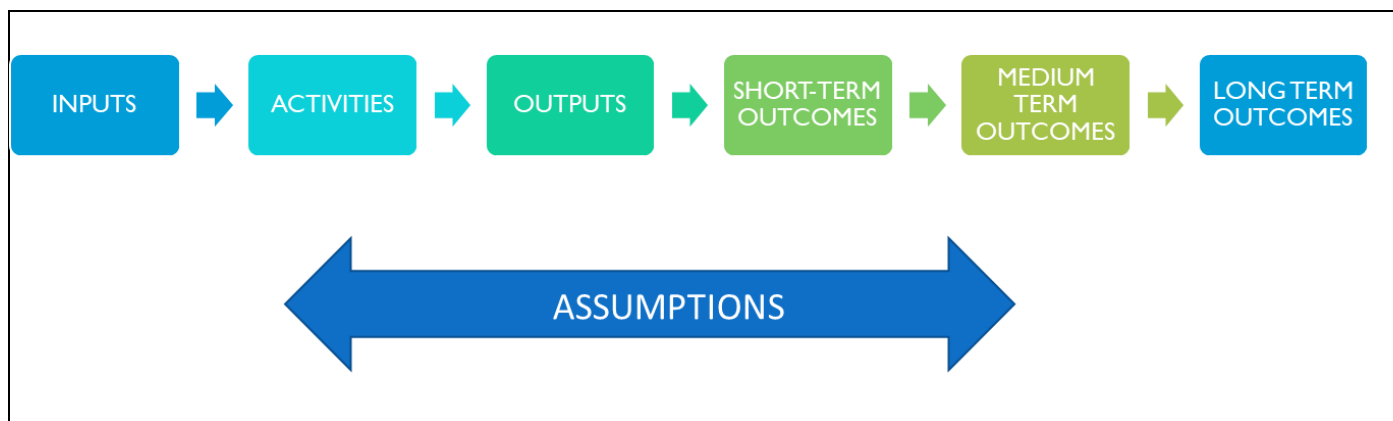
4.1 Introduction

This section describes the findings from the fieldwork and other forward-looking elements of the evaluation. It begins with a discussion of the theory of change that informed the appraisal phase. This includes a stakeholder map for Finnfund and sectoral ToCs. We then go on to present the findings from the fieldwork in two sections. The first describes the evidence that the outcomes in theory of the change are being achieved in the existing projects. The second explores whether Finnfund is institutionally set up to achieve this in the 2018-25 strategy, and if policies and procedures are fit for purpose, given the ambition of the programme.

4.2 Theory of change

Theory of Change (ToC) development is commonplace in evaluation and is widely considered best practice. A ToC describes why and how an intervention works. Also, known as a logic model, logical framework, or impact map, it should set out the theory of how Finnfund’s activities lead to short, medium and long-term changes, including any potentially unintended and/or negative impacts (see Figure 23).

Figure 23 ToC outline



4.2.1 Stakeholder mapping

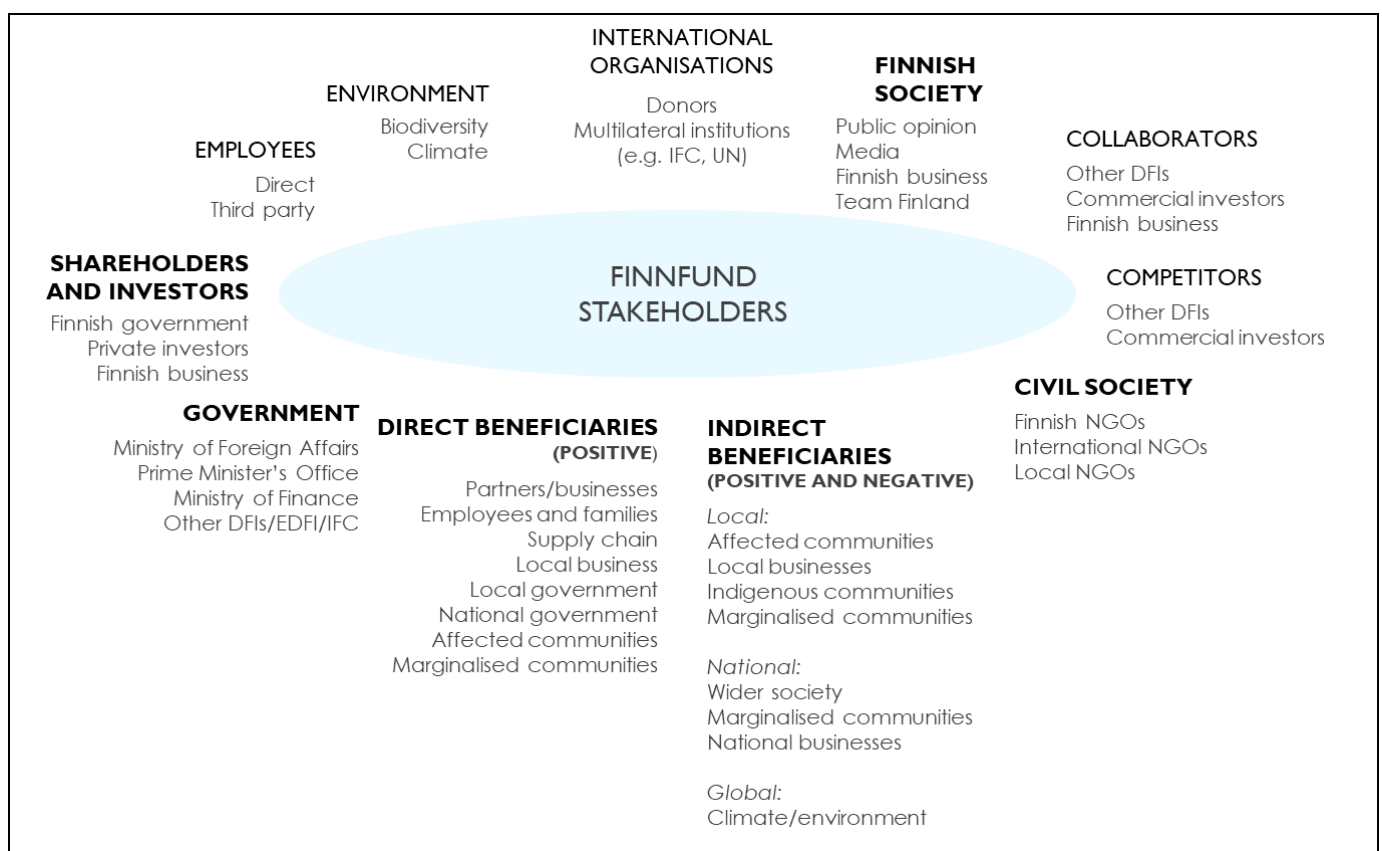
A first step in developing a theory of change is to map project stakeholders. A “stakeholder” refers to any group or entity that effects change or is affected by it. This is wider than beneficiaries and can include entities like the environment or nation states. It should also include unintended and/or negatively affected stakeholders. Involving stakeholders in evaluation is considered a best practice approach in most evaluation and is consistent with OECD-DAC and EU guidance (see Annex 6).

Not all stakeholders are of equal importance to an organisation and in developing a theory of change it is necessary to ask whether a group has sufficient significance, relative to the whole, to merit its inclusion in the analysis i.e. is it material. The aim is to focus the overarching Finnfund theory of

change on the most significant stakeholders, whose omission would influence the 2018-2025 strategy, either in terms of its objectives, or the way that is implemented. Materiality can also vary by ToC i.e. whether it is project, sector or portfolio-specific. Finally, it is sometimes useful to segment a stakeholder group (e.g. businesses). This is needed when materially different outcomes are identified for sub-groups of stakeholders, or where their influence over the subject of interest (i.e. Finnfund’s 2018-25 strategy) is significantly different.

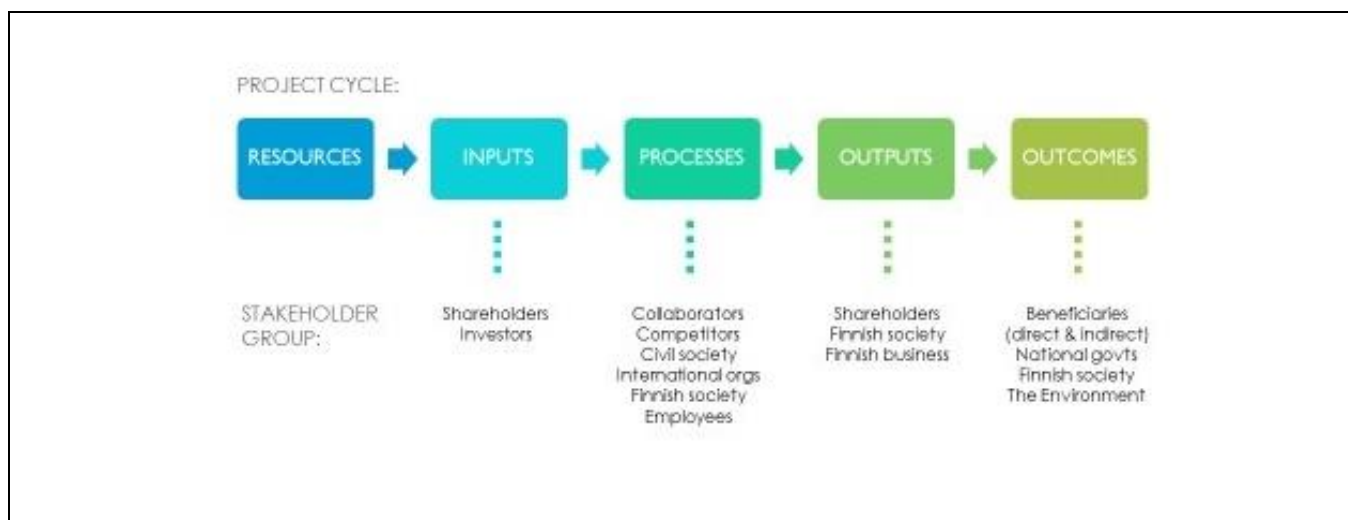
The figure below sets out a draft stakeholder map for Finnfund. This includes stakeholder categories which are partially segmented. The importance/relevance of this segmentation will vary by project but provides an example of how this might be done. Our workshop with Finnfund identified four broad groups that are highly material to the overarching ToC – beneficiaries, shareholders (especially Government), lenders, and Finnish society/civil society. These have been highlighted in bold.

Figure 24 Stakeholder map for the future strategy



One way of thinking about materiality is to differentiate between stakeholders that are material to the organisation’s inputs (e.g. shareholders), processes (e.g. interest groups) and outcomes (e.g. beneficiaries). This helps to ascertain the extent and requirement for engagement. Figure 25 illustrates ways in which stakeholders are relevant to different stages of the project cycle.

Figure 25 Relevance of stakeholders to project cycle



As discussed, the qualitative research sought to engage a wide range of stakeholder groups. These were primarily business owners and managers; however, we also spoke to NGOs, investors, policy-makers and other in-country groups such as worker’s representatives. The findings from these interviews will be discussed below when we present evidence that interrogates the theory of change.

4.2.2 Theory of change for this evaluation

There are many ToCs affecting Finnfund’s work, some explicit, others implicit. These operate as a hierarchy at project, sector, country, portfolio, and governance/mandate level. Ideally, each level should be a compatible component of the ToC at the next level. For example, project ToC should be aligned with sector ToC, and so on. At the highest level, Finnfund is an instrument of Finland’s development policy, and therefore an aspect of a more general ToC. While the MFA has recently completed the development of its own ToC this clearly cannot have affected Finnfund’s approach in the past. Evolving development policy is reflected in Finnfund’s mandate and annual OSM guidance, however, and has therefore been taken account of.

Finnfund already has ToCs for renewable energy, forestry and finance and an analysis of these was provided in the inception report. Whilst these had many positive features, they were not developed for evaluation purposes. In addition, the 2018-2025 strategy makes provision for Finnfund to move into some new sectors, or expand their activities in others, most notably agriculture. Finally, ToCs do not exist at the portfolio or institutional level and project-level ToCs remain implicit.

The primary aim of developing new sectoral ToCs was to guide the analysis for the evaluation team, by shaping the interview schedules and reporting structure. It also informed the selection of wider stakeholders to include and the schedules for those interviews. In developing the ToCs, we took account of:

1. The role of material stakeholders, activities, outcomes
2. Institutional issues: e.g. governance, policies, processes, capacity, funding
3. Implementation challenges (barriers) and opportunities (enablers)

The four sectoral ToCs are presented diagrammatically in Annex 9.

In the next section we present the evidence from the fieldwork that interrogated the ToC. This is broadly presented at the sectoral-level but we have also looked beyond that to consider how portfolio

level features and institutional characteristics of Finnfund may affect its ability to achieve the strategy.

4.3 Evidence for the Theory of Change

4.3.1 Introduction

This section describes the first tranche of findings from the fieldwork. It covers eight key assumptions underpinning the overarching theory of change. These are as follows:

- Capacity development will lead to improved project performance
- Finnfund finance and activities will lead to improved business performance
- Finnfund due diligence and support will lead to improved E&S performance
- Finnfund investment will lead to positive employment impacts
- Finnfund investment will lead to positive environmental impacts
- Finnfund investment will lead to positive outcomes for communities
- There will be minimal negative or unintended consequences
- Finnfund investments and outcomes will be additional

It is useful at this point to reiterate that whilst the fieldwork was conducted rigorously and systematically, the scope was narrow and limited to a small number of projects and countries relative to the overall portfolio. The results should therefore be taken as indicative rather than definitive.

We begin with a description of each of the sectors and countries included in the study to provide background and context. We then go on to discuss the most important aspects of the theory of change beginning with activities (e.g. capacity-development) and outcomes (e.g. employment) before moving on to the institutional features such as monitoring and contractual relationships

4.3.2 Overview of fieldwork

In Africa, the evaluation team studied seven Finnfund projects; four in Tanzania and two in Ethiopia. In Tanzania, the focus was on plantation forestry sector including field visits to three companies; Green Resources AS (GRAS), New Forests Company (NFC), and Kilombero Valley Teak Company (KVTC). The operations of all the three companies are located relatively near to each other in the Southern Highlands, a region famous for its growing plantation forestry sector. KVTC is located in the Kilombero Valley bordering the Southern Highlands plateau. In addition, we visited an avocado farm investment, Africado, in the Kilimanjaro region in Northern Tanzania. In Ethiopia, the focus was on EthioChicken, including a field visit covering the whole value chain. Two other investees were interviewed; M-Birr mobile money service provider offices in Addis Ababa, and the Ethiopia Growth and Transformation Fund (EGTF).

Four Finnfund projects were reviewed in Honduras, three hydropower - Mezapa, Los Laureles, La Vegona (all hydropower) and one solar power - Valle Solar. Finnfund previously invested in another Honduran hydropower project, Agua Zarca, but exited in 2017 following the death of prominent environmental activist Berta Caceres. Whilst Agua Zarca is not the focus of the present evaluation, the circumstances around the project have had a significant effect on the sector, including the four case study investments examined here.

In the rest of this section we provide some background on the countries visited, and also provide some background on the principle sector examined in each country.

Country backgrounds

Honduras

Honduras is the second poorest country in Central America, with 65 % of the population living in poverty. GDP growth rates averaged 3.1 % to 4.0 % between 2010 and 2017. Once reliant on commodity exports, the Honduran economy has diversified in recent years, with services now accounting for 60 % of GDP, manufacturing accounting for 28 % and agriculture just 14 %. However, agriculture still employs 39 % of the labour force, and rural livelihoods are particularly susceptible to commodity price shocks, particularly for coffee and bananas. The country has the highest level of inequality in Latin America, and faces severe challenges from crime and violence, as well as natural disasters (particularly hurricanes and droughts).

The Honduran power sector is dominated by a single state-owned power company, Empresa Nacional de Energia Electrica (ENEE), which has historically had sole responsibility for electricity generation, transmission and distribution. However, ENEE has been subject to an ongoing process of market liberalisation and privatisation since the 1990s. Today, ENEE purchases electricity from a growing number of independent power producers (making up 80 % of supply as of 2016) under power purchase agreements (PPAs), whilst the distribution function was outsourced to a private consortium in 2015. Efforts are underway to privatise the transmission function, which remains a major bottleneck to supply, with a lack of investment stunting the growth of the network.

Despite steady electricity supply growth of 6 % per annum since 2009, the World Bank estimated a 100MW deficit in 2015, due to fast-growing demand, as well as challenges with theft and fraud - Honduras suffers from some of the highest rates of electricity loss in Central America, rising from 21 % to 30 % between 2007 and 2017. National electricity access has increased from 55 % to 88 % between 1990 and 2016.

In terms of natural capital, Honduras' geographic location and tropical climate endows it with strong renewable energy generation potential, particularly relating to solar and hydropower. As such, until the early 1990s the country was almost exclusively powered by renewables, predominantly state-operated hydropower. However, following the liberalisation of the electricity generation market in the 1990s, Honduras saw fast growth in the development of new thermal energy plants, and the energy mix of the country shifted away from renewables. The increased dependence on imported oil made the country extremely vulnerable to oil price volatility, however, with oil imports reaching 10 % of GDP by 2010.

To reduce oil import dependency, the government has provided a series of incentives to renewable energy projects since the late 1990s, including tax breaks and subsidies. In 2015, a substantial subsidy for solar energy in particular led to a boom in solar plant development, with 388 MW of new capacity coming online in 2015 alone (equivalent to around 16 % of total installed capacity from all sources). To date, ENEE has failed to pay the promised premium on solar generation. However, the new solar plants have continued to operate, suggesting that they are able to cover their costs independent of the subsidy.

As of 2016, the split between renewable and thermal generation was around 50 %-50 %. Payments by ENEE in 2017 suggest thermal energy is the most expensive source of electricity, although solar becomes the most expensive if unpaid solar subsidies are taken into account. The Government of Honduras aims to have an 80 % renewables share in the energy mix by 2038. If the cost of renewable energy technology continues to fall (driven by technological advancements and scaling markets), this disparity in production costs is expected to widen, reducing subsidy dependency in the renewables sector (IRENA, 2018).

At the time of writing, all renewable energy generators interviewed were struggling to obtain payments from the ENEE, whose continued deficit is driven by large electricity losses in the system, mismanagement, and below-cost electricity tariffs. The Government of Honduras, ENEE, and a range of national and international stakeholders are in ongoing negotiations with regards to proposed strategies to improve ENEE's financial position. Measures under consideration include renegotiated PPAs and subsidies, restructured debt and capital injections, further restructuring, privatisation and staff reductions, and tariff increases.

Ethiopia

Ethiopia is one of the poorest societies in the world while having the second highest population size of all the African countries. However, it also has the lowest level of income-inequality in Africa, comparable to Scandinavian countries. GDP per capita was USD 2 200 in 2017 situating Ethiopia to the position 205/229 in global comparisons. In economic terms, it was the 5th fastest growing economy in the world with 10.9 % GDP growth rate. Businesses are heavily controlled by the government with key sectors being state-owned, including telecommunications, banking and insurance, as well as power distribution. In its current national development plan, the government emphasizes growth in the manufacturing sector, especially textiles and garments, leather goods, and processed agricultural products. The country faces severe challenges from extreme climatic events, namely periodic lack of rainfall. The worst drought in 30 years hit the country in 2015-16. The situation led to food insecurity for millions of Ethiopians (CIA, 2018).

The United Nations Food and Agriculture Organization (FAO) estimates that food production will need to increase from the current 8.4 billion tonnes to almost 13.5 billion tonnes a year to satisfy the need of the human population in the next 35 years. Competition for increasingly scarce land, water and energy sources and negative effects of the climate change create additional challenges (FAO, 2018). Smallholders are the backbone of agricultural production in developing countries. They supply 70 % of Africa's food, and smallholder farming supports the livelihoods of 500 million households around the world.

For both food security and the livelihoods of hundreds of millions of poor people in lower income countries, therefore, the agricultural sector is key the process of human development. Indeed, it will be impossible to achieve many of the Sustainable Development Goals if significant changes are not made to the agricultural sectors in developing countries. This is borne out by evidence on the potential development impacts of different sectors. After reviewing the literature on the contributions of various sectors to development, Sinha et al. (2010) find that potential impacts are greatest in the agricultural sector. As well as broad-based impacts, some sectors have high potential with respect to poverty. In this regard, Loayza and Raddatz (2010) argue that more labour-intensive sectors (in relation to their size) tend to have stronger effects on poverty alleviation. Based on this logic they also find that 'agriculture is the most poverty-reducing sector. Massa (2011) finds that the two sectors that contribute most to growth are agriculture and infrastructure and agriculture (Spratt et al., 2018).

Given this context, it is understandable that agriculture has an increasingly important role in the Finnfund strategy for 2018-2025 and is an important element of its investments in Ethiopia. For Finnfund, the sector is crucial for development outcomes in lower-income countries, particularly in terms of employment and livelihoods. Agriculture also has a direct link with human health (e.g. potentially increasing food and nutrition security) and typically involves high participation of women and marginalised groups.

Finnfund has four agricultural investments in its portfolio; EthioChicken in Ethiopia (poultry farm), Africado in Tanzania (avocado farm), Australis Aquaculture in Vietnam (seafood production), and Goldtree in Sierra Leone (palm oil). All of the investments are relatively new to Finnfund, from 2016 or after (Finnfund, 2018).

Tanzania

Tanzania's GDP per capita was USD 3 200 in 2017, which locates the country to the position 192/229 in the worldwide ranking. But, similarly to Ethiopia, it has been experiencing high growth rates in the past decade (GDP growth in 2009-17 averaging 6 %-7 % per year). Tanzania has also seen a transition towards a market economy. One of the most important sectors is agriculture, which accounts for almost one-quarter of GDP and employs about 65 % of the work force. The current government elected in 2015 has launched an ambitious development agenda focused on creating a better business environment through improved infrastructure, access to financing, and education progress. At the same time, the President Magufuli has received international attention due to his drastic policy shifts which aim at protecting domestic industry. The decisions have caused concern among foreign investors (CIA, 2018).

A recent study carried out by Held *et al.* (2017) estimates forest plantation area in Tanzania at approximately 325 000 ha. The dominating species are pine (65 %) and eucalyptus (20 %). Interviews among key informants during the evaluation field visit confirmed that the Southern Highlands region has experienced a boom of plantation forestry in the past few decades. The segment of smallholders is especially growing and it has the highest potential for expansion (Held *et al.*, 2017; Indufor Oy & Criterion Africa Partners, 2017). However, the smallholders typically use local low-quality planting material and practice inadequate methods as well as too short rotation cycles. Other challenges include the dispersed locations of the smallholders for which reason they cannot be considered as a direct substitute for large-scale plantation supplies (Indufor Oy & Criterion Africa Partners, 2017). Demand for wood products (primarily for construction sector and paper consumption) is expected to more than double between 2013 and 2035 (Held *et al.*, 2017).

In its Tanzanian forestry investments, Finnfund has not been the only DFI investor in NFC, KVTC and GRAS; CDC (UK), FMO (Netherlands) and Norfund (Norway) have supported the businesses alongside Finnfund. While Finnfund is the first DFI to invest in NFC, FMO and Finnfund are currently providing senior loans on equal terms to the company. Finnfund has provided financing to NFC since 2014 (Finnfund, 2018c) with FMO investing from 2015 (FMO, 2018). In the case of KVTC, Finnfund has provided equity and mezzanine loans in the company since 1999 (Finnfund, 2018e). GRAS has two other DFI investors (Norfund and FMO). Norfund was invested prior to Finnfund investing along with the IFC (who have now exited) Norfund and the IFC were previously invested, although the IFC had exited when Finnfund joined in 2012. Norfund is the main interlocutor among DFIs.

Finnfund's forestry portfolio consists of 10 companies/groups and EUR 101.2 mn. The investments are spread over four regions; Latin America (EUR 28 mn – 3 companies), West Africa (EUR 12.8 mn – 1 company), East Africa (EUR 51.3 mn – 5 companies/groups), and South-East Asia (EUR 9.1 mn – 1 company) as of July 2017. Most investments are directly into plantation forestry companies, with some operating indirectly through funds. In many cases, plantation activity is combined with forest industries.

As described at the start of this section, the assumptions to emerge from the ToC are:

- Capacity development will lead to improved project performance
- Finnfund finance and activities will lead to improved business performance
- Finnfund due diligence and support will lead to improved E&S performance
- Finnfund investment will lead to positive employment impacts
- Finnfund investment will lead to positive environmental impacts
- Finnfund investment will lead to positive outcomes for communities
- There will be minimal negative or unintended consequences
- Finnfund investments and outcomes will be additional

Whether these assumptions are valid or not will be central to whether the 2018-25 strategy is achieved. The fieldwork in the three countries visited was explicitly designed to assess this. The following sections summarise our findings for each assumption in turn.

4.3.3 Capacity development will lead to improved project performance

Finnfund provides a range of specialist support, although the nature and intensity of this support varies depending on project type and needs. The assumption is that knowledge transfer will build the capacity of organisations and enable them to perform better economically, socially and environmentally. For example, there is an assumption that access to E&S expertise will improve E&S performance, leading to more socially valuable companies. As well as being positive in itself, this will also increase the investability of firms, enabling them to attract additional finance and expand, multiplying development benefits. Other kinds of technical capacity-development support are also important in different sectors. In agriculture for example, there are opportunities to improve yields in a socially and environmental positive way through better farming practices and technological improvements. Similarly, Finnfund has accumulated lots of forestry sector expertise in terms of species choice and management, which can potentially improve yields and reduce rotation times. Finnfund may not always provide support directly but can recommend local consultants or facilitate the involvement of Finnish experts where appropriate.

In general, across all the projects visited, the advice and support provided by Finnfund was valued. Project management was seen as professional, and Finnfund staff pleasant to work with and possessing a good level of expertise on the sector.

In the renewables sector, Finnfund's greatest value-added in terms of capacity development has been in the form of legal and financial advice in the structuring of deals, particularly where other DFIs or international financial institutions have been involved. Partners claimed that the experience in structuring deals with Finnfund has increased their ability to engage in similar ventures in future.

Finnfund's expertise and added value in forestry was widely recognised. Forestry companies described the Tanzania Plantation Forestry Conference in 2016, and the access to networks and information that accompanied Finnfund investment, as useful over the long-term. A Finnfund representative is on the board of one of the oldest forestry investments of Finnfund, the Kilombero Valley Teak Company (KVTC) and has been taking an increasingly active role also in other plantation forestry investments. There is also DFI representation on the boards of Miro (Finnfund nomination) and GRAS (Norfund nomination). In Ethiopia, Finnfund requested that EthioChicken hire an E&S expert, which although expensive, has reportedly added value to the company.

In Honduras, clients reported, that aside from deal structuring, Finnfund played a largely 'hands off' role, trusting the expertise of the investees so long as reporting requirements were fulfilled, and no signs of trouble emerged. As an equity investor in the country, Finnfund has tended to waive its right to a board seat, which has given Honduran companies more freedom to implement their projects than would be possible with other private equity partners. While the decision not to take up board seats appears to have largely been driven by logistics, efforts have been made to stipulate actions in contracts which investees would not be able to take without written approval from Finnfund, thereby exercising a degree of board-like control over decision making. Both investees and Finnfund staff have been broadly satisfied with this arrangement.

Capacity development is an area that the future strategy seeks to address through Technical Assistance (TA). The current lack of a TA budget is unusual within the DFI community and was a

point of frequent criticism by clients (and acknowledged by Finnfund as a weakness of its existing strategy in interview).

“TA is a huge problem because it does not allow to leverage the amazing skillset within Finnfund and does not allow Finnfund to position itself in the market. TA budget should be about 1-2% of Finnfund’s budget”

GRAS and NFC reported that TA budgets were provided by co-investors, which enabled them to invest in activities like calculating carbon sequestration, building a forestry association and staff training.

E&S management was highlighted as an area that could especially benefit from TA funding. As well as the lack of TA, one interviewee complained of frequent staff changes - in contrast to the Finnfund strategy of consistent staff involvement - but described the level of advice as ‘generally ok’. In Honduras, an interviewee suggested that for Finnfund to support less mature companies, it would need to be in a position to improve its TA offer.

“More opportunities exist for Finnfund in Honduras – however, so far Finnfund has mostly been working with project developers who have experience working with DFIs. Developers with less experience may require more guidance in order to meet the required environmental and social requirements.”

In summary, our fieldwork suggests that Finnfund uses its expertise, and political capital, to benefit its clients. However, there was also evidence that engagement can be light touch, and the full potential in this area is not being realised. As we will see later, whilst clients value less onerous reporting and oversight, this may also limit the positive influence Finnfund can have, and therefore the impacts it can achieve.

There are two constraints to Finnfund’s capacity development. The first is the level and intensity of involvement with the investee. The second is the absence of TA budgets that could enable investment in key areas like E&S, business performance and development impact. Both are resource-driven: a lack of staff in the case of the former and a lack of budget for the latter. The evidence suggests the need to strengthen both, especially to leverage Finnfund’s expertise in the forestry sector, an issue that will be returned to later in the discussion.

A related question is whether future impacts would be greater by continuing to focus in the same countries, or by moving to other locations once a certain level of capacity has been achieved. In the case of Honduras, for example, it may be that the greatest prospect for increased impact and additionality come from Finnfund deepening their engagement in the country, building ‘on the ground’ presence in order to be more responsive to the risks and opportunities of a complex and relatively high-risk political and economic environment.

4.3.4 Finnfund investments will lead to improved business performance

The rationale behind private sector development is to support companies in challenging markets to grow and develop. The assumption is that growth will create more jobs and improve incomes, working conditions and livelihoods. More competitiveness will improve business performance, enabling firms to improve the quality of products and services and invest for the long-term. This is a core aspect of the theory of change from which many expected benefits will flow. Arguably, it is the main objective of DFIs such as Finnfund.

Business performance across the portfolio has already been explored in Chapter 3 as part of the ex-post study. While data limitations reduce the strength of the conclusions that can be drawn, there was some indication of increased profitability amongst investees. There are also limitations to answering this question qualitatively, particularly because of the very small sample available. The interviews did allow us to explore these questions in a more granular and contextualised way, however, and to understand how Finnfund might affect business performance.

In this regard, all interviewees spoke positively about the impact of the Finnfund investments on business performance. Some examples that they provided are as follows:

- In agriculture, EthioChicken and Africado upscaled their businesses after receiving the investment. For example, it enabled EthioChicken to purchase two greenfield sites, which has led to one farm's capacity expanding from 10,000 chicks a year to 10,000 a day, with national growth of 30 % in 2016.
- In forestry, Finnfund's investment has been described as 'critical' to ensuring the sustainability of the sector. The investees saw Finnfund as a flexible and understanding investor, due to its manageable size and the patience and long-term vision that it brought to the sector.
- In the renewables sector, Finnfund investment enabled the construction of a number of new renewable energy plants, leading to significant increases in the country's renewable generation capacity, and building the experience of developers in working with international finance. It was also reported that the financial, legal and E&S expertise of Finnfund put clients in a stronger position to attract additional finance. Several companies were able to access concessional international finance, which appears to be partly attributable to their experience with Finnfund, be it relating to financial expertise and connections, or in raising E&S standards to the level required by international finance (see Section 4.3.5).

However, important differences between the sectors were also identified, with regard to how additional the investments had been. As discussed in Chapter 2, measuring additionality is difficult and it is not something that can often be done scientifically. The approach we have taken in this evaluation is to address questions of additionality throughout, including in the qualitative elements. Interviewees were asked to reflect on the likelihood that particular outcomes would have happened without the investment, and/or whether it could be attributable to Finnfund. The findings are discussed in Section 4.3.10.

4.3.5 Finnfund involvement will lead to improved E&S performance

There are two reasons why E&S concerns are important for Finnfund's 2018-25 strategy. First, it is central to its mission as an ethical company, including the maintenance of its 'license to operate', that Finnfund avoids investment in socially harmful businesses. This recognises that economic development can produce negative social, environmental and political effects and seeks to prevent or minimise these and to establish appropriate mitigation measures or compensate groups that have been negatively affected. The second rationale is to proactively improve the E&S performance of businesses that Finnfund works with. Over the longer-term, it is expected that this would contribute towards a 'race to the top', leading to improvements in sector-wide performance, and therefore impacts.

E&S issues are a source of controversy in Finland due to previous high-profile cases, particularly the murder of Berta Caceres in Honduras, and reports of forced evictions in Uganda (Richards and Lyons 2014; Fischer et al, 2016). Whilst these could be seen as isolated examples, there are serious allegations involved (see Section 4.3.8 for a discussion of Agua Zarca). Finnfund argues that considerable improvements have been made to their processes since these events, and there is no

doubt they understand the seriousness of the issues. The events continue to cast a shadow, however, and are central to the distrust that exists between Finnfund and some Finnish NGOs.

Given the countries and sectors where Finnfund operates, it seems inevitable that future E&S issues will arise. The question is how they deal with these, and whether we can see evidence that Finnfund's procedures and metrics are leading to improvements.

We have already reviewed Finnfund's adherence to best practice and broadly found that it was compliant. The findings provided a snapshot of the main E&S issues within the portfolio and indicates that matters such as indigenous rights and cultural heritage arise in a limited number of projects in the portfolio. Despite this, they are complex, delicate issues that need to be addressed carefully based on a solid grasp of local conditions. In this section, we seek to understand whether – irrespective of the starting point – there is improvement in E&S performance over time as a result of Finnfund involvement. A second order question is whether those observed improvements are attributable to Finnfund, which will be assessed in Section 4.3.10. We discuss this now for each sector in turn.

A caveat to this section is that only 4 of the 11 projects we visited had current ESAPs, which may influence the findings here. This is partly due to low risk classifications but Finnfund also report that several projects have already made effort to close their ESAPS and reach compliance with the required E&S standards in the past.

Renewables

In Honduras all of the projects visited have basic E&S commitments to Honduran authorities as part of the granting of permits and compliance with local laws, although the projects were generally of the view that these are lower standards than those required by international organisations.

The renewables projects we visited reported positive experiences of E&S interactions with Finnfund and all considered Finnfund E&S staff to be competent and professional. Two of the four projects noted that satisfying these requirements involved significant changes to the way they do business (e.g. developing capacity in new areas and hiring dedicated staff as necessary)

“Mezapa has promoted economic development within local communities. In addition to infrastructure and reforestation projects, significant entrepreneurial growth has been seen in the community. This is due to compliance with Finnfund's E&S requirements and the outsourcing of procurement to local communities.”

The other projects were already familiar with the requirements of DFIs, and were aiming for IFC standard compliance prior to Finnfund entry. One project claimed to have 10 % of its workforce dedicated to E&S management. There was also evidence of resources being invested in community projects, and that workers appeared satisfied with employment standards across the board.

In some cases, it was reported that Finnfund's influence on E&S compliance has been carried over to new projects, facilitating the creation of more socially responsible businesses in the sector. Even where compliance is no longer required by a co-financer, companies have seen the benefits of investing in local communities and labour standards and sought to apply these in their other projects. One investee is now providing advisory services to other Honduran developers, helping them to structure deals with international financial institutions, and to develop the E&S capacities required to comply with DFIs and development banks. This advisory service is built largely on the success of the Finnfund-supported investment.

As discussed, E&S performance issues are controversial in Honduras. It is interesting that an independent fact-finding mission into the Agua Zarca project found that both IFC and local

regulations had broadly been applied in the project. This suggests that whilst Finnfund may have followed procedure, the IFC PS may not have been robust enough to ensure there was adequate due diligence and appropriate community engagement. This raises wider questions about the sufficiency of the IFC PS to guide investment decisions.

There is also a need to promote responsible social and environmental business practices in the wider renewables sector. Whilst Finnfund investments have demonstrated the potential benefits of improved E&S standards, leading to a degree of knowledge sharing and replication, the view of stakeholders consulted is that this is still not the industry norm. More work could be done to raise awareness of the importance of E&S standards across the sector, not only from an ethical standpoint, but also highlighting the potential benefits of improved access to international finance and business performance through stronger community relations.

Forestry

The forestry projects visited are working towards a range of certifications with the FSC being the industry standard. In the case of NFC, all forests are managed using FSC principles (NFC, 2017). Whilst, KVTC is managing and auditing its forests as if they were FSC certified, the company does not have full certification due to an historic conversion of natural forest to a plantation. KVTC aims to manage its landscapes as a mosaic of different types of habitats, which is positive for sustainability (KVTC, 2018b). So far, negotiations with FSC have been unsuccessful but KVTC has been granted a certificate of compliance regarding all other aspects of the standard (i.e. except the rule that no conversion should have happened before 1994).

While one forestry investee has had difficulties ensuring compliance with environmental and social standards, performance has recently improved. The investee has had a number of consecutive ESAPs. When the most recent evolution of ESAP was formulated in 2016, the company was not fully compliant with IFC Performance Standards. The third and latest round of audit commissioned at the request of DFI lenders as part of their monitoring concluded that progress remained limited. A key reason cited was a severe limitation in operating capital, including those related to E&S compliance.

During these financial struggles Finnfund has in cooperation with other DFI financiers made significant efforts to find a financially sound way forward, deploying significant staff time to oversee and guide the distressed company in assessing and addressing the most crucial E&S risks and with limited E&S funds. Interviews with Finnfund indicate that the investee is being allowed time to improve its financial situation, because without operational capital it cannot invest considerable resources into improving the ESAP implementation. Monitoring has increased in frequency and intensity to improve the situation.

A further sectoral E&S issue is the biodiversity impacts of plantations, which we discuss in section 4.3.7.

Agriculture

For agriculture, the industry standard is Global GAP, which both EthioChicken and Africado are working towards alongside IFC Performance Standards. EthioChicken staff explained that Finnfund's investment had established a deadline for implementing the required ESG standards (such as sound ESAs for greenfield farms, improved biosecurity protocols, waste and waste water management practices, etc.), accelerating progress in these areas (Finnfund, 2018a). In the case of Africado, the company reported that it had already achieved good ESG standards (e.g. winning the Global GAP prize). Finnfund's investment was mainly targeted at establishing a new farm that follows the same

standards. However, Finnfund told us it conducted a ‘thorough’ due diligence exercise for the extension as well, based on which an ESAP was formulated (Finnfund, 2017a).

Finance

As discussed in Chapter 3, E&S requirements for financial sector investments are different from direct investment as per EDFI Harmonized standards. M-Birr is classified as category C project and includes only three requirements related to social and environmental matters, covering local laws, health and safety and material changes to the company (Finnfund, 2015). However, as already discussed, it is still the case that MBirr does not have a union or any other specific grievance redress mechanisms (M-Birr ICT Services PLC, 2016). We were told by the company that matters are dealt with as they arise in team meetings, making this unnecessary. As discussed, this lack of a basic grievance procedure may present a risk in and of itself.

In the case of EGTF, both CDC and DEG had previously invested in the fund, and their E&S requirements, which follow same standards as those of Finnfund, were considered sufficient for Finnfund. In an interview, EGTF told us that whilst they understand the increasing importance of ESG issues, they are able to allocate only 20 % of the working time of one person to these matters.

Summary and recommendations

Evidence from field interviews suggests that significant E&S efforts and investments are being made across the projects. However, as with the previous discussions, these vary by sector, by project risk profile and in terms of additionality.

There were some variations between the sectors regarding how welcome/useful E&S monitoring was seen to be. In Honduras this was broadly welcomed, seen to add value to the company, and enabled them to obtain other financing. In other projects, E&S requirements were seen as onerous, particularly in the forestry sector. Whilst they understood that DFI financing comes with strings attached, and that Finnfund was one of the most flexible DFIs with regard to reporting, complaints were made about the burden, with one interviewee describing it as ‘*over the top*’.

Finnfund’s E&S capacity has grown in recent years, and the continuation of this trend is central to the 2018-25 strategy. Specific areas identified for more focus are the development of new tax and human rights policies. This is important, as to achieve the ambitious impact goals of the strategy – including building trust and confidence in the development sector and wider Finnish society – it is clear that E&S must play a more prominent role. There is a case, therefore, for more not less oversight and monitoring.

It was suggested by some companies that additional guidance would be helpful in some areas – e.g. how to implement community projects. In a number of cases, projects were aware that global standards had to be met but had little prior experience or expertise on how to do this. Streamlined guidance and examples of best practice would be helpful to new projects in order to develop E&S strategies and projects and could be developed and distributed cheaply. Emphasis on conflict resolution and engagement with national and international civil society are of particular importance when it comes to potentially controversial projects.

4.3.6 Finnfund investments will generate employment impacts

Employment impacts are central to private sector development. There is strong empirical support for the view that good quality employment provides an effective route out of poverty. Raising the incomes and aspirations of women through employment is also an important goal of development policy, due to its positive impacts on the well-being of women, children and communities. DFIs and other development agencies have therefore always counted jobs created to demonstrate impact. There are several issues, however, with standard measures of employment. First, as discussed previously, most DFIs report employment numbers for investees, which says nothing about where they were created, and to what degree. Second, even where the focus is on ‘jobs created’, this records that a position has become available, but does not describe its quality or who takes the job. This makes it difficult to assess whether value has been generated, and how much. Third, there is the issue of timing. An inefficient firm may need to shed workers to become competitive. In time, this should allow it to expand employment opportunities, but the initial effect may be the opposite. Fourth, there is the distinction between direct and indirect job creation. Some sectors, such as infrastructure, generate few direct jobs beyond the construction phase, but have significant indirect employment effects through the growth channel. Methodologies to measure these indirect effects are not perfect but do give an indication of the likely net employment impacts on a sectoral basis. Finally, many factors influence direct and indirect job creation over and above investments of the kind that Finnfund make, raising again questions of attribution.

Employment effects have already been assessed quantitatively in Chapter 3. In the aggregate, we observed a large amount of volatility but no evidence of any trend, with changes in the data largely driven by changes in investments in funds. There was some evidence found of better outcomes for women’s jobs. In this section, we have sought to look beyond development indicators and explore the quality of employment, including how it is benefiting priority groups such as women.

Scale of employment

The four sectors included in the field research are diverse in terms of their employment impacts. The employment data and responses to interview questions on employment are set out in Annex 10.

Renewable energy projects tend to have intensive construction phases, employing large numbers of low-skilled workers from local communities, but relatively few people once operational. Of the projects visited, some had kept on the best performing workers from the construction phase, with some local workers trained and promoted from manual construction work to greater responsibilities in management and maintenance. The forthcoming macroeconomic impact evaluation of Finnfund’s renewables investments in Honduras finds that, in addition to the direct employment impacts of the project, reduced power outages and productivity growth associated with the Finnfund projects have supported 5,100 new jobs (Steward Redqueen, forthcoming).

Forestry projects typically create locally important permanent and seasonal employment. All the companies we spoke to prioritised local labour from surrounding areas. In all African companies, however, expatriate workers occupied top management positions.

While Finnfund’s investments in EthioChicken and Africado are very recent, they are expected to have large employment impact. This is especially true for EthioChicken. Currently five farms employ more than 950 people who sell chicks onto clients (approximately 1800-2000 at the moment). These clients employ thousands of assistants in their areas. “End users”, mainly women at home, raise the chickens in their backyards until they the meat is sold in local markets. Finnfund’s investment memo explains that the group’s recruitment strategy has been to hire recent graduates and train them in a 3-

year Poultry Leadership Development Programme. Many of these have climbed high in the hierarchy of the company (Finnfund, 2016h, p. 3).

Africado received the first tranche of investment only a few months ago. The estimated number of new jobs after Finnfund investment is 150 permanent and 200 part-time positions. In addition, the company engages with a few commercial farmers and roughly 2000 outgrowers (Finnfund, 2016g).

Quality of employment

The quality of employment refers to the pay and conditions such as working hours, employment benefits, holiday/sickness pay, grievance procedures, and so on. It also concerns the working environment, the sustainability of employment and opportunities for training and progress in employment.

In the renewables sector, all projects visited paid locally competitive salaries and provided employee benefits substantially above the statutory minimum, and in line with Finnfund expectations. There were no reports of labour disputes or grievances. Workers at Valle Solar were pleased with working conditions, including housing provided, and health insurance. Other benefits include limits on working hours, time off for family events, pension schemes, training and development opportunities and performance bonuses. Several expatriate members of staff reported special benefits such as regular extended home leave. In some cases, community members had taken on leadership roles within the projects. In others new technical skills had allowed them to gain employment elsewhere.

Africado, NFC, KVTC and GRAS are better than average employers in the agriculture/forestry sector in Tanzania in terms of minimum pay for unskilled labour. For EGTF, the Managing Director told us that salaries of both Ethiopian and expats were “*in line with what others pay*”.

Finnfund’s role in improving investees’ employment policies and practices was difficult to detect. For long-term investees such as KVTC, it could be argued that the company and Finnfund have developed and evolved employment policy over time. More broadly, given Finnfund’s compliance with best practice, question marks remain about the veracity of performance standards. Another issue is whether DFIs in a lender role can address employment-related issues in the short term and how may they increase their leverage (e.g. via changing ownership position). In the financial projects visited, the evaluation team did not find any evidence of significant changes to employee conditions as a result of Finnfund’s investment. All forestry and agriculture companies visited have a company-based workers’ union or equivalent while the financial institutions did not have any such structure in place.

Most companies had a mechanism to report grievances and corruption, except M-Birr. We were not able to obtain the information for ETFG. All forestry and agriculture companies had mechanisms for employees to report grievances. In GRAS, the system has been in place only since 2016.

Finally, all staff members interviewed during the field visits (NFC, KVTC, GRAS, and Africado) considered themselves lucky to work in these companies. They mentioned that when there are complaints, they are minor, and they have been handled correctly.

Female employment

The value of women’s economic empowerment is widely recognised in development policy. It is also an important priority for Finnish development actors. This has been recognised by the MFA and in the 2018 OSM there is a requirement for gender markers to be developed. Nonetheless, gender remains notably absent from Finnfund’s strategy. As such, gender impacts were not an explicit feature of the theory of change, though the issue was raised as a priority by Finnfund staff in workshops and

interviews. Given this, and its importance to Finnish development policy, we have included gender impacts in this part of the evaluation.

One of the few discernible areas of impact in the ex-post analysis was women's employment. In the qualitative study we assessed the extent to which gender was a priority for the companies as well as gathering data on women's employment impacts.

As we can see from Annex 10, there is a big difference in rate of female employment across the sectors. The renewables sector in Honduras has almost no female employees. Globally, women are underrepresented in clean technology roles, taking substantially less than half the positions available. Even taking that into account, the rate of female employment in Finnfund renewable projects is very low. There was also little exploration of gender impacts on these projects. Although women are thought to be a major beneficiary of electrification, there was no evidence available of this in practice.

Participation in forestry is also low, where women occupy between 10 and 24 % of jobs. However, in forestry investments also typically have nursery operations where most employees are typically female. The best sector for female employment is agriculture. In EthioChicken women make up 40 % of the workforce. It is also expected that this will increase as farms are currently recruiting more women than men. In Africado, women occupy several key positions, including nine supervisors, the pack house data recorder, and financial manager. M-Birr currently employs 46 people of which 22 are female, including the CEO. We did not receive disaggregated data for EGTF.

None of the companies visited had carried out gender analyses, but several were satisfied with the current level of women's participation in the companies' activities. Companies do not tend to report on the salary gap between men and women, nor do they specifically target women in recruitment. However, all companies were positive about employing women and argued that they try to include women whenever possible. There also appears to be strong gender differentiation in recruitment, with certain roles seen as being appropriate for women and others not.

When it comes to promotion, KVTC and Africado women workers' representatives told us that it is more difficult for women to obtain promotions than men. Whilst discriminatory practices may well be an issue, a key challenge is that women tend to be less well-educated than men. Despite this, in all companies where the evaluation team had access to female employees (KVTC, Africado, and M-Birr); women expressed their satisfaction with work and described good relationships with the employer. Africado women's representative told the team that women are treated with respect at the workplace, though both the HR Manager and the women's representative made the point that there are huge barriers to women's progression in employment in Tanzania. They argued that affirmative action is required, suggesting a stronger potential role for DFI-funded companies. In M-Birr, women hold some key positions. Interviews and document review did not provide any indications that this was a result of intentional gender equality policy in recruitment, though this is often the case with smaller firms.

Other marginalised groups

A focus on marginalised groups is not a feature of the Finnfund strategy but was something that was raised as a priority by Finnfund staff and is a feature of sustainability standards and international best practice. Indeed, the intention of working more in FCAS is to reach groups that are most excluded from the labour market. However, it was very difficult to capture any data on this in the fieldwork. Employment figures in Africa were not disaggregated by ethnic group as neither Tanzania nor Ethiopia recognises the concept of indigenous peoples in their territories. National laws therefore do not provide protection (IWGIA, 2018). The interviews suggested that investees do not consider this as a critical matter from the point of view of sustainability and corporate responsibility.

Across the projects visited, there was evidence of positive impacts in terms of the quality of employment in investee companies. It is unclear how much of this can be attributed to Finnfund, but it is a useful complement to the quantitative analysis of employment effects presented previously.

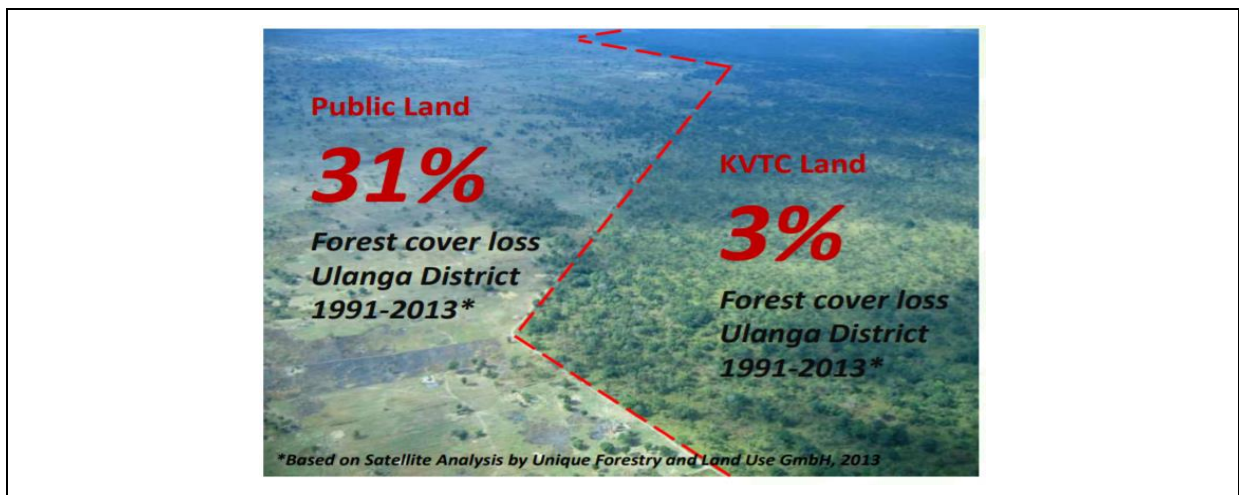
4.3.7 Finnfund investments will have positive environmental impacts

As well as minimising the risks of environmental and social damage, Finnfund seeks to invest in projects that have positive environmental impacts. Of the four sectors, the most important in this regard are renewable energy and forestry, though agriculture can also have important environmental effects, as evidenced by internal E&S assessments by Finnfund, which found evidence of environmental problems, but a commitment to improving standards among investees. As environmental issues are core to the primary activities as is the case with forestry and renewables, the remainder of this section focuses on these sectors.

Forestry

Finnfund invests in plantation forests to promote afforestation, protect natural forests and support jobs and livelihoods in rural areas. Appropriate certifications, such as FSC, are also part of the investment criteria. Forest plantations aim to avoid biodiversity loss through the deforestation of surrounding natural forests, sequester carbon, and reduce illegal logging and charcoaling by providing jobs and an alternative source of timber to local communities. This point was echoed by KVTC who argue illegal logging and charcoaling are contributing to a rapid loss of forest cover, which may be as high as 30-40 % since 1994. Compared to these figures, new plantations establishment is insignificant. The picture (Figure 30 below), demonstrates how plantation forestry can contribute to forest conservation.

Figure 26 Environmental conservation in KVTC managed land compared to public land



(KVTC, 2015)

The approach is not without controversy. Some NGOs and academics argue *inter alia* that forest plantations reduce biodiversity due to monocultural crop use, the species used have an overly narrow genetic base (threatening commercial viability), and plantations can create negative environmental impacts by disrupting local water systems, or displacing native species.

According to Finnfund, this issue is not well-understood by critics, and not all environmental NGOs take the same view. This was supported by interviews with WWF Finland who broadly share

Finnfund’s approach that forestry plantations should be established on degraded land rather than natural forest areas and should be supportive of the rights of local communities. WWF has established the New Generation Plantation (NGP) initiative, which starts from the position that plantations can be positive for both biodiversity and community rights, if well planned and managed. Under the NGP initiative, plantations should:

- Maintain ecosystem integrity
- Protect and enhance high conservation values
- Be developed through effective stakeholder involvement processes
- Contribute to economic growth and employment.

NFC, GRAS and KVTC have respectively 34, 40 and 70 % of the total area protected as conservation zones. This is consistent with the theory of change, which expects that actively managed plantation forests will lead to better conservation of natural forests. KVTC is known for its landscape-level environmental management that includes a mosaic of natural habitats, forest plantations and wetlands with important wildlife corridors (KVTC, 2018b). While the approach is feted (e.g.(KVTC, 2015)), a KVTC interviewee questioned the business sense in protecting 70 % of the land leaving only 30 % for plantations. GRAS is in the process of re-defining natural habitat classes on its land to strengthen the management of conservation efforts in the countries in which it operates.

Regarding the genetic base and narrowness of the species, FDT argued that this is one of the constraints to forestry in Africa. Tree improvement programmes are long-term, and governments have been unable, or unwilling to invest in them. However, the situation is changing and KVTC is participating in a project with FDT to carry out genetic trials.

From an environmental perspective, the most important impact beyond sustainable forest management (SFM) is arguably the sequestration of carbon from the atmosphere. A study carried out by the Cirrus Group found that NFC removed approximately 1.17 million tons of carbon from the atmosphere between July 2014 and June 2017. Data from GRAS indicates that they have sequestered 690 000 tons of carbon, although the time-scale is not clear. We do not have data on carbon sequestration for KVTC.

Renewables

The two most important outcomes in the ToC for renewables are electricity generation (see Section 4.3.8) and avoided future carbon emissions. The four projects in Honduras are estimated to displace 221,000 tonnes of carbon emissions per annum (Steward Redqueen, forthcoming). The government in Honduras aims to reduce its emissions by 15% of the projected business-as-usual scenario of 29 million tons by 2030, which equates to a reduction of 4.35 million tons per year. The emissions displacement of the four Finnfund-supported projects is therefore meeting 5% of the national emissions reduction target. Table 27 breaks this down by project.

Table 27 Emissions displacement of Finnfund-supported projects

Location	Tonnes of carbon
Mezapa	28,000
Los Laureles	21,000
La Vegona	100,000
Valle Solar	72,000

In addition to CO2 effects, a number of projects observed an increase in biodiversity around the project sites, as land in the surrounding areas formerly used for livestock grazing underwent a natural ‘rewilding’ process. Afforestation initiatives have also taken place around the project sites in a number of instances. For example, having felled around 100 trees during construction, Valle Solar has since planted almost 1,000 new trees.

Only two of the sectors that we looked at have material environmental impacts: renewables and forestry. For both sectors, there is clear evidence of carbon sequestered and emissions reduction. For forestry, however, there is a debate about the impact on biodiversity, which may need to be addressed more actively.

4.3.8 Finnfund investments will have positive impacts on local communities

Across the sectors we visited, all projects, with the exception of finance, were having substantial potential community impacts, both positive and negative. Unlike the other projects we visited, M-Birr and ETFG did not have contractual requirements to implement community development projects. The ways in which community impacts take place vary by sector and the three remaining sectors will be discussed here in turn. We briefly discuss finance at the end of the section.

Renewables

In the renewables sector, one way in which local communities can benefit is through improved access to affordable electricity and new power connections. The ToC for this sector is that new connections enable rural and remote communities to become electrified, boosting economic development and improving the lives of people living in those communities. Increasing the supply of electricity could also reduce prices making essential services more affordable. Estimates of the power provided by the plants visited are:

- Mezapa – Supplies 48.1 GWh of power to around 45,900 poor households.
- Los Laureles – Generated 30 GWh of power in 2016, providing power to almost 38,000 poor households.
- La Vegona – Electrified five rural villages (over 200 families) which previously were not electrified. Supplied 162 GWh of power to 205,000 rural households in 2015.
- Valle Solar – Generated 132 GWh in 2016.

It should be noted that these are gross output figures, and not necessarily additional. According to the impact study commissioned by Finnfund (Steward Redqueen, forthcoming), the greatest benefit in Honduras with regards to electricity supply came from the displacement of costly fossil fuels, and the improved reliability of supply, thereby reducing business down time. The report estimates that reducing dependence on expensive diesel plants in this way, the increased renewable energy supply associated with the Finnfund investments has reduced annual national electricity subsidy requirements by some USD 45.1 million, or around 1 % of Honduran tax revenues, and displaced the necessary importation of around 545,000 barrels of fuel (USD 32.8 million) per year. This is a welcome fiscal benefit to the government, and particularly the financially struggling ENEE (although not yet a saving that has been passed on to consumers through adjusted tariffs). The report also looked at productivity gains as a result of improved energy supply and estimated that the four Finnfund investments have led to increased economic activity worth around USD 80 million, primarily in services and manufacturing. This in turn translates into an estimated 5,100 new jobs.

With electricity supply coverage at almost 90 % in Honduras, there were few benefits relating to additional electrification of rural areas, with only one in four projects having extended new connections to nearby communities.

All projects have also been involved in community development projects, including supporting local health, education and water and sanitation programmes through the donation of funds, medicine, equipment and the construction and renovation of infrastructure. The construction of access roads to project sites has reportedly had positive effects on remote communities in project areas. Project owners told us that communities have been supported to prepare project proposals for collaborative community projects. In one case, a local community had used these new skills to prepare proposals and deliver them to the municipal government.

It is important to note that positive community impacts from Finnfund and other DFI investments in Honduras are largely overshadowed by the 2016 murder of the activist Berta Caceres (see Box 1). Whilst the project was not a focus of the present evaluation, the death of Berta Caceres and subsequent local and international media attention has affected everyone in the sector. Most stakeholders were keen to raise the issue.

Box 1 Agua Zarca

Agua Zarca was designed as a 22MW run-of-the-river hydropower project on the Gualcarque River in western Honduras, fully owned by Honduran company Desarrollo Energéticos, S.A. (DESA). Finnfund was a B lender in the project, whereas FMO and CABEI were A lenders. The project became the subject of international attention following the murder of prominent environmental activist Berta Caceres in March 2016. Berta Caceres had been the head of COPINH, a local NGO leading the opposition to the construction of the project citing concerns over environmental damage and lack of consultation and coordination with the local indigenous Lenca communities. Following Caceres' death, Finnfund and FMO put all disbursements to the project on hold and the works were discontinued, and in May 2016 Finnfund and FMO announced that they would be seeking a responsible exit from the project, which was completed in July 2017. Contractual relations with DESA have been terminated, and DESA have indefinitely suspended operations at the site.

An independent international fact-finding mission was commissioned in mid-2016, the findings of which suggested that, whilst national laws and IFC Performance Standards were largely adhered to, the weak rule of law and high levels of poverty and violent crime in Honduras may require E&S actions above and beyond these standards for projects such as Agua Zarca, including early-response conflict resolution protocols. The report also suggested that efforts be made to uphold commitments to local community projects that were included in the project design, and that community consultations continue to determine the future of the project.

Finnfund and FMO are committed to finance community projects in the area, and dialogue with the communities is ongoing. However, controversy remains regarding the role of DFI finance in this investment.

On 29 November 2018, seven people were convicted of the murder in Honduras, including two former employees of DESA, the company which owns the Agua Zarca hydropower project. The judiciary process is still ongoing and at this stage it is not possible to get a complete picture of the case yet.

The key messages from developers interviewed as part of the present evaluation were as follows:

- Careful relationship management with communities is vital, including early-stage sensitisation and education initiatives prior to the project.
- Whilst high levels of violent crime, poverty and inequality can make Honduras a challenging environment to work in, strong local knowledge and on-the-ground presence can mitigate this.
- The tragedy at Agua Zarca should not discourage future investment in renewable energy in Honduras. Environmental risks can be managed and mitigated, and renewable energy remains a cleaner alternative to thermal energy.

Those interviewed also made the point that objection to renewable energy projects often comes not from the immediate communities themselves, but from national and international NGOs. There was a recognition that work needed to be done to improve relations in this area.

There is some evidence that projects have learned from the Agua Zarca case. A number of interviewees noted that the community projects undertaken as a result of partnership with Finnfund and other international investors are now seen as an important investment for a company and beneficial to business practices. As well as bringing benefits to the communities themselves, local community ownership and buy-in to projects helps reduce the risk of violence, theft and other disruptions. The owners of Valle Solar told us that when the Agua Zarca protests took place, Valle Solar was not affected, as the community took measures to protect the site. This is seen as a sign of community buy-in to the project, and an endorsement of the importance of community investments.

Forestry

There are three aspects to the ToC for communities within forestry projects. The first is that it will reduce local land conflicts and improve cohesion by creating a shared resource around which communities can coalesce. The second relates to the outgrower programme, where smallholders become integrated to an industrial value chain by receiving quality seedlings, technical advice and a secured buyer for their wood. At the same time, forestry companies can expand the area that potentially produces raw material for their factories. Collaboration with farmers also allows them to manage community relations in surrounding areas and to increase positive development impacts. In addition, investments in infrastructure such as forests roads and transportation should also serve local communities.

As we did not have the time and resources to interview community groups, we relied on secondary literature and Finnfund or company documentation to assess the quality of community relations (EBS Advisory, 2018; EOH Coastal and Environmental Services, 2017; Finnfund, 2016a; KVTC, 2018b; NFC, 2017). Based on this evidence, two of the forestry projects – NFC and KVTC) appeared to have positive community relations.

In the case of GRAS, a recent article on Scandinavian investments and agricultural modernization in Tanzania paints a negative picture of community relations, including the role of the former CEO (Bergius and Widgren, 2017). The article provides a list of academic papers that have also taken a critical approach to GRAS’s investments in Tanzania and in East Africa in general (Bergius et al., 2017), though it should be noted that the evaluation team have not independently verified these claims.

All the three plantation forest companies provide out grower support to farmers in surrounding communities. Table 28 shows the scale of the outgrower programme in forestry.

Table 28 Scale of the outgrower programme in forestry

Project	Size
NFC	750000 – 1,000,000 seedlings, 1,000 farmers
KVTC	1,258 hectares in 2018 (estimated) plus maintenance
GRAS	250,000 seedlings, 7 villages, plus training and TA

All the projects visited had received support from the Finnish bilateral Private Forestry Programme (PFP). This was in the form of funding for KVTC and NFC and by purchasing seedlings from GRAS. However, the outgrower support component is no longer included in the PFP Phase II Programme

Document, which has come as a negative surprise to experts that are stakeholders of the PFP (e.g. Indufor staff, the company that has provided TA to the programme; the Finnfund investees; external experts). One expert we spoke to told us that this was due to a reduction of the programme budget from approximately EUR 20 million to EUR 10 million from the first phase. However, we were also told that it represented a shift in MFA policy away from a focus on individual outgrowers to developing the capacities of Tree Growers' Associations (TGAs). The approach aims at strengthening the negotiation and technical skills of smallholders through more organised social structures and linking them more to the public extension service.

Investees that provide support to outgrowers thought that this provides benefits to the company and local communities alike. However, they also argued that the priority should be on ensuring that the “mothership” is operating on a solid financial basis. Likewise, they argued that supporting smallholders makes sense only if they can be linked to an existing industrial value chain. Experts working in the investee firms criticised the fact that donors and DFIs sometimes see the number of outgrowers as a proxy for development effects, and overly focus on the number reached. They argue that the poverty of smallholders can be reduced only if they produce high quality products and if the market is secured, and that this should be the focus. Investees also have to carry the burden of providing technical assistance to the farmers, which means considerable investments of time and money. In spite of this support, there is no guarantee that the farmers will (a) produce sufficient quality products, and (b) eventually sell the wood to the company that provided the support (contracts exist between the parties, but it is virtually impossible to enforce them if the farmers decide to sell elsewhere). Given this, the company has to ensure that its own plantations produce sufficient raw materials in the long run.

Finally, as mentioned above, the three forestry projects make direct investments in local communities. Examples include:

- NFC (NFC, 2017):
 - Establishment and training of village savings and loan associations
 - Doctor's accommodation
 - Classroom block
- KVTC Social Fund (KVTC, 2018a, 2018b):
 - Schools, dispensaries, etc.; in total 140 separate projects to date
 - Poaching and fire patrolling contracts with the communities worth USD 25 000/year
 - HIV/AIDS awareness programmes by providing training as well as distribution of condoms and medicines
 - Since 2002 an amount of approximately \$400,000 has been disbursed through the Social Fund Programme.
- Through its operations, GRAS has invested over USD \$913,000 on community development projects (EOH Coastal and Environmental Services, 2017; Green Resources AS, 2018a). In 2012, GRAS' largest construction projects were:
 - teacher's accommodation for eight teachers at Uchindile Primary school,
 - a girl's dormitory at Uchindile
 - secondary school, with capacity for 48 girls
 - a maternity ward and nurses house in Mapanda”

Recent years the community programmes have stalled or been delayed due to lack of operating finance that has caused delay in number of operations, including forestry and E&S management. External social and environmental monitoring reports lists the corrective measures required, for example delays or poor quality in dispensary, classroom, village office and doctors house, community hall, toilets for primary school construction projects. These refer to those community projects that have been agreed but for which delivery has stalled significantly due to company lack of operating

capital and have caused frustrations and disappointments in the communities and deteriorating company-community relationship. There are also communities which did not express grievances.

The companies were of the view that these community development activities do generate good will, but the focus should be on the core business which they believe creates important development effects. Interviewees questioned the companies' obligation to build infrastructure in villages that is not directly related with the business. This is echoed by critics of CSR projects, where these are often seen as tokenistic, or even used to divert attention from core business activities (Rahaman et al, 2004; Christian Aid, 2004). When this was put to Finnfund, they were firmly of the view that these projects were creating important social benefits and ensuring that communities were a) being compensated appropriately, and b) being bought in to the projects. It seems likely that the most successful, and defensible CSR projects are those with a clear link to the project (i.e. distributing benefits), which also meet a well-identified local need.

In this regard, villages typically identify priorities themselves (e.g. in the village committee) and then the company approves or rejects the proposal. In some cases, communities act as the investment owner of the projects to save the company's time, while in others, the company implements the construction with the purpose of ensuring quality. The fact that village committees, which are often male dominated, prepare the proposal, suggests that there is no guarantee of women's participation in the process. On the other hand, the type of projects that have been implemented would be expected to benefit men, women, boys and girls alike, such as a teacher's house, a school, or a medical facility.

Agriculture

The most important community outcome from agriculture – and part of Finnfund's rationale for entering the sector is food security. In EthioChicken, the 'end user' – those who eventually sell the chickens - benefit from egg production prior to sale. One interviewee told us that wasting in children has decreased due to increased egg consumption, but there are no official statistics available to confirm this. There is a barrier to chicken becoming a staple protein, however, potentially limiting these effects. Local people eat chicken only during festivities when they take the whole day to cook the dish following a traditional method. Whilst EthioChicken has not had a problem selling its products in increasing amounts, this tradition may suggest a natural cap on sales and the role of chicken meat in the Ethiopian diet. However, one interviewee told us that as chicken production increases, prices will drop, and people's behaviour will change. The government is also campaigning to increase the consumption of chicken meat in Ethiopia. EthioChicken was also one of the projects where we were able to interview community members and clients. These groups generally expressed their contentment with the company as an employer and social actor.

It is also our understanding from the research that Africado enjoys good relations with the local community. Impacts on diets, as well as an outgrower programme, are the main ways in which the community are seen to benefit. In 2010, the company started a pilot programme to plant avocados in local communities. In 2014, the first group of 26 farmers were successfully certified to Global G.A.P., and a second group of 228 farmers was certified in 2015 (Global G.A.P, 2016). According to one interviewee, the scheme has grown to engage approximately 2000 farmers. Another interviewee told us that Africado is focusing on increasing the yield of the existing outgrowers rather than their total number. The farmers have to buy the seedlings at production cost and contribute labour to maintaining the plantation. According to Africado, the benefit of the outgrower scheme is that the families can consume the lower quality – but highly nutritious - fruits to diversify and improve their diets. Again, avocados are not part of the traditional diet, and are considered animal, rather than human food. However, preferences are changing, and we could observe during the field visit that several markets stalls were selling avocados for human consumption.

Finance

Community impacts were discussed in interviews with M-Birr and explored in our document review. The main community benefits likely to result from financial investments are increased access to finance by priority groups such as SMEs or women entrepreneurs, or financial inclusion. We have some evidence of this from M-Birr, where the product enables beneficiaries to engage in financial transactions. According to the European Investment Bank M-Birr services are available in 7,000 locations processing payments for 750,000 households with around 3 million beneficiaries and 280,000 mobile core clients. No further information is available on the social benefits of these transactions. However, the EIB report goes on to describe it as ‘*transformational for a country where only one in five people have a bank account, while half of all adults own a mobile phone*’ (European Investment Bank, 2018).

4.3.9 There will be minimal negative/unintended consequences

All interviewees were asked to identify any negative, unintended consequences or missing impacts. Interviewees did not identify many material impacts that have not already been covered in this chapter. In renewables, the risk of negative impacts tends to be highest during the construction phase of the projects. As discussed, the need for community acceptance of the projects is crucial at this stage. However, it is at this point that there may also be damage to the natural environment, workplace accidents or injuries. For example, there were two fatalities during the construction of one hydro project, and some minor injuries reported on other projects. No other major incidents or negative impacts were reported across the projects.

Across the other projects, there was one company who considered the interest rates charged to be excessive. The other main negative feedback for Finnfund related to the onerous nature of reporting, as discussed previously. However, these are also the companies that arguably require the greatest oversight due to the problems in that sector. M-Birr considered the reporting requirements to be quite light, and as discussed, they were largely welcomed in the renewables sector.

4.3.10 Additionality

Additionality is fundamental to the overall success of Finnfund’s strategy. If its activities are not additional to what would have happened anyway, then it cannot claim any impact, and the goal of ‘tripling impact’ is at risk from the start. Given this, it is worth reflecting on the issue again here. We begin with a discussion of financial additionality.

Financial additionality

As discussed previously, financial additionality is likely to be highest under certain circumstances. For example:

1. In countries or sectors where capital is scarce, expensive, or absent entirely.
2. During downturns in market sentiment towards particular markets or sectors, where Finnfund may provide countercyclical finance when commercial investors may not, and also not pull out of investment projects when a private investor might.
3. Where Finnfund provides a different kind of finance that the project needs - e.g. its willingness in the renewables sector to be an equity or quasi-equity investor, whilst other DFIs have typically been involved on the debt side. Where Finnfund have been equity investors, partners and other

DFIs noted that this was a major help in achieving the adequate debt-to-equity ratio to satisfy lenders and ensure that an overall financial package could be structured. Where Finnfund can provide funding on better terms than commercial alternatives, which may be essential for project viability. An important element of this is maturity. Particularly in the renewables and forestry sectors, investments need very long time-horizons. The supply of long-term, ‘patient capital’ is notoriously difficult in low-income countries, and Finnfund’s ability to supply longer tenors is thus likely to be additional in many environments.

4. Where Finnfund is the largest, most important or first investor. An example here is in forestry where Finnfund is often the leading and/or most important investor. Another would be in innovative agricultural projects, particularly in markets from which other DFIs have withdrawn. This could also be the case with an investment fund, which Finnfund helped to found, or acted as an ‘anchor investor’ attracting others. Whether this is additional would depend on the nature of the fund. General funds operating in established markets would be likely to attract funding regardless of Finnfund’s involvement. More specialist funds operating in difficult markets and sectors, in contrast, may be heavily reliant on this sort of activity.
5. Where additionality is achieved by DFIs as a group. For example, where new technologies are brought to market and the underlying economics are improved due to DFI investment (e.g. Fintech or solar power).

These criteria suggest that financial additionality is most likely in the poorest countries that Finnfund operates, suggesting that as it increases its exposure to these countries, additionality will increase. At the sector level, the same can be said for forestry and also agriculture, both of which struggle to attract investments on the terms needed. Renewable energy is a more complex case, but there is some evidence that DFIs as a group have been highly additional, even if it is hard to argue this for Finnfund in some individual investments. Mainstream equity fund and financial sector investments, can certainly be additional, but this is dependent on the nature of the investee, and does not automatically follow.

Outcomes additionality

As well as financial additionality, Finnfund may also be additional by bringing valued skills and expertise in addition to finance, which improve the efficiency or competitiveness of the investee. They may also change the business focus on investees, such as by encouraging financial institutions to lend more to impactful sectors. Finally, they may also generate improved E&S outcomes through their influence, enhancing development impacts, and also potentially the long-term competitiveness of investees.

Even where Finnfund can be seen to be ‘additional’, a second order question is whether outcomes would have happened anyway (i.e. ‘deadweight’) and whether those impacts can be directly attributable to the Finnfund investment (i.e. ‘attribution’). Again, these questions are challenging to answer. What we can conclude from this discussion is that these tend to vary by sector, project and type of impact. For example, deadweight for E&S improvements is likely to be high if other DFIs are already involved, or if IFC Performance Standards are already in place. Additionality in employment has already been discussed, but there are several examples where attribution of job-creation to Finnfund is likely to be low.

The following sections pull together our findings from the fieldwork with respect to additionality.

Financial additionality in renewables

The renewable sector has become more attractive to commercial investors in recent years, with continued developments in renewables technology driving down costs and reducing subsidy dependence. However, securing commercial finance for utility-scale investments in countries such as Honduras, with high risk ratings and underdeveloped capital markets, remains challenging. As such, a continued role for DFI finance is likely, due to its patient capital and risk tolerance. Where multiple DFIs are operating, investments from any one of them may not always be strictly financially additional. However, DFI funding in general is likely to be additional, and Finnfund's participation in this funding plays an important role. Moreover, in Honduras, Finnfund has carved out a niche in the DFI space through its willingness to act as an equity investor, whilst other DFIs have remained as debt financiers. Through this, Finnfund has improved the equity-to-debt ratio of a number of projects, and subsequently leveraged additional debt finance.

In Honduras, we also noted that some investees showed a relatively high degree of sophistication, and an awareness of (and connection to) international sources of finance. Some had prior experience working with DFIs and development banks, and were already accustomed to, and implementing, the associated E&S compliance standards. Some were also confident that alternative sources of finance would have been sought to implement their projects as planned. However, the additionality here is likely to be higher for the smaller or more remote companies where the financing options are more constrained.

“Mezapa was a challenging project due to its remote geographical location - acquiring funds for the project was therefore difficult. Bringing in Finnfund as an equity investor gave other investors more confidence in the project.”

The rates and terms for debt finance from domestic banks in Honduras are high, and there are limited options with regard to equity partners. In addition, Finnfund entered the arrangements in 2009 following the coup in Honduras when international debt financing was extremely difficult.

“Considering the political situation in Honduras [during the 2009 coup], acquiring funds for [Los Laureles] without Finnfund would have been nearly impossible. If it had not been for the support from Finnfund this project would have never happened.”

Moreover, although Finnfund has tended to support a number of more viable companies, the most common alternative funding mechanism for those believing their investments would have gone ahead regardless was through reinvested earnings. If this had been the case, it would have reduced the developers' abilities to invest in other projects in the sector – as such, Finnfund's investments may be considered additional within the overall finances of the developers in question.

Finance

Demonstrating additionality in finance is more challenging. While some international banks have reduced or ceased their operations in Africa in recent years, large domestic institutions tend to be very profitable (see Spratt, 2013 for an analysis of the reasons for this). They are thus unlikely to have difficulty raising finance in general. For example, whilst M-Birr described the investment as 'critical' to the success of the company, they also reported that they were in discussions with Swedfund at the same time and could have gone ahead with Swedfund. Finnfund dispute this, and argue that they were the only investor in M-Birr at a critical time, and invested considerable effort in the company's development, without which it may well not exist.

There are other ways to think about additionality, however. Finnfund may bring considerable expertise to bear, which can be additional even if the financing itself could have been obtained

elsewhere. It is important to assess all these different forms of additionality before taking a view on whether Finnfund's activities as whole have been additional.

Finnfund uses its finance to encourage these institutions to expand their lending to key groups, such as SMEs, female entrepreneurs and low-carbon development. If successful, this would be additional from an outcomes perspective. As described in the ex post assessment section, however, we do not have the data to directly assess whether this has been the case, though Finnfund build these requirements into contracts, and are clearly committed to achieving impacts in this area.

Agriculture

Based on the criteria above, the potential for additionality is higher in agriculture than either finance or renewables, particularly as many DFIs have withdrawn from the sector in recent decades. Both EthioChicken and Africado were already operating successfully on a financial basis before the Finnfund investment, but the financing was described as key for expanding the businesses. The assessment for EthioChicken was that the business would have partly gone ahead, and that they would have eventually found other source of financing. Similarly, Finnfund is not the first investor in Africado. The company also broke even in 2016, which meant that Finnfund entered a situation where Africado was already making profit but wanted to expand the production.

Nonetheless, we should here also consider the additionality of outcomes and the value of softer forms of support, which will be discussed below.

Forestry

The sector where Finnfund investments appears to be having the greatest current additional impact is forestry. This is also the sector that has experienced the most financial turbulence. Two of three forestry companies we visited have been struggling financially, while one is doing better and could be exited in a few years. All of the investees are performing worse than anticipated, suggesting that initial forecasts were over optimistic. The best performing of the three, suffered several times from delays in the construction of its sawmill and processing operations since the establishment of the company (Finnfund, 2012b), though company is now running well, however, with plantations approaching maturity. In one case, the gap between projections and financial results have led to half the original loan being converted to equity (Finnfund, 2018c). The most problematic forestry investment has gone through a dramatic restructuring of personnel, including many lay-offs between September 2014 and May 2017 and changes in top management positions (Finnfund, 2016e). It is clear that financial problems are common across the sector. The lack of finance available (and the features that make it unattractive to commercial investors) are directly linked to Finnfund's additionality, however, as discussed above. Finnfund is also sometimes the first DFI to invest, paving the way for others.

In an interview with another DFI, Finnfund was described as the leading DFI in forestry. Other DFIs reportedly value Finnfund's forestry expertise and look to them as the leading investor. Finnfund was apparently "instrumental" in the formulation of this DFI's own forestry strategy. Finnfund's central role in forestry was echoed by the investees who saw them as critical to the sustainability of their companies and potentially the forestry sector in Africa. Finnfund has also shown resolve in the sector, when other DFIs have sought to exit. Even when Finnfund is not the only DFI investor, therefore, it is the only DFI that shows ongoing commitment.

This brings us to an interesting conclusion. Although forestry investments are long-term, risky (financially, politically, environmentally and socially), and time-consuming to manage, this is also

where Finnfund may be able to generate the greatest amount of value, because of its additionality and the developmental importance of the sector. This is an issue that will be discussed in more detail in the recommendations section as it is critical to an effective assessment of the future strategy.

Additionality of outcomes

In terms of the additional benefits that Finnfund brings, there are two areas that merit further discussion. The first is additionality of employment outcomes. The qualitative research found better than average employment quality across most of the investments, though it is not clear how much these conditions were attributable to Finnfund and/or other DFI finance.

The second area is E&S performance. Although there is no question that Finnfund staff are committed to E&S work and are well regarded by investees, in many cases it is unlikely that the companies' performance will have changed considerably as a direct result of Finnfund involvement. In many instances, companies were already working towards standards for other financiers, or had begun to do so in order to be eligible to apply. However, there is evidence that Finnfund has added value by ensuring the maintenance and ongoing prioritisation of standards. For example, Africado attributed considerable added value to the Finnfund due diligence process by saying that "*after that, things just had to be done*". Given that Norfund are already an investor, it may point to differences in how DFIs approach the issues. It may also be an example of an area where DFIs as a group are having an impact.

In the renewables sector we also saw some evidence of a 'race to the top'. The sponsor behind La Vegona and Valle Solar told us he is now applying these standards in his business elsewhere, whilst the Los Laureles sponsor is working to promote international E&S standards elsewhere in the industry. These wider benefits may not have occurred without the experience of implementing standards in partnership with Finnfund.

Conclusion

Of the four sectors, financial additionality is likely to be lowest in finance and highest in forestry and agriculture, though there will certainly be exceptions to this. This is purely a function of the availability of financing in each of these sectors. Interviews with Finnfund suggest that this is well understood.

The level of commitment to forestry is unique amongst DFIs, and reflects Finnish experience of, and expertise in the sector, as well as an understanding of its crucial development role in many low-income countries. The same is true of agriculture. At the same time, these sectors are complex and generate significant risks, not least because of disputes over land rights, and the interaction between commercial rights granted to companies, and traditional rights exercised by communities, often informally. Partly for these reasons, DFIs have scaled back their agricultural investments, and forestry remains a small part of portfolios. While private investment is available, this is more for very large-scale projects, and is also less likely to be bring as strict E&S requirements, nor to be on the terms or maturity needed. This suggests strongly that Finnfund's investments in these sectors are likely to be additional, both financially and in other ways.

4.3.11 What evidence is there that Finnfund is institutionally set up to achieve this?

Contractual relationships and due diligence

An important means by which Finnfund influences the partners it works with is through contractual relationships. These are an important institutional mechanism for Finnfund and will influence its ability to achieve the 2018-25 strategy.

While evaluating the robustness of these relationships is challenging without a counterfactual, this issue was included in interviews with the partners. As discussed above, there was a difference in opinion between Honduran/renewable energy investees and the companies visited in Africa as to the onerousness of these arrangements. This was especially the view of the forestry companies, and GRAS had the strongest opinion. KVTC thought the requirements onerous but not complicated. Africado was surprised by the thoroughness of the due diligence process to the extent that they considered it almost an overkill. However, Finnfund was also seen as the most pragmatic and flexible among the DFIs. In interview, Finnfund told us that they try to be smart and ask the questions that matter.

Some investees (e.g. MBirr) described the requirements as minimal, and there are clear merits in minimising the reporting requirements. However, as discussed, this is not intrinsically a good thing, and a balance needs to be struck between what is asked of DFIs and what Finnfund need. A good example was Honduras, where projects reported that whilst compliance and documentation was somewhat burdensome, findings from the data collection have been useful for the businesses themselves, and overall the exercise was considered worthwhile in terms of granting access to other DFI finance that would not otherwise have been available. This is an important message that could be shared with other investees as they seek to grow and attract different forms of finance.

Finnfund receive much criticism from sections of the Finnish NGO sector for the lack of robustness of their due diligence. This is a point that Finnfund strongly rebut and there are arguments on both sides. However, it does underline the importance of both the *process* and the *content* of due diligence and how these are communicated with others. From a process perspective it is important that Finnfund are visible on the ground and linking with local groups and communities as much as possible. In terms of content, the recent incorporation of human rights into ESAPs and E&S reviews is welcome. Moreover, TA budgets could augment their effectiveness. In sectors and locations where investments are controversial, it is especially important that risks need to be scrupulously assessed, monitored and managed.

Tax policy

Like many DFIs, Finnfund takes the issue of tax seriously. This is understandable. High income countries collect far more government revenue as a percentage of GDP than do low income countries – roughly 30% versus 10% on average. This severely restricts government's ability to fund programmes in areas like health, education and social protection. Part of the reason is that lower-income countries have much larger informal sectors, which is difficult – though not impossible – to tax. Another reason is that, even in the formal sector, there is less likely to be a culture of tax compliance. Finally, particularly with multinational companies, complex tax structures and profit shifting between jurisdictions may be used to artificially lower tax liabilities. Ensuring that the investees pay the taxes that they should in the countries in which they operate, therefore, is a stated

objective of most DFIs, including Finnfund. In terms of increasing its impact in the new strategy period, this is a very important issue.

That said, the nominal amount of tax paid each year by investee firms, is not a particularly useful indicator. There are many reasons why actual tax paid could vary sharply from year to year. Business conditions, and therefore profits, may change. Tax holidays may be available. Heavy investment may take place in some years but others, and so on. None of these things can be influenced by Finnfund. While we have looked at tax payment figures in the ex post assessment, it is more informative to explore whether Finnfund has the necessary processes and procedures in place, and whether these are likely to be effective. To this end, we have compared Finnfund’s approach with the EDFI *Principles for Responsible Tax in Developing Countries*.

The results are summarised in Table 29 below.

Table 29 Comparison of Finnfund’s approach with the EDFI Principles for Responsible Tax in Developing Countries

EDFI principle	Finnfund response
Adopt and publish a tax policy	<p>Finnfund’s tax policy as of January 2018 is publicly available at: https://www.finnfund.fi/yritys/sustainability/en_GB/tax/</p> <p>The policy was developed in consultation with PwC and a number of NGOs, whilst drawing on the tax policies of other DFIs (including FMO and Swedfund). PwC remains as an ongoing external advisor on tax matters.</p>
Seek to prevent participating in potentially harmful tax situations, where there is a significant risk of tax evasion by the client or an unfair tax treatment towards the client, and require client compliance with tax law in the developing countries in which business is conducted.	<p>Finnfund appraises the tax situation of would-be investees prior to investment, sets tax-related terms and conditions at the contracting phase, and subsequently monitors tax payments annually to ensure full compliance with local laws. This is true both of direct investees and investments made through funds. Finnfund also investigates the background of any co-investors, but does not claim any responsibility for their tax arrangements.</p> <p>As well as ensuring compliance with local laws, Finnfund follows Government of Finland guidance on combating “aggressive tax planning” – i.e. the exploitation of loopholes to minimise tax commitments, even if it is done so in a way that is technically not in violation of tax laws.</p> <p>Tools for assessing tax policy and conducting due diligence on tax issues were developed with support from PwC. Self-reported tax payments of investees are compared with taxable income to assess effective tax rates and identify potential for aggressive tax planning.</p>
Avoid participating in corporate structures created for the sole purpose of shifting taxable profits away from the developing countries in which business is conducted. DFIs participate in transactions involving intermediary jurisdictions or holding company structures outside host countries when such structures are deemed necessary to mobilise financial resources and to	<p>Finnfund investigates the ownership structures of all projects prior to investment, requiring that structures be transparent to the relevant authorities.</p> <p>Finnfund does not accept the use of holding company structures unless such use is demonstrably for sound economic purposes and not solely for tax reduction purposes.</p>

EDFI principle	Finnfund response
<p>fulfil development objectives. The use of OFCs should be limited to jurisdictions that are committed to the internationally accepted standards defined by the Global Forum on Transparency and Exchange of Information for Tax Purposes, which include the automatic exchange of tax information (AEOI), and at least largely compliant with them.</p>	<p>Moreover, Finnfund is prohibited from investing through holding structures at all where countries either (a) do not comply with the OECD’s <i>Global Forum on Transparency and Exchange of Information for Tax Purposes</i>, and/or (b) are included on the Council of the European Union’s list of non-cooperative jurisdictions.</p>
<p>Promote transparency by disclosing, to the extent possible and within the legal limits of client protection, project specific information. Due to legitimate expectations of privacy this would not usually extend to disclosure of beneficial ownership of investees unless such disclosure is already required by law.</p>	<p>Finnfund publishes annually on a country-by-country basis the aggregate taxes and fees paid by its investees.</p> <p>Finnfund also encourages its investees to maintain a publicly available tax policy.</p>
<p>Recognise the role of tax in development effectiveness reports by including information collected on taxes paid by clients at an aggregate level. This would complement other development indicators and help position the role of development finance in reaching the Sustainable Development Goals (SDGs).</p>	<p>Tax payments by investees are considered a form of impacts, and are reported within the Development Effect Assessment Tool (DEAT) as tax revenues per million Euros invested. The possibility of a negative impact is also considered in the event of subsidisation.</p> <p>Whilst additionality is considered within DEAT, tax impacts are given in the aggregate and are not currently adjusted to represent attribution to Finnfund. Finnfund is part of an EDFI working group on attribution, which is developing common approaches and methods for assigning attribution to tax revenue impacts.</p>

In addition to the above, Finnfund monitors ongoing developments in international tax policy through organisations such as the OECD and engages with other DFIs via EDFI on issues of taxation. As in other areas of its activities, Finnfund is compliant with relevant guidelines. Again, however, it may be necessary to go beyond this in some cases. With regard to the EDFI Principles, there is considerable room for ambiguity. For example, the requirement to “avoid participating in corporate structures created for the sole purpose of shifting tax-able profits away from the developing countries” is very vague. The key term is ‘sole purpose’, where almost any structure could be shown to have some other purpose than profit shifting. A DFI could interpret this principle as strictly or loosely as it chose and still be compliant. Finnfund seems to have recognised this and does go further in this, and other, areas. Companies face strong pressures to minimise the tax they pay, and DFIs such as Finnfund need to provide equally strong incentives, backed up by effective monitoring, to counteract these.

Evaluation policy

Evaluation is sometimes described as having two elements: 1) optimising decision-making (improving) and reporting to stakeholders on benefits created (proving). This purpose is consistent with the theory of change, which requires data on impact to 1) promote continuous improvement and 2) improve accountability i.e. to enable Finnfund to have a continued licence to operate and improve stakeholder perceptions of its legitimacy as a development actor. These two goals are both furthered by a better outcomes measurement.

A common theme throughout this evaluation is the need for evidence to demonstrate impact and the limitations of existing outcomes measurement. In interviews, Finnfund staff were generally aware of this, and it was also raised as weakness by NGOs. In particular, there was criticism of the lack of consideration for additionality in measures such as jobs created and the inability to capture impacts that are central goals of Finnish development policy such as women’s empowerment. This was contrasted with the strict requirements for NGOs to demonstrate impact and additionality and the lack of a level playing field for Finnfund in Finnish development policy. Although they are in some ways different entities, both are using public money to achieve social objectives and should have an equivalent level of accountability to taxpayers and other stakeholders.

Evaluation is an area that Finnfund has sought to strengthen in recent years, including creating new development impact roles and a new evaluation policy. The new policy places emphasis on the importance of evaluation to Finnfund’s work. The memo on the State of Finland’s corporate governance states that Finnfund should be evaluated on two grounds: 1) development policy goals and 2) the operations of the company. The former are monitored using an indicator set which aims to measure change for companies, wider stakeholders and wider society.

The strategy distinguishes between ‘monitoring’ - information on change that has happened – ‘audits’ – that confirm that processes and practices are adequate and ‘evaluations’ which focus on broader impacts on stakeholders and society. The strategy also emphasises the importance of mixed methods (as appropriate to the question being asked) and the triangulation of those methods to improve the reliability of the findings. These are all important components of an evaluation strategy and evaluations conducted in this way should add to the overall evidence base.

Finnfund has several mechanisms by which M&E data are captured. First, it uses the DEAT tool (see Box 2) to assess the *expected* development impacts of its investments to feed into investment decisions. Second, it commissions external evaluations to gain an unbiased perspective. Third it monitors development impacts. While the policy also describes mid-term and post hoc evaluations of projects, Finnfund staff informed us that there is insufficient budget to carry these out at present, and the policy will have to be changed to reflect the reality of its evaluation budget (approx. €100,000 per annum).

To date, they have commissioned three external evaluations on renewable energy. These are the first evaluations they have commissioned, and they hope to commission about 2-3 each year. The decisions about which areas to evaluate will depend on the information that they feel they require to supplement the gaps in HIPSO data. They plan to continue to approach these from a sectoral perspective. Areas that they are interested in are commissioning are:

- an evaluability study of the forestry sector looking at the impact on local communities
- impact within the financial institutions, especially the impact of funds.

There are no plans do project-level evaluations at present, but it may be something that is considered if it is strategically important in the future. Evaluations are not done at exit, as there would only be a small number of (sometimes anachronistic) exits. To overcome the limitations with existing measures, Finnfund is currently developing new indicators for the forestry sector. These have been tested in Tanzania by Finnfund staff. Table 30 lists these indicators

Table 30 Finnfund’s new indicators for the forestry sector

New indicators developed for forestry sector	
Biological asset value	Improved infrastructure
Production (by product)	Taxes (or tax like payments) paid

Sales (by product)	at local level
Value of domestic purchase of goods and services	at central level
Number of permanent employees (FTE)	Areas of forest under management
of which women	Hectares planted (per species)
Number of part -time workers	Buffer zones
of which women	Protected areas
Total salaries paid to local staff	Seedlings
Contribution to community development	Carbon sequestered

Although the evaluation policy has many positive elements, we recommend strengthening it in several ways. First, it could benefit from a clearer statement on the purpose of measurement, the approach to evaluation that should be taken and how development results should be used. This could include a set of principles that set out Finnfund’s position on evaluation more proactively and ambitiously. These could cover important tenets of good measurement such as measuring what matters, engaging stakeholders, transparent reporting, additionality, materiality and the role of qualitative and quantitative information in informing investment decisions.

Second, we recommend focusing on a small number of sector-specific indicators (in line with what is being planned). Our analysis highlights many gaps between the theory of change and what is being measured and we would recommend using the ToC approach to identify those indicators. There also needs to be better integration between the indicators/ToC and investment decisions.

This approach is widely used by grant-makers to select projects in the philanthropic sector and may be usefully applied by Finnfund. Projects that wish to apply for funding would be asked to demonstrate how they support at least one of Finnfund’s ToCs. DEAT could also be adjusted to be consistent with the ToC and the indicator set. This approach would ensure that Finnfund are rigorously focusing on development impact in their investment decisions and this would then drive measurement content and evaluation decisions. The debate about the appropriateness or otherwise of Finnfund investment decision would then be at the level of the ToC, which would make explicit the trade-offs that Finnfund is grappling with and create clear lines of accountability to stakeholders.

Our third recommendation, in concert with this, is to commission in-evaluations on sectors or business models. There is already provision for this in the evaluation policy, but it could benefit from a greater mix of methods than have been used to date. Whilst modelling studies are useful, there is scope to use qualitative case studies and mixed methods approaches like contribution analysis. A benefit of the latter is that intentionally addresses additionality, which is an important gap in the evidence base.

A major caveat here is that this approach would require proper resourcing. A common rule of thumb for development or social interventions is that 5-10 % of operational budgets should be spent on evaluation. Some research suggests this is too low, and that 10-15% is needed for rigorous evaluation, including experimental methods (Zandniapour and Vicinanza, 2013). In practice, this is unrealistic for most institutions, as well as being undesirable as it would divert too much resource away from frontline activities. The William and Flora Hewlett Foundation surveyed peers in the philanthropic community and found average spending on evaluation between 1.5 and 7.5% of annual expenditure (Twersky and Arbretton, 2014). Unfortunately, corresponding figures for DFIs are not available, but these estimates do highlight the gaps between the current evaluation budget and best practice estimates in broadly comparable fields. The importance of evaluation to Finnfund’s strategy should not be underestimated. Poor quality measures or overclaiming of benefits undermines the case for

investment and increases scepticism about the motivations for private sector development. Good, transparent evaluation is crucial to building trust in Finnfund, increasing accountability to stakeholders and ensuring that Finnfund is a learning organisation. All of these are key to ensuring the strategy is achieved.

Box 2 The Development Effect Assessment Tool (DEAT)

Finnfund uses a tool called the Development Effect Assessment Tool (DEAT) for assessing the expected development impact of all investments. DEAT is considered a key tool for analysis and feeds into all decision-making. The model itself is relatively simple and (as with many such tools), the data feeding into it are critical to its usefulness and success at capturing development impacts.

The first DEAT was developed in 2012 based on FMO model, and with their assistance. It was detailed with different questions for different sectors and was soon found to be too labour intensive, too comprehensive with limited added value into the process. DEAT has undergone couple of revisions since; the latest started in 2017 and was put into practice 2018. The scores from different years are not comparable.

The main revision in the 2018 version is the introduction of DEATLite, a lighter version of DEAT that can be completed on the basis of information available for the first Investment Committee (IC) meeting. The rationale for this change was that the first IC meeting is the venue where decisions are taken whether an investment is taken into serious preparation and the investment team can start use their time and resources. As development impact is one of the key decision criteria, the information has to be available then (in the IC meeting).

In all versions, the structure of DEAT has remained the same, comprising sections for 1) strategic relevance (against priorities given to us by our owner); 2) market development (anticipated effect on customers and end-users, local producers and suppliers, and local competition, jobs, taxes, exports); 3) additionality (finance and qualitative).

It is important that DEAT is understood as a pre-investment screening tool and not as a measure development impact, hence the problem with using it for evaluation purposes (see below). Arguably, DEAT is a way of converting desk analysis of development impact into a numerical score.

The strengths of DEAT include: it's easy to use and provides comparable scores, while addressing the key anticipated development effects. It is now consulted earlier in the investment process to ensure that development impacts are being addressed earlier in the process. DEAT also enables qualitative information to be expressed quantitatively, which allows it to be placed alongside financial data in a comparable way. The weaknesses include: it is qualitative, gives you an idea where impacts may be located but requires other methods to capture those impacts. It also favours priority sectors. Finnfund's owners want to see prioritised investments and pilot projects get higher scores because of strategic priorities. In addition, well documented investments usually get better scores, and uncertainty leads to lower scores. To date, there has been no post-hoc assessment of the use of DEAT on development impact and investment decisions but over time such an analysis will be possible as data become available.

Organizational structure, personnel and capacity

Central to Finnfund's work is managing trade-offs between profitability, development impact, commercial and ESG risks and Finnish interest. As we saw earlier, Finnfund has a wide constituency of stakeholders, many of whom hold competing interests, and from whom Finnfund requires a license to operate. Moreover, the investment and development impact worlds have very different intellectual traditions, which are often at odds with each other. To date, Finnfund has managed this tension by a) seeking to attract staff that understand both objectives i.e. that have themselves reached a compromise position and can work across the tensions and/or b) seeking to balance the staff representation in ESG, development impact and investment.

Historically, Finnfund has operated somewhat ‘under the radar’ in Finland. There has always been some opposition from those ideologically opposed to private sector development in general, but this was quite limited. Finnfund’s national profile, and hostility towards them, increased sharply after the large cut to the ODA budget in recent years, which happened at the same time as Finnfund’s budget was increased. It should be noted that the increase to Finnfund’s budget did not come from savings to ODA elsewhere, including the funding of NGOs in Finland, though this appears to be the perception in some quarters.

Although there is still strong hostility towards Finnfund in parts of the NGO community, this is certainly not uniform. Many NGOs, particularly the more long-standing institutions, and those involved in private sector development, are very positive about Finnfund. Even among strong critics, perceptions are improving, partly due to the expansion of development impact and ESG staff, and a perception that Finnfund is starting to take these things seriously. It is important that these trends continue.

For E&S issues, much decision-making is based on qualitative assessments and this requires staff to be very knowledgeable of their subject. A core element of the assumptions that underpin the process is that the classifications A-C are the right ones - i.e. that C projects, which have a lesser impact do not require the same level of due diligence as projects with higher classification. Although this is constantly being monitored, there is obviously scope for error, and it is very important to get those initial decisions right. The same could be said for the management of commercial risks, where considerable discretion is used, not least in decided what is an acceptable level of credit risk in general, as well as as country and sector concentration levels.

To a large extent this approach is working. However, there are substantial risks as it is quite dependent on particular individuals’ qualities and personalities and their ability to continue to seek compromise. There are of course formal structures within which staff operate, but the ability to override limits and thresholds on a discretionary basis is notable. Where the balance of senior people (management and governance) to change, this discretion would enable major changes to be made to Finnfund’s approach, creating a risk to the 2018-25 strategy. To protect against this, it may be sensible to ‘hardwire’ core strategic elements into the institutional structure of Finnfund, as discussed in more detail below. Finnfund has started to build institutional capacity by developing new policies to support and guide staff, building on a solid foundation in this area. However, more could be done to embed the careful balance to achieve sound, safe and effective investments. There may be a need to codify more of how Finnfund operates and what makes for a good investment decision.

The composition of the Board may be important in this regard, not least because the Board currently has discretion to overrule many procedures and limits. A concern was raised during interviews with Finnfund staff about the lack of E&S specialists on the Board. However, to support quality decision-making, the E&S team initiated an internal peer review system in 2018. Since 2016, the E&S team has also had an internal procedure to discuss due diligence results before these are being presented to the board. Since 2018, this has been now modified somewhat and complemented with more in-depth peer review procedure for selected projects (typically all A and B+ and at times others). These kinds of processes should prove valuable for future.

Transparency

Finnfund’s policy on disclosure sets out its approach to transparency. It describes transparency as important to its mandate and states that Finnfund “*strives to make information concerning its strategies, policies and activities available to the public to the extent possible.*”. The policy lists the types of information it discloses which broadly cover:

- corporate information about Finnfund
- information on operational procedures and policies, and
- project related information on partners, investments and development effects.

Throughout this evaluation, the evaluation team experienced a high level of cooperation from Finnfund who readily shared information and were generous with their time to explain the strategy. This could be interpreted as an indication of increased transparency with the public.

Transparency is an area in which Finnfund receives much criticism in Finland. There are several reasons for this: previous experiences of trying to access information from them, the perception that results and information are spun and rancour over the fallout from Agua Zarca. In the case of the former, some NGOs believe that Finnfund has not been fully transparent with activists and are not disclosing information which they consider to be commercially sensitive. This creates a dilemma for Finnfund who need to be able to offer clients a degree of confidentiality to encourage them to work with them. However, without knowing more about the case it is difficult to know whether this is legitimate or not.

More widely, there is a case for Finnfund improving its commitment to transparency and stakeholder engagement, though it has made considerable efforts in this area. One recommendation from a policy specialist interviewed is that Finnfund disclose information about failures as well as successes. There is concern that Finnfund overclaims positive results. The need to be on a ‘positive news’ footing is understandable given the controversy around Finnfund. However, it is our observation that this is counterproductive and greater openness about things that don’t work well could build support for Finnfund and engage stakeholders in the trade-offs that Finnfund is grappling with.

Engagement with wider development policy

As discussed throughout this report, Finnfund is something of an outsider in Finnish development policy. Although there is evidence that this has begun to improve, the changes to the way in which Finnish development budget is disbursed is a source of controversy and risks further alienation. This is especially important for the future strategy which relies on buy-in from all stakeholders to be successful. Whilst Finnfund needs to continue to be held to account, they also need the space to focus on their strategy without being constantly expected to divert valuable resources to public relations.

One way to achieve this would be to seek to become more integrated into the development community and to be seen as primarily a development rather than a financial actor. There is no reason why Finnfund should not be on the Development Policy Committee, for example. A better relationship with those development NGOs that are hostile to Finnfund, would also enable Finnfund to draw on their expertise – as appropriate – to support the identification and management of risks.

Another area of contention is the Finnish Interest requirement. Although this is loosely interpreted by Finnfund and the MFA, there is no guarantee that this would always be the case. This was also an area of controversy amongst some Finnish NGOs, who were concerned about the narrow interpretation of Finnish interest. They argued that Finnish people value social, political and environmental justice and that these are more appropriate goals of Finnish interest than commercial objectives. Although in practice the loose interpretation means that this is not interpreted in this way, it could be. One option would be to remove the requirement for Finnish interest. A second option would be to define Finnish interest as being explicitly about the public good and Finnish values. Our conversations with Finnfund suggest that this is an important part of their commitment to forestry, small-scale agriculture and has prevented them from investing in private sector education in Africa. In that sense, Finnish interest is already about Finnish values. However, it is not interpreted like this. More clarity on what this means

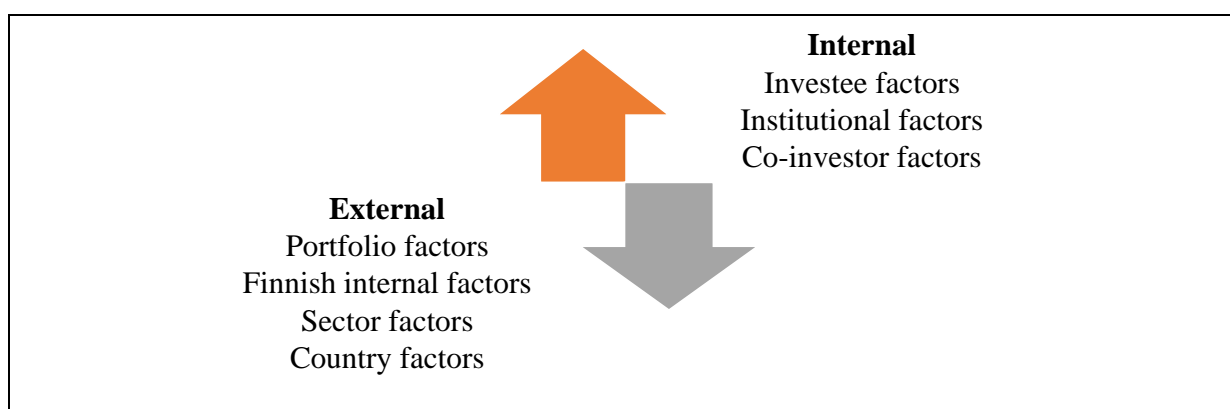
and an irreversible link with non-financial values could both improve the perception of Finnfund and ensure that in the future it is not misused.

5 Factors influencing the 2018-2025 strategy

A key objective of this evaluation is to assess the likelihood that the 2018-25 strategy will be achieved and consider what could be done to increase the chances of this happening. Accordingly, this section focuses on the strengths and weaknesses of the strategy, drawing on evidence from the ex post evaluation and appraisal phase to inform this.

We approach this via seven factors that the evaluation has identified as most material. These can be grouped into internal and external elements with Finnfund having more potential influence over the former than the latter. Figure 27 illustrates the seven factors.

Figure 27 Internal and external influences over 2018-25 strategy



It is important to recognize that there are trade-offs between these elements. Finnfund aims to triple its impact and double its size, not to double its impact while doubling its size. This means that much more impacts need to be achieved for a given level of investment. Finnfund already operates in very high-risk/high-impact environments and intends to increase this in the future. Indeed, as well as improving its ability to predict, manage and monitor impact, this is how more impact will be achieved. This has consequences, however, which are important for the goal of doubling in size.

However, these trade-offs are not insurmountable. In this section, we identify a series of strategy requirements that require a set of supporting activities. These activities are set out in the recommendations below. In terms of prioritization, all of the factors matter to the strategy, even if the individual elements within them vary in importance. However, we lead here with the external factors, in particular the portfolio level and Finnish internal factors, as these potentially pose an existential threat to the strategy and even to Finnfund itself, and therefore must be tackled effectively.

5.1 External factors

5.1.1 Portfolio-level factors

Although Finnfund's portfolio is obviously not 'external' to it, the forces that influence the impact it will have over the 2018-25 strategy are. The key element here is the balance between financial return and development impact, which is the result of the composition of the portfolio, particularly the sector and country balance. The way that this balance will affect Finnfund's ability to deliver the strategy is

the result of country and sector characteristics over which Finnfund has no control (i.e. external). The composition of the portfolio, however, is a deliberate choice albeit a heavily constrained one.

As well as clear guidance in the OSMs in terms of income-group and sector, Finnfund’s financial sustainability requirement has a major influence over asset allocation, and largely explains the weight of financial sector investments, for example. In our view, if Finnfund simply doubles in size with the same return requirements, and funding structure it will not be able to achieve the strategic goals of tripling impact. The latter is only possible by a significant increase in the weight of portfolio that is allocated to high potential impact countries and sectors. This will inevitably increase the risk of major losses, and we would argue reduce the average returns that Finnfund can expect to obtain over time. Accommodating this requires structural change to one or more of these elements. Most importantly, the way the Finnfund doubles in size, will have affect whether it is able to increase its impact.

If it maintains the same financing structure and return requirements as now, it may be able to achieve a small increase in impact through better processes but doing more would threaten its self-sufficiency requirements. If it expands based primarily on private investment, its ability to achieve impact relative to the size of its activities is likely to fall not rise, as investors will expect a higher return than is currently achieved, potentially lowering impacts. If it expands using direct public financing from the government, it will only be able to increase impact at the scale required by lowering its return requirement and being prepared to accept periodic losses.

Table 31 identifies the portfolio level requirements for the 2018-25 strategy to be achieved in the column to the left. The right-hand column links these to activities that the MFA or Finnfund could take to support this. We start with the core strategic issue described above, and present three options that we think could address this. Other portfolio-level factors that will influence whether the strategy is achieved follow.

Table 31 Portfolio-level factors

2018-2025 Strategy requirements
Finnfund doubles in size and triples its impact.
Finnfund expands the size of the direct equity component of the portfolio to enhance impact while maintaining portfolio stability.
Finnfund successfully improves the E&S performance of investees, boosting impact per unit of investment.
Finnfund develops and pioneers an effective approach to development impact measurement that is credible.

5.1.2 Finnish internal factors

Perhaps the greatest risk to Finnfund itself, and therefore its ability to achieve its strategy, is that it loses political support, or Finnish public opinion becomes radically opposed. There are no easy or quick answers, but the most important change required may be in mind-set. Finnfund has attracted much criticism, some justified, some not. The temptation in these circumstances is to carefully manage information flows and rebut criticism aggressively. This would be a mistake. The only viable option in the longer-term is to become more integrated into policy and development circles, to explain better the very real trade-offs that Finnfund faces, to seek advice and inputs where appropriate and useful, to demonstrate impact credibly, and to bring public opinion with it. We outline the relevant issues in Table 32 and return to this point again under country-specific factors.

Table 32 Finnish policy and public opinion factors

2018-2025 Strategy requirements
Finnfund maintains and enhances political support amongst parties in Finland
Finnfund improves its reputation within Finnish civil society, including among development NGOs.

5.1.3 Sector-specific factors

Finnfund faces different risks in its strategic priority sectors. In forestry and agriculture, the principle risks are commercial, which could undermine Finnfund’s ability to achieve its impact goals, both directly through the failure of projects, and indirectly through negative shocks to Finnfund’s balance sheet. In Finance, the greater risk is that development impacts are not generated, or that Finnfund’s investments are not additional so that any impacts that do result cannot be attributed to them. While the environmental benefits of renewable energy investments are clear, commercial risks may also be greater than currently assumed. Ensuring that costs continue to fall is key to the sector, but this risks undermining the sustainability of long-term price agreements entered into by government, which could come to look very expensive. Understanding the different nature of these risks, and managing them carefully, is key to the 2018-25 Strategy. These are set out in Table 33, and organised by sector.

Table 33 Sector-specific factors

2018-2025 Strategy requirements	
Forestry	Sufficient projects are commercially viable and major, correlated losses are avoided
	Concerns over biodiversity and land rights are addressed and carefully managed, avoiding major reputational risk
	Finnfund maximises its position as a respected and influential voice in the forestry sector to promote positive change, increasing the commercial viability and development impact of sector.
Agriculture	Strong evidence is generated on the high development impact and commercial feasibility of small-scale agriculture projects
	Major, coordinated, economic shocks are avoided
Renewables	Renewable projects are designed to maximise positive spill overs, and more evidence emerges of the wider social, economic and environmental benefits of renewable energy.
	Renewable energy generation becomes cost competitive with fossil fuels, and future reductions in costs do not undermine the sustainability of previous long-term pricing commitments made by governments.
	It is widely accepted that those involved in the renewable sector, including Finnfund, have learned lessons from the Agua Zarca case and are able to identify and manage E&S issues
Finance	Correlated financial crises do not emerge across the finance sector portfolio
	Finnfund selects financial sector investments that deliver high, and additional development impacts

Finnfund successfully influences banking investments such that they increase their lending to marginalised groups and high-impact sectors

5.1.4 Country specific factors

These are risks particular to the countries that Finnfund invests in and are likely to increase as Finnfund more investments are made in lower income countries. It is not possible to eliminate these risks, but requires a process of identification and mitigation, which Finnfund already engages in. As well as engagement with government, the most important element is robust policies that deal equitably with competing rights and are adapted to local conditions. This requires good local knowledge and engagement with stakeholders from the project design stage onwards. Participatory techniques could be used to build consensus, which can also inform aspects of evaluation.

As we have seen, Finnfund adheres to international standards on E&S issues, but as demonstrated by the Agua Zarca example, this is not always enough. A human rights policy is currently being designed, and it is important that this a) addresses the rights issue set out here and b) makes provision for local adaptation. In our view this would be enhanced with more external engagement, including with Finnfund’s critics.

Country knowledge cannot be gained from afar. Finnfund is also not large enough to maintain permanent representation in every country. It needs to collaborate more with those that have this knowledge, including Finnish NGOs with long experience of working in many of the countries in which it operates. Table 34 summarises the relevant country-specific factors.

Table 34 Country-specific factors

2018-2025 Strategy requirements
Major political shocks do not undermine the viability of forestry or agricultural projects in particular countries
The costs of supporting renewable energy projects does not erode political support for the sector at the national level
Deep knowledge of local and national cultural, historical and political norms helps Finnfund successfully manage complex E&S and rights issues, including in remote and rural areas.

5.2 Internal factors

5.2.1 Investee-specific factors

Table 35 describes the investee-specific requirements for the 2018-25 strategy. We focus on investee selection and the influence that Finnfund has over investees. Clearly, if there is limited influence, then the expected outcomes will happen. How can influence be encouraged? Perhaps the most important element is additionality. If Finnfund’s finance is not additional, in that the investee could have secured the same financing elsewhere, then leverage will be very low. Where Finnfund is supplying finance in sectors and locations that others are not, leverage will be higher. A contrast here is forestry and agriculture, where we would expect leverage to be higher, and finance, where this is less likely.

The second element is the form of investment. Being lower risk than equity, loans provide a valuable source of stability to the portfolio. They also reduce leverage, however. Equity funds have similarly

low potential for influence. Particularly in projects where significant change is needed, active equity investment will provide greater scope. This brings us back to the trade-offs previously. Projects where most change is needed are also likely to be higher risk. Increasing the weight of equity investments in such projects could therefore increase the overall risk in the portfolio but may be essential if more impacts are to be achieved. Recognising and addressing this is essential for the strategy's success.

Table 35 Investee-specific factors

2018-2025 Strategy requirements
Owners and managers in investee companies are sufficiently committed, competent, and honest to ensure competitiveness.
Investees can attract high quality management and staff
Investees converge with and maintain high E&S standards.
Investees have the capacity and willingness to collect impact related data

5.2.2 Institutional factors

The evaluation team believes that Finnfund currently works very well on an institutional basis. Given our experience with other DFIs, the balance that has been created and maintained between different objectives is impressive and unusual. The key risk for the strategy is that this is not maintained, and the main reason for concern is that the current balance is largely the result of particular individuals and the dynamics between them, rather than institutional structures. The balance of rule and discretion is important, as sufficient flexibility needs to be maintained to deal with unforeseeable circumstances.

Table 36 Institutional factors

2018-2025 Strategy requirements
Finnfund's senior management and board continue to successfully balance impact and financial stability concerns.
Finnfund is able to attract and retain high quality staff with strong sectoral expertise
Reputational risk is successfully managed

5.2.3 Investor-specific factors

Investor-specific impacts on the strategy have two elements. First, Finnfund's ability to select investees that are attractive to private investors, to positively influence investee behaviour, and to create appealing financial structures. Second, its ability to coordinate with DFIs and other development actors to provide complementary finance, both within particular deals and across value chains. The first is a precondition to achieve the 2018-25 strategy and is covered in Table 37. For the second element, Finnfund is already well integrated into the DFI community, but this community is not famed for its ability to coordinate effectively. Efforts are underway, led by the IFC, to create a formal body for information sharing and cooperation. Finnfund is part of the DFI bodies that are discussing this initiative, and this is a good opportunity to push this agenda.

Table 37 **Investor-specific factors**

2018-2025 Strategy requirements
Co-investors are willing to make complementary investments in Finnfund projects, including other DFIs sharing risk.
Finnfund's investments are supported by complementary investments in other parts of sector value chains.

The final section of this evaluation codifies the analysis presented in this chapter and elsewhere in the report into specific recommendations, which link directly to the strategy requirements.

6 Conclusions

In the following chapter, the overall conclusions of the evaluation are presented as direct answers to the research questions.

6.1 Conclusions derived from the ex-post questions

Have Finnfund's activities been aligned with its mandate and annual guidance?

C1 – Whilst the annual guidance has been effective at shaping Finnfund's activities, there is evidence of unintended consequences.

Finnfund is strongly incentivised to meet the targets in its annual guidance, making it important that these are carefully constructed to achieve the desired result, and that unintended consequences are taken account of. Headline targets for employment and tax can encourage claims to be made without evidence of attribution. On the other hand, a lack of gender related targets disincentivises a focus on this issue, and it is therefore welcome that this has been addressed in 2018. Financial sustainability targets have had a major impact upon its activities and the composition of its portfolio. This is discussed further below.

Has Finnfund followed DFI and international best practice on environmental and social risk management?

C2 - Yes, but the the limitations of international good practice E&S standards in ensuring that high E&S standards are being achieved was also found. This could be improved by increased E&S resources.

Managing and minimising E&S risks is crucial if Finnfund is to achieve its impact goals. With regard to due diligence, although Finnfund is broadly compliant for high risk projects and thorough in its process, E&S risks may still remain. More resourcing and engagement with relevant sectors will be required, especially as Finnfund moves to higher risk projects and locations. In terms of impacts on E&S performance, although there are examples of where this is effective, there are questions about how additional it is. To move beyond its current performance level, Finnfund will require dedicated TA budgets to support clients to make investments in this area.

Has Finnfund followed DFI and international best practice on commercial risk management?

C3 – Although conservative in some areas, this is balanced by the assumption of significant credit risks, which are likely to rise further. This may leave Finnfund vulnerable to a coordinated shock across a major section of the portfolio.

Achieving high impact is impossible without assuming significant risk. Finnfund's already faces considerable credit and market risk. If the goal of tripling impact is to be delivered this will have to rise further. As well as increasing investments in high risk countries and sectors, Finnfund intends to focus on fewer, strategic sectors. Less diversification raises risks further, particularly where a strategic sector – agriculture – is inherently more risky than the more diversified set of sectors it will displace.

Have Finnfund's investments positively contributed to development effects?

C4 – While data availability prevents us from reaching firm conclusions on ex post development impact, there is some evidence of increased employment and improved business performance among investees

Given the sectors and countries where Finnfund invests, it is likely that significant impacts are being achieved in many cases. Although we cannot directly address questions of attribution and causality, there is some evidence that business performance and employment of investees has improved over time. This is supported by qualitative findings, but stronger evidence is needed. Finnfund will require more robust M&E infrastructure if it is to credibly demonstrate development impacts.

Have Finnfund's investments been additional?

C5 – Finnfund can be additional in two ways. While we believe both forms of additionality are being achieved to a certain extent, they are unlikely to be being maximised. There is a need for further research to understand this better, and thus inform future strategic choices.

Additionality should not be thought of in binary terms, but as a spectrum. The strongest forms are where Finnfund's investment is crucial for the creation or survival of an investee. Less strong, but still additional, is where investment could potentially have been obtained, but was not of a suitable form, thus enabling an investee to expand, for example. In a weaker sense, investments may not be financially additional, but they may allow Finnfund to influence investee behaviour positively, improving outcomes. These distinctions relate to the credit that Finnfund could potentially claim. For the strongest forms of additionality, it may be reasonable to claim credit for all employment generated or tax paid by an investee, as it would not exist without Finnfund. For weaker forms, it is only possible to claim credit for changes in these outcomes, and only then when attribution to Finnfund's influence can be robustly demonstrated.

6.2 Conclusions derived from the appraisal questions

What evidence is there that the programme design is likely to achieve the Theory of Change?

C6 – In terms of choice of sector and countries, Finnfund is broadly on track to achieve the Theory of Change that underpins its future strategy.

As the appraisal findings show, there are positive self-reports on a range of outcomes from the projects visited. These include capacity development, the quantity and quality of employment, business performance, E&S performance, community and environmental impacts. Although we cannot generalise from these findings to the whole portfolio, we can conclude that small sample evidence finds Finnfund has achieved positive impacts in the projects we visited across this wide range of important outcomes.

What evidence is there that Finnfund is institutionally set up to achieve this?

C7 – Finnfund has many institutional strengths but also areas of weakness. Its strengths are largely the result of the current balance of staff and could be threatened by staff changes.

In the previous chapter, we discussed relevance of institutional factors for the strategy. Finnfund's

policies could be described as generally good but with room for improvement. They could benefit, for example, from wider stakeholder inputs. Organisationally, whilst Finnfund has managed the trade-offs that it faces well until now, this could be at risk in the future, especially as the organisation grows. Hardwiring key strategic factors into Finnfund's mandate, and potentially modifying the composition and discretion of the board, may be a useful way to protect against this.

To what extent does the future programme/Finnfund institutional structure need to be revised to increase the likelihood that the theory of change is realized?

C8 – Given its existing portfolio and funding structure and its requirement to achieve a certain level of returns, it is unlikely that Finnfund will be able to triple its impact under the current conditions.

More impact means more risk, and this is not compatible with the current funding structure and return requirements. The way that Finnfund 'doubles in size', coupled with a more effective approach to impact assessment, will be central to whether it is able to increase its impact, and to what degree.

How should the planned additional €130 million MFA loan be spent?

C9 – How this investment, and future investment, is used is central to the goal of increasing impact.

As the balance between public and private finance will shape the impact Finnfund can achieve, it may be that more public finance is needed in the future if Finnfund is to achieve its goal of doubling in size while also tripling impact.

7 Recommendations

7.1 Introduction

As discussed in the previous chapter, the way that Finnfund expands (i.e. ‘doubles in size’) is the key determinant of whether or not it is able to also ‘triple its impact’. There are three possibilities in this regard, each of which have several variants, and which can be combined in various ways:

1. Increase public funding
2. Expand existing private credit mechanisms
3. Create new mechanisms to attract, or manage, private finance

Public funding options

Currently, the MFA funds Finnfund in three ways. First, there is the original share capital provided that enabled Finnfund to commence and continue operations. The MFA has purchased additional Finnfund shares in subsequent years – e.g. €10 million in 2017 and 2018. As MFA shares would be repaid – most likely at a profit – if Finnfund was liquidated, there are accounted an asset on the government’s books. Second, there are ‘development policy investments’ (DPIs), such as the €130 million provided in 2016, which is formally a convertible loan under EUROSTAT rules, albeit a very long-term one on concessional terms. Third, the MFA provides guarantees for the Special Risk Instrument (SRI), which are accounted as a risk on the government’s balance sheet until guarantees are needed. The MFA follows the ‘instrument approach’, where funding for Finnfund is only classed as ODA when it is disbursed by Finnfund. In the case of DPIs, these are returnable, such that ODA is counted positively when an equity investment is made, and negatively when it is exited (following OECD rules, ODA is not counted on loans, positively or negatively). When guarantees are triggered under the SRI mechanism, in contrast, the resulting transfer to Finnfund is non-returnable. As elsewhere, SRI funds are only counted as ODA when they are disbursed in relation to equity investment

There are also public financing forms that are not used, but potentially could be. First, while the MFA provides guarantees under the SRI mechanism, there is not a general sovereign guarantee for Finnfund’s debt. While this would not increase Finnfund’s capital base directly, it would enable it to borrow on more favourable terms in international capital markets. Second, unlike many DFIs, Finnfund does not have a dedicated Technical Assistance (TA) budget. As TA is non-returnable, this would have to be supplied as an ODA grant by the MFA rather than as a Development Policy Investment loan. Alternatively, Finnfund could generate its own TA budget from returned earnings, either within the existing framework, or through budgetary space created by a corresponding reduction in Finnfund’s return target in its annual OSM.

When considering options to expand public funding, it is therefore necessary to weigh the advantages/disadvantages of these different delivery mechanisms in relation to the 2018-25 strategy. Before doing so, the potential private sector routes to expansion will be considered.

Existing private borrowing mechanisms

Finnfund’s capital structure combines an equity base, the great bulk of this is held by the government as shares, retained earnings, and debt issued on the Finnish market. This latter component accounts for 46 % of Finnfund’s available resources, compared to 40 % equity and 14 % retained earnings.

A straightforward option would therefore be to issue more debt instruments and expand this borrowing. Two questions arise. First, is this a cost-effective way of raising finance? Second, is there appetite amongst Finnish investors for additional debt? On the first question, short-term borrowing costs in Finland are unusually low compared with potential alternatives. The reasons given for this in interviews is that the market is small, and participants know and trust each other, reducing information asymmetries on creditworthiness and lowering borrowing costs without increasing transaction costs (e.g. through monitoring requirements). This suggests that, at least compared with the option of increasing borrowing internationally, expanded operations in the Finnish market could make sense, though this is limited by sensible restrictions placed on the amount of short-term borrowing Finnfund can access as a proportion of its funding. As Finnfund expands, however, this could certainly increase at the same rate while staying within these limits.

On the second question, interviews with Finnish investors that currently hold Finnfund debt suggest that there would be appetite for more, as the debt is seen as stable and relatively low-risk compared with alternatives, and thus serves a useful role in balancing investment portfolios.

For Finnfund, one of the factors that has enabled them to maintain a good balance between commercial and development considerations, is the current capital structure, where public equity and private debt are well balanced. This seems a reasonable argument, suggesting that any increase in private borrowing should be (at least) offset with increased public investment using one or more of the mechanisms described above.

New private finance mechanism options

A final route to expansion is to develop new private finance mechanisms. These can be divided into two main options. First, Finnfund could develop new equity funds, most likely in partnership with a suitable private actor. In principle, such funds could be open to public investment (i.e. retail funds), but a more feasible approach would be to seek to manage assets of Finnish institutional investors. Our understanding is that planning was quite advanced to launch a fund of this sort in 2007, but this was derailed by the onset of the global financial crisis, which strongly reduced investor risk appetite.

An interesting example of this approach is IFU in Denmark, which has launched a number of funds as described in Annex 5 of this study. The Danish Climate Investment Fund (DFIF) and Danish Agribusiness Fund (DAF) were launched in 2014 and 2016 respectively, and combine public investment with institutional investor finance (60 and 37 % of the total in each case). Relatedly, IFU Investment Partners (IIP) was set up by two Danish pension funds to provide additional capital to large investments undertaken by IFU and Danish businesses. IFU also manages a number of other specialist funds, but these have less private finance involvement – e.g. the Arab Investment Fund (AIF), and Ukraine Investment Facility (UFA). IFU has clearly developed considerable capacity to effectively manage funds of this kind, as evidenced by the launch of new funds and the transfer of longer-established funds to IFU management. This has certainly enabled them to significantly increase mobilised capital, which is likely to have translated into increased development impact.

An interesting issue is the return requirements that are likely to be attached to such funds. Institutional investors face fiduciary responsibility to maximise benefits for their members. Finnish investors can also take non-commercial factors such as development impacts or the environment into account, but not to the extent that this lowers returns. In the case of IFU managed funds, the DFIF has a target return of 12 % per year, while the corresponding figure for the DAF is 10 %. Across its portfolio, Finnfund has achieved much lower returns than this. Breaking down the portfolio, Finnfund's equity investments average a 5.2 % return from 2009-17, while fund investments over the same period showed a small average annual loss.

Of course, targeted and realised returns are very different things, with the latter often being much lower than the former. A better comparison is therefore to look at Finnfund’s targeted return. Its five-year average return target is 2 % or more.

It is important to adjust these figures for different accounting practices. Finnfund follows Finnish Accounting Standards (FAS), while IFU follows the International Financial Reporting Standards (IFRS). In the former, assets are booked at acquisition value or lower if the market price has fallen. Increases in valuations are not taken into account. Under IFRS, in contrast, assets are booked at fair value market prices, reflecting both increases and falls. As a result, the value of IFU’s assets, and therefore its reported annual profits, may be inflated relative to Finnfund. As well as reporting on FAS terms, Finnfund calculates market values for its own internal purposes, taking account of unrealised gains as well as losses. On these measures, average four-year returns to 2018 for all Finnfund instrument is 8.4 %. As loans are generally more profitable than equity investments, this figure cannot be directly compared with equity targets or returns. The figures also vary significantly by sector. On these measures, financial and energy investments are by far the most profitable sectors, while forestry and agribusinesses – though positive – are far less profitable.

Although IFU managed funds contain a first-loss element funded by the government, it remains the case that, when loans are stripped out, seeking to obtain returns at the level of IFU-managed funds would require Finnfund to focus on the most lucrative sectors, either finance or energy. Forestry and agribusiness funds, based on the figures we have, would be unlikely to deliver returns at the level required.

A second option would be issue specialist bonds, either on the Finnish market, or internationally. Interviews with investors suggest that there could be particular appetite for ‘green bonds’ with a focus on the renewable energy sector, but also forestry as plantations reach maturity and approach the harvesting stage of operations. A similar targeted approach could be taken with funds of course, where a green fund focused on similar sectors would also be potentially attractive. Investor interviews suggest caution in this regard, however. One issue is time-horizons. Private equity funds have a limited lifespan of 10 years, or possibly 12. Finding, completing and exiting investments, within this time-frame may not be compatible with the long-term approach that institutions such as Finnfund need to take in many cases. In practical terms, making a success of this requires a very strong ‘market focus’, which it was suggested that Finnfund may not have, given its primary objective of achieving development impacts. While managed funds using institutional investment may be suitable in some situations, these would need to be carefully analysed and defined, for the reasons discussed above. Longer-term ‘green bond’ structures, in contrast, could potentially be used to expand financing in ways that did not conflict with Finnfund’s development mandate.

Table 38 brings these elements together into 6 options for expansion.

Table 38 Expansion Options and Implications for 2018-25 Strategy

	Options	Public component options	Private component	Implications for 2018-25 strategy
1	Status Quo x 2	Public equity investment doubled	Outstanding	Would only enable impact to increase relative to now if Finnfund’s return requirements were significantly lowered, enabling more risk to be taken on. Even then, requirement to service increased private debt would limit the additional risk
		Convertible loan provided to double total		

		public investment	privately held debt doubled	that could be absorbed. Additional sovereign guarantee would reduce borrowing costs, potentially reducing the tension in this regard. Although impact could be increased, difficult to see how it would be possible to ‘triple impact’. A very large expansion of the SRI would potentially make this possible.
		SRI mechanism expanded		
2	Status Quo x 2 + TA	As above	As above	NA
		TA annual grant		Would enable investment in M&E systems, on the ground presence in countries, and support for ESG improvements by investees, increasing impact.
		TA retained earnings		As above, but benefits would be offset by need to generate additional internal profits to fund.
3	Public > private + TA	Public investment increased threefold, rising sharply as a proportion of capital structure.	Commercial debt held at current level	The options and implications are the same as for 1, but the greater weight of public investment would make it easier to reduce Finnfund’s return requirements, and potentially absorb losses resulting from greater risk, while continuing to service outstanding debt. Increased public equity/private debt ratio would enable Finnfund to undertake a higher proportion of direct equity investments, which creates the potential for more impact. Less of a case for sovereign guarantees.
		TA options as above		As in option 2, but more scope for Finnfund to fund TA out of retained earnings with potentially reduced return requirements.
4	Status Quo + green bonds	As now	Large-scale issuance of long-term green bonds to fund major expansion	Would enable a major expansion of environmentally focused investments, but prevent expansion into other developmentally impactful areas.
5	Status Quo + green funds	As now	Launch of one or more green equity funds	As above, but shorter time horizons of investors, combined with higher return expectations, would bias investments to the relatively short-term, high yielding alternatives, reducing development impacts.
6	Status quo x 1.5 + green	Double current public funding,	Issue green bonds at 50% of	A more mixed model would mitigate the shortcomings with both green bonds and

	bonds/fund	ideally as capital investment	increase in public investment, and launch equity fund of similar size	equity funds. Investments could be targeted that meet the requirements of these mechanisms, while the additional public funding could be used to a) reduce Finnfund returns requirements/expand SRI to take on more risk, b) enable more direct equity investments, and c) invest in non-green developmental sectors.
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In reality there are many more than six options of course. We have taken as a starting point the desire to double in size, and distinguished the main ways this could be done. In practice, different levels of public and private financing are possible. Each would affect the current balance in terms of capital structure, however, with implications for how much additional impact could realistically be achieved.

Given the public sector's greater ability to accept lower returns, and to absorb potential losses, it seems likely that increasing the weight of private borrowing/investment to public financing would limit Finnfund's ability to take on more risk, and therefore reduce its ability to achieve a large increase in development impact as set out in the 2018-25 strategy. If the current balance is maintained, this is potentially achievable, but only if the public component of its funding is prepared to reduce return requirements (e.g. to zero), and also guarantee a higher proportion of losses (e.g. through further expansion of the SRI). If public financing increases relative to private actors, reduced return expectations etc would still be needed, but to a lesser degree. Any new private financing mechanisms have the potential to mobilise significant investment, but would constrain investment options in terms of sector, and also limit investable opportunities through higher return requirements. To even maintain current impact levels in these conditions would again require the public financing component to accept lower returns/higher losses, and increasing impact to the level required would multiply these effects.

Finally, as well as increasing impact sharply, Finnfund also needs to credibly demonstrate these impacts. The creation of a significant TA budget, and its use to boost investee impact, and robustly measure these effects, is essential regardless of which option is pursued.

In this final chapter we set out the main recommendations emerging from the evaluation. As with the conclusions, these are structured around the research questions that have guided the evaluation.

7.2 Recommendations derived from the ex-post questions

Have Finnfund's activities been aligned with its mandate and annual guidance?
<i>C1 – Whilst the annual guidance has been effective at shaping Finnfund's activities, there is evidence of unintended consequences.</i>
An important question for the evaluation was the extent to which Finnfund is consistent with the OSM guidance set by the MFA. Another is whether OSMs are providing Finnfund with the right direction. Although this was not directly addressed, recommendations relevant to the OSM emerged from the research and will be briefly summarised here.
1. Review the profitability criterion. This has been discussed in detail above and requires no further discussion, but we identify it here as an important element of the OSM that requires consideration as part of wider strategic choices.
2. Review the targets (and the use of targets) in the OSM. The OSM has contained a series of

quantitative targets that have informed the work of Finnfund and the future strategy. There is clear evidence that they are influencing behaviour within Finnfund. However, they may have created pressure to achieve targets at the expense of other considerations. The trend away from specific targets (e.g. on jobs) is therefore to be welcomed, and we would encourage this to be continued.

Our recommendation also relates to the issue of unintended consequences. Thinking through these issues more carefully is important. We also recommend that the MFA support Finnfund to move towards a more meaningful measurement system and that accountability measures are designed collectively that take account of both the improving and proving objectives of measurement. As part of this, there should be a recognition that accountability information should also flow outwards and downwards towards affected communities and wider stakeholders and not just upwards to the MFA. A focused indicator set is central to this, linking Finnfund and the MFA's ToCs. These should also directly reflect of the priorities of Finnish development policy, such as women's empowerment.

3. Review Finnish interest criterion. Although this is loosely interpreted by both the MFA and Finnfund, it is not seen in this way by the development and NGO community, who interpret 'Finnish interest' as economic interests. Critics argue that this does not reflect Finnish values, which are focused on the public good. Whilst it is clear to the evaluation team that Finnfund does take account of Finnish values in its decision-making, this may be misunderstood. Given that Finnish interest has various interpretations and is very loosely applied, there is a question as to its value given the controversy it generates.

Has Finnfund followed DFI and international best practice on environmental and social risk management?

C2 – Yes, but the the limitations of international good practice E&S standards in ensuring that high E&S standards are being achieved was also found. This could be improved by increased E&S resources.

In the light of this conclusion, we make the following recommendations:

- A key part of any expansion is the need for greater 'on the ground' presence to better understand, and be responsive to, a complex and relatively high-risk business environment, as well as providing projects with more guidance on E&S matters, particularly relating to civil society relationship management. Working closely with local actors is an important element of this.
- Local communities should be integrated into projects from the outset, and should benefit from these projects as appropriate (ideally being economically integrated).
- Finnfund should draw on the expertise of country and sectoral experts to support due diligence, ESAP design and subsequent monitoring.
- Provide streamlined guidelines and best practice examples for new projects to develop E&S.
- For controversial projects involving competing rights or environmental concerns engage closely with civil society to understand and manage risk.
- Create and deploy TA budgets to support partners with E&S improvements, data collection and community engagement.
- Monitor and strictly enforce ESAP compliance for high risk projects.
- Ensure compliance with minimum standards for low-risk projects, and go beyond this where necessary.
- E&S staff continuity on projects should be the norm whenever possible.

Has Finnfund followed DFI and international best practice on commercial risk management?

C3 – Yes. Although conservative in some areas, this is balanced by the assumption of significant credit risks, which are likely to rise further. This may leave Finnfund vulnerable to a coordinated shock across a major section of the portfolio.

We therefore make the following recommendations:

- Finnfund currently uses the due diligence process to increase the likelihood that selected project are viable, and also assists with the creation of robust business plans. Maintaining and strengthening this focus is essential, and the availability of a TA budget to support this would be helpful.
- Diversification should be increased, geographically and particularly across value chain based on estimated covariance of risk.
- Investments should be regularly stress tested, including extreme scenarios.
- Geographical diversification is essential to minimise the portfolio effects of country risk.
- Engage with governments, and other Finnish and non-Finnish development actors that do, to prevent major shocks, or receive prior warning of unavoidable shocks.

Have Finnfund’s investments positively contributed to development effects?

C4 – While data availability prevents us from reaching conclusions on causality, there is good evidence of increased employment and some evidence of improved business performance among investees. This is supported by qualitative findings, but stronger evidence is needed.

In light of this, we make the following recommendations:

- Choose countries on the basis of need and potential impact and commit for the long-term.
- Strengthen the evaluation policy to provide a clearer rationale for evaluation with focused measurement around a set of core indicators.
- Augment internal evaluation with regular external evaluations. These should be a combination of quantitative methodologies where appropriate (e.g. as in the recent Steward Redqueen study), and detailed case studies in strategically important areas using techniques such as contribution analysis and process tracing. The latter will help understand where and how Finnfund is achieving impact, and how this could be enhanced. Taken together, this combination of internal and external approaches would enable impacts to be credibly measured and reported.
- Expand the size of the direct equity component of the portfolio, and devote more resources to active management of the direct equity portfolio.
- As well as other DFIs and development actors, greater collaboration with Finnish bilateral programmes could be valuable.
- To promote good reporting, develop common reporting formats and streamlined approaches and educate investees on the benefits of data, including commercial benefits.
- Initiate and promote peer learning on these issues among investees.
- Use TA budget to support all of the above activities.

Have Finnfund’s investments been additional?

C5 – Finnfund can be additional in two ways. While we believe both forms of additionality are being achieved to a certain extent, they are unlikely to be being maximised at the present time. There is a need for further research to understand this better, and thus inform future strategic choices.

We therefore make the following recommendations:

- Analyse (internally and through external studies) the different ways that Finnfund can be additional, perhaps developing a spectrum from strong to weak additionality based on the criteria dis-

cussed in this report.

- Estimate the total level of additionality in the portfolio, and inform investment decisions with the requirement to progressively increase this over time.

7.3 Recommendations derived from the appraisal questions

What evidence is there that the Strategy is likely to achieve its objectives?

C6 – In terms of choice of sector and countries, Finnfund is broadly on track to achieve the Theory of Change that underpins its future strategy.

While this is essential if impacts are to be increased, a number of the selected strategic sectors are also high risk. We make the following recommendations at the sectoral level in light of this.

Forestry

- Investees encouraged to diversify activities and customers (e.g. governments are main buyers of poles, which are key to plantation forestry).
- Cooperate with FDT in genetic trials to enhance biodiversity.
- Use TA budgets to support partners to invest in ESG and support development impact.
- Engage more with critics of the plantation approach to argue case for Finnfund approach.
- Ensure competing rights are addressed in due diligence, community benefits are built into project business plans, and relations are well managed on an ongoing basis.
- Increase leadership role in the development community by drawing upon, generating and disseminating evidence of the drivers of successful forestry projects.

Agriculture

- Due to the scarcity of projects in this sector, Finnfund should work with stakeholders in Finnish, international and domestic civil society to identify promising projects. There is also a case for funding start-ups to stimulate innovation and the emergence of new business models.
- Many DFIs have withdrawn from the sector because of perceived risk and operational complexity. To leverage more finance into the sector, Finnfund needs to build an evidence base that commercially viable projects with high development impact exist and can be feasibly invested in at scale.

Renewables

- Finnfund could support, with other development actors, research to demonstrate the wider benefits of renewable energy, with a particular focus on distributional and equity elements.
- Support innovations to lower the costs of smaller-scale, off-grid projects.
- Use technical expertise more actively to help address technical issues (e.g. maintaining grid stability with high proportion of intermittent energy supply)

Finance

- Undertake formal stress tests of its financial sector investments, included where financial contagion spread across developing countries and regions.
- Seek to diversify financial sector risk in the light of these analyses. Financial sector investees should be selected on the basis of their ability to reach underserved, disadvantaged groups, and/or supply new and valued products to these groups.
- Ensure investments are as additional as possible. Finnfund sets ambitious targets for the expansion of lending to key groups and monitors closely whether this is achieved. The results of this need to be measured more comprehensively and communicated.

The quality of projects is clearly a key determinant of achieving the 2018-25 strategy. In light of this,

we make the following recommendations for investees.

- Codify the necessary qualities of good managers/owners, seek out partners that have those skills, and provide ongoing support owners/managers to enhance these skills.
- Monitor performance closely and respond swiftly to problems.
- Ensure investees have resources and networks to attract foreign staff where needed in key areas. Over the longer-term, support quality training of local staff to reduce reliance on foreign experts.

What evidence is there that Finnfund is institutionally set up to achieve this?

C7 – Finnfund has many institutional strengths but also areas of weakness. Its strengths are largely the result of the current balance of staff and could be threatened by staff changes.

At the institutional level, we make the following recommendations:

- Finnfund is unusual amongst DFIs, in that impact and financial concerns are well balanced. In our view, however, this is largely the result of the current balance of staff, and particularly that of senior management. The Board has discretion over key decisions and is able to override most rules and restrictions. This currently works but were the composition of senior management and the Board to change, there is every chance this could change. To address this, we recommend hardwiring key features needed to achieve the 2018-25 into Finnfund's governance structures. Specifically:
 1. Set ceiling for maximum level of risk across the portfolio needed to maintain financial stability and meet return requirements
 2. Set floor for minimum level of risk across the portfolio needed to increase 'triple impact' over time
 3. Measure total portfolio risk accurately and frequently and adjust up and down as needed
 4. Ensure financing structures are compatible with ceiling and floor being set at levels compatible with the 2018-25 strategy.
- Consider strengthening the E&S and development impact specialism of the Board so that it can absorb and interpret the information it receives in this area.
- Finalise and apply human rights policy robustly.
- Strengthen M&E capacity to robustly measure and report development impacts.

To what extent does the future programme/Finnfund institutional structure need to be revised to increase the likelihood that the theory of change is realized?

C8 – Given its existing portfolio and funding structure, and its requirement to achieve a certain level of returns, it is unlikely that Finnfund will be able to triple its impact under the current conditions.

The way that it doubles in size, will strongly influence whether Finnfund can increase its impact, and to what degree, particularly given current financial return requirements. We identify 6 options in this regard:

1. Status Quo x 2
2. Status Quo x 2 + TA
3. Public > private + TA
4. Status Quo + green bonds
5. Status Quo + green funds
6. Status quo x 1.5 + green bonds/fund

Tripling impact will only be possible by taking on more risk, lowering average returns and increasing the risk of losses. As private investors will not accept this, Finnfund's public shareholders would need

to do so. As Finnfund expands, the balance between private and public investors, as well as the nature of private investors/creditors, will determine how large this adjustment would need to be. The nature of public finance also matters. While there are various options available, straightforward capital investment provides Finnfund with the greatest operational flexibility, and also is most supportive of the private borrowing costs they will face.

We have also identified the loss of support from Finnish public opinion as a significant threat to the strategy. In light of this, we make the following recommendations:

- The unique contributions that Finnfund makes in the international community should be communicated better so that it can be understood, valued, and enhanced. To achieve this Finnfund should engage in more dialogue with civil society.
- More effort should be made to communicate the importance of private sector development in general, and the role that Finnfund plays in this. Finnfund has many supporters and allies in Finnish civil society, who could be encouraged to take on a more vocal role in this regard.
- Become more integrated into Finnish development policy, including membership of the Development Policy Committee.
- All of the above would be enabled if Finnfund is better able to credibly demonstrate impact, and is seen as a development rather than a commercial actor.
- Finally, transparency should include a greater openness about mistakes, which can be an opportunity to explain better the challenges and trade-offs that Finnfund faces.

How should the planned additional €130 million MFA loan be spent?

C9 – How this investment is used is central to the goal of increasing impact.

The evaluation team were explicitly asked to advise on how the additional funding for Finnfund should be used. As the financing is in the form of a loan, it is returnable, and can thus only be used for investment purposes (i.e. recommendation 5). Recommendations 1-4 would therefore be funded through the increased returns generated by this increase in portfolio investment, and/or the TA budget recommended elsewhere in this report.

1. Increase ability to understand and manage country and E&S risk. As discussed previously, Finnfund works in complex and challenging countries and sectors, and intends to do more so. This brings significant risks, which need to be carefully managed. Devoting resources to developing more in-country expertise, including a permanent presence in key countries, is the best way to do this.

2. Increase ability to positively influence investees on business and E&S performance. Finnfund does not have a TA budget, restricting its ability to support investees to improve performance in key areas. The strategy depends on impact and this will be greatly enhanced by better investee performance. A significant TA budget would enable Finnfund to do this much more effectively than now, as would taking a much more role as an equity owner.

3. Expand M&E capacity. Finnfund's current evaluation budget is €100,000. Given the scale of its activities, and the importance placed on evaluation in the strategy, this is too low. Expanding internal capacity, and also commissioning a mix of qualitative and quantitative studies is essential to increase impact. Large-scale early investment to build capacity could be made, reducing the level of future TA support needed each year.

4. Analyse and systematically manage commercial risk. Finnfund's strategy requires more risk to be taken. This is unavoidable if impacts are to increase, but requires an accompanying increase in the ability to analyse and manage credit risk across the portfolio.

5. Expand portfolio financing. All the expansion options discussed above require more public

funding. Depending on the option chosen, this could come in the form of general funding, but an attractive option would be to increase the SRI budget significantly, and additionally to the recently approved increase.

The activities covered by recommendations 1-4 are core to Finnfund's activities and would therefore normally be part of general expenditure. Throughout this report, however, we suggest a significant increase in capacity and systems, which would require up-front expenditure. One option would be to finance these one-off investments internally in anticipation of the increased returns that the additional €130 million will generate. An alternative, or complementary approach, would be to support this investment with the TA budget proposed in this report. One attractive option would be to fund the initial, one-off investments through the TA budget, and the higher ongoing operational costs through the additional returns generated by the €130 million of investments.

The types of one-off activity we have in mind are: the commissioning of research into E&S and commercial risk, the development of in-house systems informed by this research, the training of Finnfund staff, the development and implementation of complementary systems for investees, and the training of investee staff. Once systems and capacity were in place, running costs would then be covered by Finnfund's internal resources, but a one-off investment would enable a step-change in capacity that would yield significant long-term benefits in our view.

Recommendation 5 concerns how the loan should be used in Finnfund's investment activities. All the financial structure-related recommendations in this report entail the public element potentially accepting greater losses. While more public investment will be needed in the future if Finnfund is to double in size while also 'tripling its impact', the most sensible use of this loan would therefore be to increase Finnfund's capacity to take on more risk. The long-term nature of the loan, and the terms on which it is offered, make this feasible. The options in this regard are discussed above.

7.4 Concluding remarks

Finnfund has an ambitious strategy for the years ahead. This is achievable but does require some major strategic choices to be made. The keys to this in our view are: a) to ensure the portfolio is structured and funded to enable the right balance of impact and return to be achieved; b) building and maintaining strong public support in Finland; and c) focuses on maximising development impacts in all investments, and credibly demonstrating that these impacts have been achieved, and are attributable to the activities of Finnfund.

The goal of doubling in size is both reasonable, as Finnfund remains a small DFI, and essential, if the desired increases in impact are to be achieved. History abounds with examples of problems caused by overly rapid expansion, so it would make sense to do this gradually over time. An essential part of this is ensuring the Finnfund's capacity to identify, structure and manage investments successfully expands as the portfolio grows. Just as important is the capacity to measure impacts robustly and credibly, to use this to guide investment decisions, and to communicate effectively. In terms of sequencing, Finnfund would be well advised to invest significantly in expanding this capacity, before significant growth in operations begins.

Annex 1: Terms of Reference

May 8th, 2018

Draft Terms of Reference for an

Evaluation of the Finnish Fund for Industrial Cooperation Ltd. (Finnfund)

1. Introduction and Background

The Finnish Fund for Industrial Cooperation (Finnfund) is the national Development Finance Institution (DFI) of Finland. Finnfund was founded by the Parliament of Finland through the Finnfund Act in 1979 (291/79). Finnfund provides equity, loans and guarantees to private sector companies in developing countries and has as its' overarching objective to further the economic and social development of its' target countries. The target countries are by Law defined as the developing countries according to the OECD DAC's classification, as well as any additional countries approved by Cabinet. Currently the only such country is the Russian Federation.

Finnfund is owned by the Finnish Government (93,8 %), the Finnish Export Guarantee Agency Finnvera (6,1 %) and the Confederation of Finnish Industry (0,1 %). The company falls within the ownership steering mandate of the Ministry for Foreign Affairs (MFA). The MFA names the Finnfund board and sets the policy goals of the company. The policy goals are determined annually by ministerial decision and they are communicated by the MFA to the Finnfund board in the form of an Ownership Steering Memorandum (OSM). The OSMs of the years 2011-2018 are attached to this Terms of Reference.

In the international development policy arena, the adoption of Agenda 2030 and the SDGs have highlighted the need to mobilize private capital to finance development and to combat climate change. To reach the Sustainable Development Goals (SDGs) the UN has estimated that additional annual investment of USD 1 500-2 500 billion is needed in the infrastructure of developing countries. The overall annual volume of global ODA is USD 140-150 billion. The public finances of developing countries and the ODA provided by governments of developed countries need to be augmented by resources from the private sector in order for the SDGs to be met. In addition, private sector innovation is essential for driving technological changes that aid in the effort. The role of the private sector has been broadly recognized by donor countries and instruments that try to leverage funding and catalyse innovation by the private sector using ODA have received more funding globally.

In line with the global agenda, the current Development Policy of the Finnish Government (2016-2019) puts a strong emphasis on developing the private sector of developing countries and combating climate change. It also stresses the need for achieving wider societal impact beyond the core economic benefits of that development. Finnfund is in the policy seen as a key instrument for implementing this vision. The balance of Finnfund has since the adaptation of the policy been strengthened through a EUR 130 million long-term convertible loan in 2016 and a capital increase of EUR 10 million in 2017. A further EUR 130 million convertible loan and a EUR 10 million capital increase are under consideration for 2018. In addition, the MFA is considering resuming a guarantee for high risk and

impact investments amounting to EUR 75 million. This follows the positive evaluation of a similar scheme that was in place 2012-2015. Finnfund has made a profit every year save one (2010) during the last 10 years and the profits have been re-invested.

Utilizing its' strengthened balance sheet Finnfund has been able to rapidly increase its' investment portfolio, which at the end of 2017 amounted to EUR 393 million. In addition, Finnfund's undisbursed commitments and board approvals amount to EUR 286 million, bringing its broad portfolio to EUR 679 million. In accordance with MFA ownership guidance in effect since 2012, that directs the company to make at least 75 % of its' investments in Lower-Middle Income (LMIC) or poorer countries, Finnfund's portfolio in the DFI context has an unusually large proportion of its' portfolio invested in poor developing countries. Due to the increase in the size and the complexity of the portfolio, Finnfund has increased its' staff from 56 in 2015 to 71 in 2017.

Finland has its' next parliamentary election in 2019 and a new development policy programme is expected for the period 2020-2023. It is likely that the new programme will continue to put an emphasis on Finland's contribution to achieving the SDGs. The Finnfund evaluation will i) aid the preparation of the next development policy by providing information on the functioning of Finnfund as a channel for ODA, ii) provide input for the MFA in strengthening its' ownership steering at the policy level and iii) support the Finnfund board and management in developing appropriate management strategies.

2. Objective of the Assignment

1.1 General objectives

The objective of the assignment is to evaluate how well Finnfund has implemented its' mandate during the period 2008-2017, as defined by the Finnfund Act and the annual OSMs by the MFA.

1.2 Scope of Work

The evaluation will look at all work of Finnfund during the calendar years 2008-2017. The 10 -year period includes periods before and after 2012, from which time Finnfund has been directed by the MFA OSMs to make at least 75 % of its' annual investments in lower middle-income or poorer countries.

The analysis should include, but not limited to, the investment policy and its' implementation, the structure and organizational capacity of the company, the functioning of the board as well as corporate strategies and their implementation. The evaluation will include the special risk instrument, in spite of its' evaluation in 2018, as it is an essential element influencing the investment decisions of Finnfund. The business partnership programme Finnpartnership, to which Finnfund provides administrative support under contract with the MFA, will be excluded from the evaluation. Finnpartnership's strategy and operational guidance is set directly by the MFA separately from the OSMs and as a grant programme its' immediate objectives differ from those of Finnfund. Links and synergies between Finnfund and Finnpartnership, as well as other instruments of Finnish development cooperation, can however be part of the analysis.

In accordance with the Evaluation Policy of the MFA, the assignment will also not look at the link between the larger development and trade policy objectives of the MFA and the OSMs. This would exceed the mandate of this evaluation and is planned to be part of a wider evaluation conducted by the MFA Evaluation Unit during the next cabinet period. The evaluation should however analyse positive and negative effects stemming from the OSM targets on the activities and results of Finnfund, as well as their relevance, realism and appropriateness in that context.

The evaluation will comprise all five OECD/DAC evaluation criteria; a) relevance, b) efficiency, c) effectiveness, d) impact and e) sustainability.

3. Evaluation Issues

The evaluation will in line with the general objective and the five evaluation criteria outlined above (a-e) pay specific attention to the following issues, of which the first four (i-iv) are of particular importance:

- i) **Relevance and additionality.** Finnfund provides equity funding, loans, guarantees and expert advice to companies from e.g. a corporate governance, development and country context, technical and corporate social responsibility perspective. The evaluation should assess the relevance of Finnfund's activities from the perspective of the company, including the objectives and targets set in the Ownership guidance by the MFA, and if they might be improved or added to. The evaluation should also assess the additionality of Finnfund's funding, i.e. to which extent the funding fills, a gap not taken by the financial markets, e.g. due to weak or non – existent geographic or sectoral markets. The evaluation should therefore provide an overview of Finnfund's additionality vis-à-vis commercial financing.
- ii) **Commercial risk management.** Finnfund invests in high risk environments, where norms and institutions are underdeveloped, investment information can be unreliable, good public governance has limitations and markets are small, susceptible to policy shocks and often volatile. The ability to take commercial risk and a long-term view in this difficult environment is one of the core reasons for the existence of Finnfund, but commercial risk has to be managed responsibly, so as to stay within the mandate as defined by the Government of Finland. The evaluation is to assess the risk management processes of Finnfund in order to determine if risk is classified and managed in line with commonly accepted practices in the financial services industry and DFIs in particular.
- iii) **Environmental, social and human rights related risk management.** Finnfund investments cause primarily positive, but inevitably also negative externalities. The negative externalities can relate to the natural environment, local communities and individual persons. The evaluation is to assess how well these risks are managed as a part of the due diligence process before an investment decision and how they are monitored throughout the lifetime of the investment. Also the adequacy of risk mitigation strategies and resources are to be assessed.
- iv) **The effectiveness in delivering desired outputs.** Finnfunds investments are often complex ventures that have very concrete immediate outputs (a product or service). The evaluation is to assess to what degree Finnfund is able to select and support commercial ventures, in accordance with its strategies and market opportunities, so that they can become successful and achieve long-term profitability and growth.
- v) **The effectiveness in delivering desired outcomes.** Finnfund aims to contribute to development outcomes through the economic and social benefits of the companies and projects where it invests. The effects can be direct (in the business), indirect (to other businesses/actors linked with the business) and/or through positive externalities (e.g. replication, market effects and/or technological change). The evaluation is to assess to what degree the investments of Finnfund contribute to positive development outcomes in the societies of developing countries.
- vi) **The effectiveness in leveraging other funds.** Finnfund's ability to crowd in other investors through taking an early or central role in an investment, providing specific value-added, is an essential part of its' additionality. The evaluation is to assess to what degree Finnfund is able to leverage its' own investment to crowd in other funding and how this role might be strengthened.

- vii) **Efficiency of the organization.** Finnfund is a publicly owned special policy purpose company that is required to cover its own costs. The evaluation should, using benchmarks where possible, assess the cost efficiency of Finnfund in meeting its' policy objectives.
- viii) **Results measurement.** The MFA OSMs require Finnfund to report on 14 indicators each year. In addition, Finnfund has developed theories of change for some sectors and through its' Development Effectiveness Assessment Tool (DEAT) measures the anticipated development impact of investment proposals at various stages before they go to the board. The evaluation will assess whether Finnfund is able to reliably report on the OSM indicators and on the appropriateness of DEAT as well as its' implementation.
- ix) **Communication.** As a publicly owned development finance institution implementing the development policy of the Finnish Government, Finnfund needs to be able to report on its' impact in a way that accurately conveys the work of the institution to the taxpayers and other stakeholders. In addition, Finnfund needs to be able to respond to communications needs arising from its' investments, including from materializing risks. The evaluation is to assess the communication strategy and organization of Finnfund and the strategy's implementation.
- x) **Sustainability of investments.** The evaluation should assess the sustainability of investments and how Finnfund has contributed to this. It will involve assessing the commercial sustainability, i.e. the continued financial return of the investments, the continued development results and the continued responsible management of environment, social and human rights risks in exited projects/companies. It also involves assessing issues of relevance for the project sustainability in the pre-investment phase and during implementation, as well as assessing Finnfund's strategy for exiting companies.

4. Outputs and Plan of Work

The assignment will result in a final report to be approved by the MFA. This report will be classified due to the sensitive nature of the corporate information that is part of it. In addition, the assignment will produce a public summary report, which will include all essential information not deemed to be classified.

The assignment will also produce an inception report, a first draft report and a final draft report:

- The inception report will outline the methodology and detailed workplan of the assignment. The inception report will be produced within 6 weeks of the commencement of the assignment. The MFA, after having consulted Finnfund, will provide comments to the consultant within two weeks of having received the inception report.
- The first draft report will be produced 11 weeks after the consultants have received comments on the inception report by the MFA. It will be discussed at a workshop including MFA and Finnfund staff.
- The final draft report will include the comments from the workshop. It will be submitted to the MFA for comments before the final report is produced for MFA approval.

5. Methodological Issues

The evaluation will consist of desk study of the key documents guiding the activities of Finnfund, both produced by the MFA and by Finnfund itself. It will also include an analysis of board documents, investment briefs and analysis related to individual Finnfund investments.

The evaluation will include a benchmarking exercise to at least two similar sized DFIs, as well as a field visit to at least three countries on two continents and no less than 10 investments. The benchmarking exercise is intended to compare the effectiveness of the DFIs in delivering desired outputs,

measuring results, managing costs and handling risk. The field visits will validate Finnfund management's assessment of the commercial viability, development impact and risks of the investments prior to the investment decision by the board (ex-ante) and the reported (ex-post) development impact, as well as the relevance of Finnfund for the company invested in.

With regard to the source material, the evaluation will primarily be relying on information provided by Finnfund, with the exception of analysis to validate that information or relating to the benchmarking exercise.

The inception report will produce a more detailed outline of the methodology.

6. Composition and Qualifications of the Evaluation Team

The evaluation team must have substantive experience of evaluating or assessing development finance institutions or other publicly owned investment vehicles and development cooperation programmes, including ones focussed on private sector development. The team must be familiar with international best practise with regard to evaluation methodology.

The team will consist of at three senior team members with the following four competencies: i) acting as a team leader in evaluations of at least a similar magnitude

ii) expert experience of private sector development evaluation, iii) experience of corporate finance and iv) experience of managing environmental, social and human rights risks. The team may in addition be supported by junior staff.

7. Tentative time schedule

It is expected that the evaluation will take three and a half months:

- Start of assignment May 15th, 2018.
- Inception report due by June 26th, 2018.
- First Draft Report due by September 25th, 2018.
- MFA and Finnfund workshop before October 12th, 2018.
- Final Draft Report by October 26th, 2018.
- Final Report by November 16th, 2018.
- Final Public Summary Report by November 30th, 2018.

8. Mandate and Authorization

During the assignment, the Consultant is entitled and expected to discuss with the pertinent persons and organizations and authorities on matters related to the methodology development and the appraisal processes. The Consultant is expected not to disclose trade secrets outside the MFA and Finnfund and will be required to

sign non-disclosure agreements to that effect. The Consultant has no authorization to make any commitments on behalf of the Government of Finland. The MFA will have the right and responsibility to advise and comment the work of the Consultant. The guideline and appraisals prepared by the Consultant shall be subject to the approval of the MFA.

Attachments: 1) The Finnfund Act, 2) MFA Ownership Steering Memorandums (OSMs) 2011-2017, 3) Finnfund Corporate Strategy 2017-2025, 4) Evaluation of the Finnfund Special Risk Instrument

2018

Annex 2: People Interviewed

Organisation	Participant
Africado Ltd.	James Parsons, Managing Director
Africado Ltd.	Paschal Shayo, Human Resource Manager
Africado Ltd.	Ezekiel Lazaro, Chairman of Workers' Union
Africado Ltd.	Susan Nkini, Vice-Chairwoman of Workers' Union
Africado Ltd.	James Morega, Farm Manager
Africado Ltd.	Laizel Sumuni, Associate Farm Manager
Africado Ltd.	Festus M. Nkuru, Outgrower Manager
Centre for Corporate Responsibility	Nikodemus Solitander,
Community	Meseret Bekele, Beneficiary - Tulu-Bollo
Community	Gettie Fitta, Beneficiary - Tulu-Bollo
Confederation of Finnish Industries	Petri Vuorio
EthioChicken	Endrias Alganeh, Corporate Environmental Health Safety & Social Manager
EthioChicken	Ulric Daniel, Managing Director
EthioChicken	Berhane Girmay
EthioChicken	Jeremy Watson, Supply Chain and Procurement Director
EthioChicken	Fikreselase Dawit, Farm Manager
EthioChicken	Mlkamu Nigusse, Field Veterinaryian
Fair Trade Finland	Maija Seppälä, Programme Coordinator
FCA Investments Ltd	Jukka-Pekka Kärkkäinen, CEO
Finn Church Aid	Jouni Hemberg
Finn Church Aid	Jukka-Pekka Kärkkäinen
Finnfund	Jaakko Kangasniemi, CEO
Finnfund	Helena Arlander, Director of Risk Management and Impact
Finnfund	Juho Uusihakala, Senior Development Impact Adviser

Organisation	Participant
Finnfund	Erkki Tuomioja, Chairperson of the Supervisory Board of Finnfund
Finnfund	Kaisa Alavuotunki, Senior Development Impact Adviser
Finnfund	Riikka Molander, Head of Portfolio Team Fund Investments
Finnfund	Riikka Thomson, Manager, Environmental and Social
Finnfund	Ritva Laukkanen, Chairperson of the Finnfund Board
Finnfund	Sylvie Fraboulet-Jussila, Senior Environmental and Social Adviser
Finnfund	Karoliina Lindroos, Environmental & Social Adviser
Finnfund	Seela Sinisalo, Environmental & Social Adviser
Finnfund	Marjaana Palomäki, Environmental & Social Adviser
Finnfund	Ilkka Norjamäki, Investment Manager
Finnfund	Kati Keinänen, Portfolio Officer
Finnfund	Jari Matero, Senior Investment Manager & Team Leader (Agribusiness & Forestry)
Finnfund	Pauliina Halonen, Investment Manager
Finnfund	Markus Pietikäinen, Chief Investment Officer
Finnish Development Policy Committee	Marikki Stocchetti, Secretary General
Finnvera	Tuukka Andersén
Finnwatch	Sonja Vartiala, CEO
FMO	Gerhard Engel, Senior Investment Officer
Forestry Development Trust	Ijumaa K. Singo, Genetic Resources Manager
Friends of the Earth	Ville-Veikko Hirvelä, Activist
Green Resources AS	Lars Ellegård, Group Chief Financial Officer
Green Resources AS	Erik Knive, Group Chief Executive Officer
Green Resources AS	George Bottger, Operations Manager
Green Resources AS	George Balusi, Chief Accountant
Green Resources AS	Victor Kimey, Country Certification Manager/ESG Manager
Independent Consultant	Anna-Leena Simula, Independent Consultant

Organisation	Participant
Independent Consultant	Harri Seppänen, Independent Consultant
Independent Consultant	Merja Mäkelä, Independent Consultant
Indigenous People and the Earth	Meri Mononen-Matias, Economist
Indufor Oy	Thomas Selänniemi, Senior Adviser
Indufor Oy	Asko Siintola, Consultant
IRESA (La Vegona/Valle Solar)	Adolfo Larach (Sponsor)
IRESA (La Vegona/Valle Solar)	Luis Suazo (CFO)
IRESA (La Vegona/Valle Solar)	Sofia Sandoval
IRESA (La Vegona/Valle Solar)	Jacabo Da Costa (Financial Analyst)
KEPA (Finnish NGO platform)	Hanna Aho, Policy Adviser
KEPA (Finnish NGO platform)	Anna-Stiina Lundqvist, Policy Adviser
Kilombero Valley Teak Company	James Njala, HR & Administration Manager
Kilombero Valley Teak Company	Joseph Kilongo, Chairperson, Workers Union
Kilombero Valley Teak Company	Habiba Said, Chairperson, Women Committee (Workers Union)
Kilombero Valley Teak Company	Kenneth Kayuni, OSP Manager
Kilombero Valley Teak Company	Joseph John, HAS Manager

Organisation	Participant
Kilombero Valley Teak Company	Kennedy Haule, Social Manager
Kilombero Valley Teak Company	Hans Lemm, CEO
Kilombero Valley Teak Company	Vlad Vejnovic, Planning and Resource Manager
La Vegona	Miguel Montoya (Plant Manager)
La Vegona	Mario Chavarria (MASS Manager)
Los Laurales	Javier Prats (Sponsor)
Los Laurales	Jose Luna (Plant Manager)
M-Birr	Kidist Zegeye, CEO
M-Birr	Endashaw Tesfaye, Commercial Manager
Mezapa	Rafael Piccioto (Sponsor)
Mezapa	Hegel Velasquez (E&S coordinator)
Mezapa	Jorge Rodriguez (Gerente General)
Mezapa	Luis Padilla (Gerente de Operaciones)
MFA of Finland	Kari Leppänen, Counsellor MFA of Finland
MOSS ICT Consultancy (M-Birr)	Thierry Artaud, Executive Chairman
New Forests Company	Roberts Nyachia, Head of CSR&Sustainability
New Forests Company	Lee Johnston, Managing Director
Office of the Prime Minister of Finland	Pekka Hurtola
Office of the Prime Minister of Finland	Marja Pokela
PhD Researcher	Anne Arvola, PhD Researcher
Private Outgrower	Shambel Muleta, Sale Agent
Private	Assefu Mekonnen, Sale Agent

Organisation	Participant
Outgrower	
Schulze Global	Greg Metro, Partner of SGI Frontier, Managing Director for Schulze Global's Ethiopia operations
Siemenpuu säätiö	Kai Vaara, Activist, Beekeeper
Seligson	Ari Kaaro
Stakeholder ki Africado Ltd.	Hamza B. Munisi, Chairman of Wiri village
Stakeholder of Africado Ltd.	Petro James, Ward Executive Officer, Carragua
The Finnish Evangelical Lutheran Mission (FELM)	Niko Humalisto, Advisor
University of Helsinki	Barry Gills, Professor
Valle Solar	Daniela Tabora (E&S Coordinator)
Valle Solar	Yalmar Cardenas (Plant Manager)
Valle Solar	Eduardo Arias (General Manager)
WWF	Aleksi Heiskanen
WWF	Anne Tarvainen

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Annex 5: DFI Benchmarking Report

This annex reports on the findings of a benchmarking exercise carried out to assess the performance of Finnfund on a range of issues relative to a comparator group of DFIs. The DFIs chosen for comparison were Swedfund (Sweden) and IFU (Denmark). To avoid issues of confidentiality, all information and data used is publicly available. While the analysis is thus limited by the breadth and quality of what is publicly available, every effort has been made to select meaningful areas for comparison.

A further caveat is that the impact data for these DFIs, and arguably all DFIs, is not of sufficient quality, nor comparable enough, to be incorporated into a benchmarking exercise. Given that this is the most important variable, without which effectiveness comparisons cannot be made, the figures here should be treated with caution. The efficiency measures reported below should therefore be treated with caution. High or low relative administrative costs could reflect organizational efficiency, but could also affect relative investment in achieving development impact. A seemingly inefficient DFI, therefore, may thus be highly efficient in terms of its ability to deliver impact with a given set of resources.

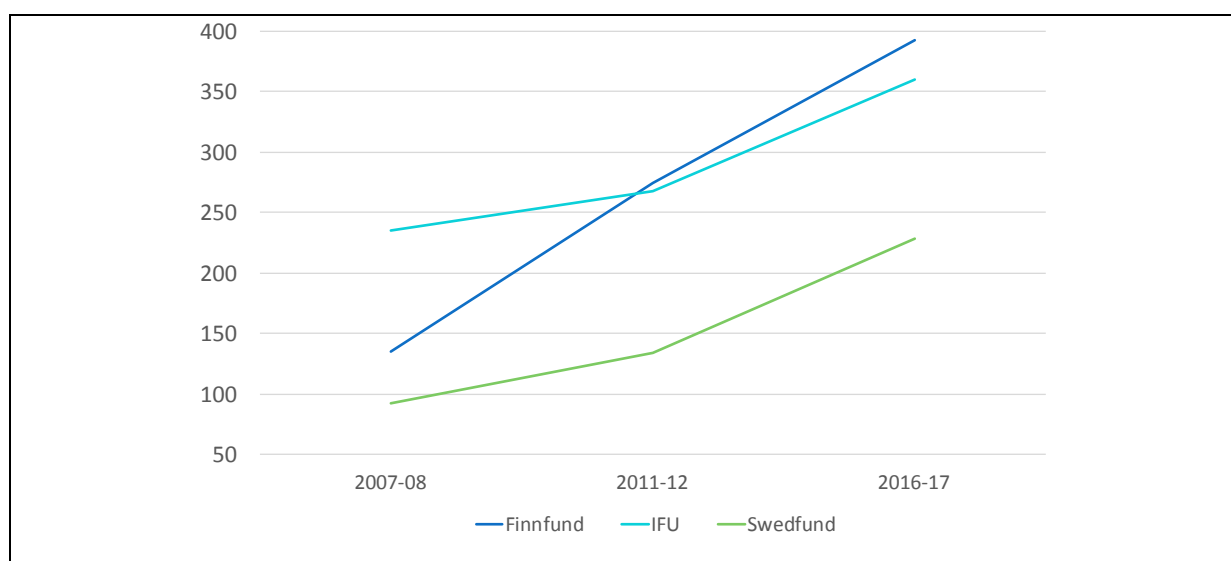
Table 39 (below) sets out the key characteristics of each of DFI. These include organisation setup and mandate, details of investment and non-investment services, current portfolio, and financial and developmental performance.

The DFIs have much in common. They have similar objectives relating to the double bottom line of financial return and developmental impact and are similarly owned and guided by state development policy and relevant departments. They use similar instruments (equity, debt and mezzanine finance, plus some investments through intermediary funds), although IFU has a significantly larger share of its portfolio in equity at two-thirds, compared to just a third of Finnfund's portfolio and a quarter of Swedfund's. All three have a heavy focus on sub-Saharan Africa followed by developing Asia, with a general trend being an increasing focus on low-income countries, moving away from historic investments in emerging markets and middle-income countries in Eastern Europe and elsewhere.

Of the three, IFU is the oldest and has the largest international presence, with offices in 11 countries (despite only having a slightly greater number of full-time staff than Finnfund). Swedfund has around half the staff of either Finnfund or IFU. All three have comparable operating costs, although relative to its smaller size (in terms of staff and gross income), Swedfund's operating costs are more significant than the other two.

In terms of active portfolios, all three have seen significant growth over the past decade, with Finnfund experiencing the greatest expansion, from below €150 million to almost €400 million (Figure 28). The figures used here are the accounting figures of the three DFIs – i.e. how much has actually been invested to date - and so are lower than some other measures of portfolio size.

Figure 28 Total portfolio investments (EUR millions)



As with most DFIs, all three were initially capitalised largely through public funds, and all aspire to be self-financing, reinvesting the proceeds of their investments in new projects. Finnfund is unique in its ability to raise finance on capital markets, which is not backed by government guarantees. To date, a larger share of Finnfund’s capital has been sourced from commercial markets than from the Government of Finland (46% versus 40% respectively), which negatively affects its profitability due to funding costs. All three DFIs have received capital injections of one form or another from the state at various times, which has enabled expansion of their portfolios. Of the three, Swedfund has received the most significant injections in recent years, with additional funds proposed for 2019 and 2020, suggesting a continued portfolio expansion that is likely to rival those of Finnfund and IFU in the coming years.

Finnfund and Swedfund’s Finnpartnership and Swedpartnership respectively provide financial and advisory services to domestic firms wishing to enter developing markets and seek partners. Swedpartnership offers financial support to Swedish SMEs seeking to engage in knowledge and technology transfer with developing country firms on a long-term basis. Support is provided in the form of a loan that is convertible to a grant upon successful completion of an agreed project plan, of a value up to €200,000 or 40% of the project value. €2.9 million was allocated for Swedpartnership in 2017. Finnpartnership offers business partnership support (including financial support for planning and development phases of a project), a ‘matchmaking’ service, and advisory and mentoring services to Finnish firms wishing to establish long-term commercial enterprises in developing countries.

IFU offers technical advisory services and financial support to business plan and investment preparation, including support through the Project Development Programme, a DKK 50 million (€7 million) fund established in 2016 to co-finance project preparation. Similarly, Swedfund has recently established a Project Accelerator to support the development of pipeline investments.

In addition to their core investments, IFU manages a number of additional funds that have been set up in partnership with the Danish state and institutional investors. More details are provided in Box 3.

Box 3 IFU managed funds

The Danish Climate Investment Fund (DFIF) was established in 2014 with total capital of DKK 1.3 billion (€174 million), 40% financed by the Danish State and IFU, and 60% from private institutional investors. DCIF provides risk capital for climate-related projects and is now fully invested. It has a target return of 12% and is currently invested in 18 projects totalling DKK 902 million (69% invested).

The Danish Agribusiness Fund (DAF) was established in 2016 with DKK 800 million (€107 million), 63% from the Danish State and IFU and 37% from pension funds. The fund invests in developing and emerging country agribusiness. The fund targets a return of 10% and is currently invested in six projects totalling DKK 305 million (38% invested).

The Arab Investment Fund (AIF) was established in 2011 by IFU and the Danish state with total capital of DKK 150 million (€20 million) to invest in social and economic development projects in the Middle East and North Africa.

IFU Investment Partners (IIP) was set up by two Danish pension funds to provide additional capital to large investments undertaken by IFU and Danish businesses. Capitalised at DKK 500 million (€67 million), the fund follows the same due diligence and other processes as IFU and is therefore considered a streamlined way of bolstering IFU investments without duplicating processes.

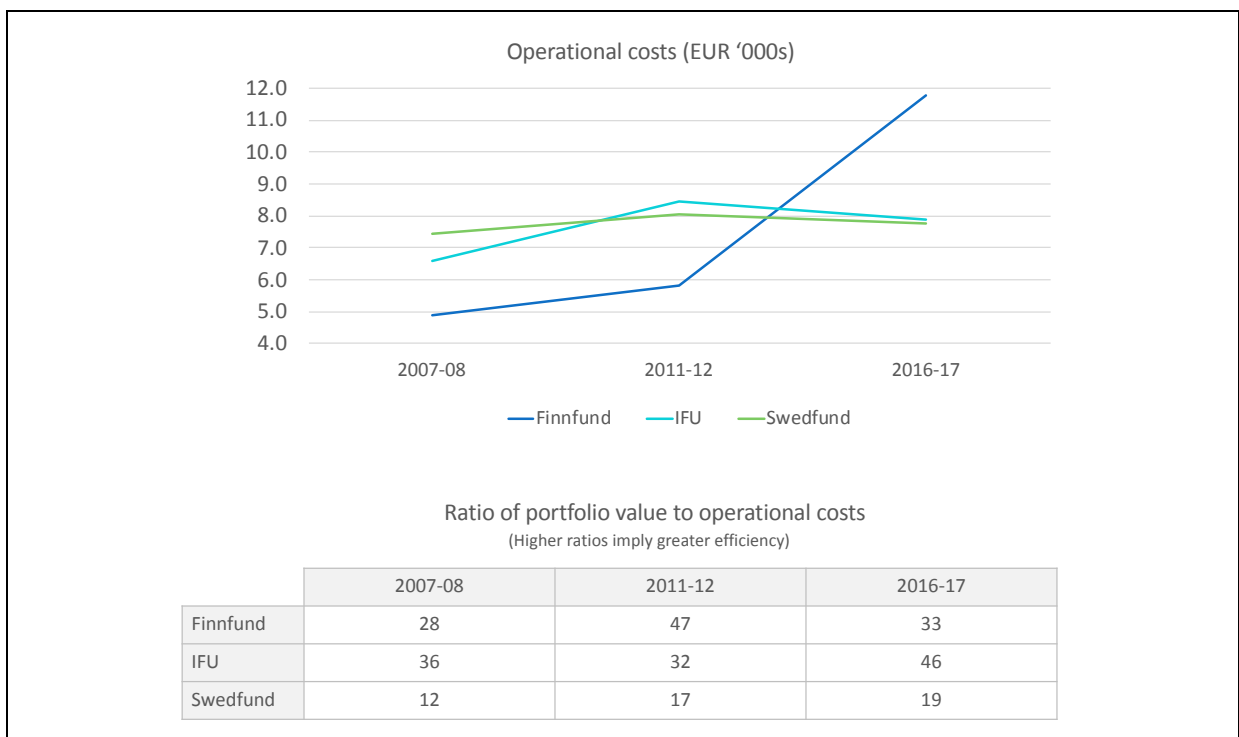
The Ukraine Investment Facility (UFA) is a four-year programme (2015-19) established by the Danish Ministry of Foreign Affairs promoting Denmark-Ukraine risk capital projects, with DKK 30 million (€4 million) allocated.

Danida Business Finance (DBF) was established in 1993 to provide concessional financing to large-scale (usually public) infrastructure projects. Administrative responsibility for the fund was moved into IFU in 2017.

All of IFU's managed funds have similar requirements to IFU's core portfolio in terms of investing where there is a Danish interest present.

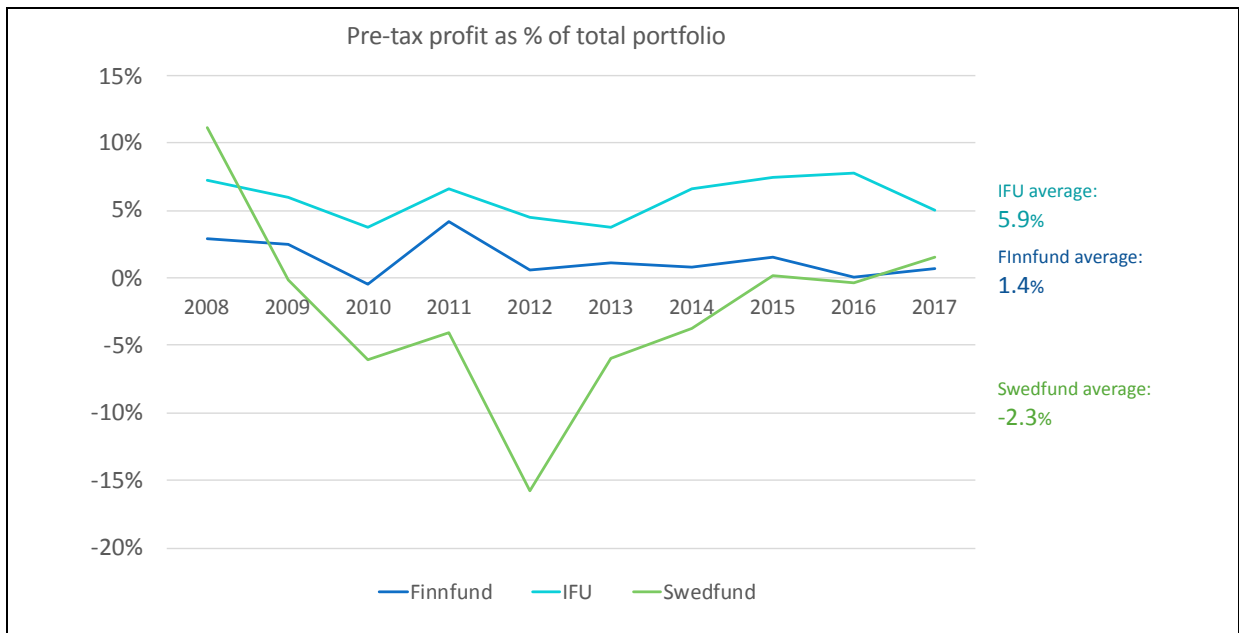
Finnfund has seen an increase in operating costs corresponding to the portfolio expansion seen in recent years, whilst Swedfund and IFU have seen slight reductions in operating costs since 2012, despite continuing to grow their portfolios (Figure 29). Figure 29 also shows the ratio of portfolio value-to-operating costs – i.e. the number of Euros invested per Euros spent on operating costs, with higher numbers suggesting greater operational efficiency. At present, IFU has the greatest efficiency ratio, whilst Finnfund has dipped slightly since 2012, and Swedfund trails significantly behind – whilst having similar operational costs to IFU, it currently manages a substantially smaller portfolio.

Figure 29 Operational costs



In terms of financial performance, IFU has performed best over the past decade, with an average before-tax return equivalent to 5.9% of the invested portfolio value, and no negative years. Finnfund turned a profit in nine out of ten years but averaged a lower return of 1.4%. Swedfund made a loss in seven of the ten years, including consecutive loss-making years between 2009 and 2014 (Figure 30).

Figure 30 Pre-tax profit as % of total portfolio

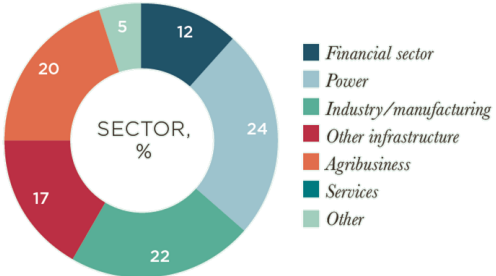
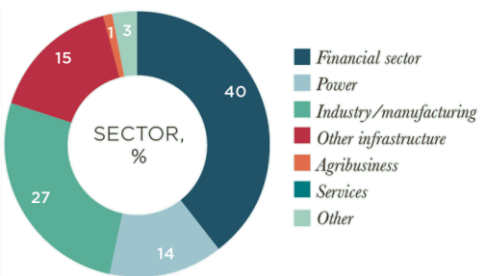
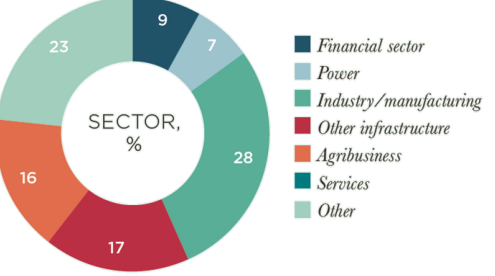


It is important to note that these headline figures are rather misleading. Finnfund and Swedfund follow similar accounting principles, where assets are booked at either their acquisition value, or lower if valuations have fallen. Increases in market value are not taken into account. IFU, in contrast, follows IFRS standards, where assets are valued at fair value market prices. As a result, the book value of IFU's assets, and therefore its implied profitability, is likely to be inflated relative to Finnfund and Swedfund. A more direct comparison is between Finnfund and Swedfund, where we see that Finnfund performs well, particularly when one takes account of the negative impact on Finnfund's profit margin of its debt servicing costs, which Swedfund does not face.

Table 39 Comparison of Finnfund, Swedfund and IFU

Variable	Finnfund (Finland)	Swedfund (Sweden)	IFU (Denmark)
Year founded	1980	1979	1967
Offices	Helsinki (HQ)	Stockholm (HQ), Nairobi.	Copenhagen (HQ), plus China, India, Kenya, Nigeria, South Africa, Ghana, Colombia, Singapore, Brazil, Ukraine.
Employees	71 full time staff.	39 full time staff.	84 full time staff, plus a network of 39 advisors across 20 countries.
Mission	To build a better world by investing in responsible and profitable businesses in developing countries.	Participate in economically, socially and environmentally sustainable investments that create better conditions for people living in poverty and under repression.	Provides advisory services and risk capital to Danish companies wishing to do business in developing countries and emerging markets in support of economic and social development.
Governance and mandate	Majority owned by the state (94.1%), plus Finland's export credit agency, Finnvera, (5.8%) and the Confederation of Finnish Industries (0.1%). Board nominated by the Finnish Ministry for Foreign Affairs (MFA). Mandate is guided by the annual steering memorandum from the MFA.	Administered under the Ministry of Enterprise and Innovation (MEI), albeit with budget coming from Ministry of Foreign Affairs (MFA). Board nominated by the MEI. Mandate delivered via Owner's Instructions from MEI, with some input from MFA on development policy. MEI nominates Swedfund's eight-member board.	Self-governing fund established by the Danish government. Board and CEO appointed by the Danish Minister for Development Cooperation. Mandate delivered through multi-year strategy documents developed with the Ministry of Foreign Affairs (MFA) (currently the 2018-21 strategy, launched in 2016), as well as periodic updates to the mandate from the MFA. Key developments in the mandate in recent years have focused on the eligibility of investee countries (see 'Investment Criteria', below).
Funding	40% from Government of Finland, 46% raised on capital markets, 14% from reinvested earnings (as of October 2017).	Financed out of the International Development Cooperation budget, under the Ministry of Foreign Affairs. Saw a 62% increase in capital between 2012 and 2015 due to a €133 million injection from the government. Received a further SEK 400 million (€39 million) from the government in 2016 in support of investments relating to renewable energy. Swedish	Initially capitalised by the Danish government in 1967 (totalling DKK 750 million / €40 million). Operations became self-sustaining until a second capital injection from the government in 1996 (DKK 750 million / €101 million over five years). Currently self-financed with revenues comprised of income from

		Parliament approved a SEK 600 million (€58 million) capital injection for 2018, with the same proposed for each of 2019 and 2020.	interest, dividends and capital gains.
Investment instruments	Invests both directly and indirectly (i.e. through intermediary funds). Direct investments account for 64% of all investments, which in turn is split between equity (36%), debt (53%), mezzanine finance (12%) and guarantees.	As of end of 2017, investments were split across equity (23%), debt (46%) and funds (31%).	Equity, mezzanine, debt finance and guarantees. Current balance of 66% equity, 34% debt. Also acts as fund manager for the Danish Climate Investment Fund (DCIF), Danish Agribusiness Fund (DAF), IFU Investment Partners (IIP), Arab Investment Fund (AIF) and Ukraine Investment Facility (UIF). 20% of active projects are currently through these funds. See Box for more details. Took over administration of Danida Business Finance in 2017, providing favourable finance to developing country public infrastructure projects.
Investment criteria	Guided by criteria of social and environmental responsibility, development impact, Finnish interest (broadly defined) and profitability.	Investments of USD 3 million to USD 15 million (€2.6 million to €13 million), with horizons of 5-10 years. Investments must meet criteria relating to (a) impact on society, (b) sustainability, and (c) financial viability. Aims to focus predominantly on sub-Saharan Africa going forwards (60-80% of the portfolio). Always a minority investor, typically 25% - 35% of the total investment.	At least 50% of investments must be made in countries with income levels below 80% of the upper limit for Lower Middle Income countries (using World Bank definitions). Investment size up to DKK 100 million (€13 million). Always a minority investor, typically contributing around 30% of the total investment. A “Danish interest” is required - either a Danish investor, a Danish company either supplying to or sourcing from the project company, Danish board membership or management of the project company, use of Danish technology in the project, and/or job creation in Denmark. The definition of “Danish interest” has been relaxed to a degree in recent years, with direct financial ties to a Danish firm not being required since

			2015. It is also not clear how stringently the Danish interest requirement is applied in practice.
Portfolio	Total invested in portfolio companies: 2017: €393 million 2012: €274 million 2007: €135 million	Total invested in portfolio companies: 2017: €229 million 2012: €134 million 2008: €92 million	Total invested in portfolio companies: 2017: €360 million 2012: €268 million 2007: €234 million
Geographic focus	46% in sub-Saharan Africa, 24% Asia, 16% Latin America, with the remainder divided across other developing regions.	As of 2017, regional split across Africa (62%), Asia (20%), Eastern Europe (5%), Latin America (3%) and other (10%). Aiming to keep sub-Saharan Africa at 60-80% of portfolio in 2018-20.	Current portfolio split includes 35% Europe, 33% Asia, 21% Africa, 10% Latin America, 1% global. However, IFU is increasingly focusing on low income countries, as reflected in recent investment decisions. Of 37 new projects approved in 2017, 15 were in Africa, 15 in Asia, 4 in Latin America, 2 in Europe and 1 global.
Sectoral focus	Priority sectors include forestry, financial services, renewable energy and agriculture. Sectoral breakdown as of 2016: 	As of 2016, sectoral split of finance (40%), industry and manufacturing (27%), infrastructure (15%) and energy (14%). Focus going forward will be on the priority sectors of (a) climate and energy, (b) financial institutions and funds, and (c) healthcare. 	Largest sectors include industry and manufacturing, infrastructure and agribusiness. Sectoral breakdown as of 2016: 
Non-investment services	Finnpartnership offers advisory services (including match-making and mentoring services) and financial support to Finnish	Established in 2016, the Project Accelerator provides financial support to the development of new projects in order to boost financial viability	Offers advisory services relating to business and investment planning, and project preparation grants to SMEs. The Project Development

	companies seeking to enter developing markets.	and sustainability of pipeline projects. Swedpartnership offers financial assistance (up to €200,000) for Swedish SMEs seeking to establish partnerships with firms in developing countries, with an emphasis on technology and knowledge transfer.	Programme was established in 2016 with DKK 50 million (€7 million) to support project preparation, with DKK 10.5 million (21%) disbursed to date across six projects.
Impact	Supported 25,603 direct jobs, 1.2 million indirect jobs, €334 million in tax revenues, 1.7 million micro loans and 6,619 GwH of energy generation in 2016, marking substantial increases over the previous year.	Focus on Sustainable Development Goals, particularly relating to job and tax revenue generation, sustainable energy, environment and climate, gender equality, human rights and anti-corruption. Currently supporting 133,000 jobs (up from 108,000 in 2014), including 44% women (up from 25% in 2014). 84% of investees have an ESG policy in place, and 84% have an anti-corruption policy. EBA (2018) found data too limited to make conclusive statements around impact but noted that switching to lower-income / higher-risk environments was likely increasing additionality and potential for impact.	Sustainable Development Goals-focused development impact tracking through their Development Impact Model (DIM), with a particular focus on job and tax revenue generation, as well as additionality, sustainability and leverage. The DIM was designed following the introduction of the SDGs, and focuses on a set of 38 indicators pertaining to general and sector-specific development targets, as well as sustainability. 180,000 people employed by project companies in the active portfolio. Projects contributed DKK 2.8 billion (€375 million) in local taxes in 2017. According to their annual report, there was an investment leverage factor of 11.8 in 2017, but it is not clear if this includes their managed funds or not. Environmental, social and governance issues managed by a sustainability policy and advisory board.
Financial performance (see discussion above for impact of	Ten-year average pre-tax profit as a percentage of total portfolio: 1.4% Years with positive returns: 9/10 (see figures above, for trends)	Ten-year average pre-tax profit as a percentage of total portfolio: -2.3% Years with positive returns: 3/10 (see figures above, for trends)	Ten-year average pre-tax profit as a percentage of total portfolio: 5.9% Years with positive returns: 10/10 (see figures above, for trends)

different accounting standards on these figures)			
Operational efficiency	<p>Total operating costs and operating cost-to-portfolio size ratio (figure in brackets is number of Euros invested in portfolio companies per Euro spent on operating costs – a higher number implies greater operational efficiency):</p> <p>2016/17: €11.8 million (33)</p> <p>2011/12: €5.8 million (47)</p> <p>2007/08: €4.9 million (28)</p>	<p>Total operating costs and operating cost-to-portfolio size ratio (figure in brackets is number of Euros invested in portfolio companies per Euro spent on operating costs – a higher number implies greater operational efficiency):</p> <p>2016/17: €7.8 million (19)</p> <p>2011/12: €8.1 million (17)</p> <p>2007/08: €7.4 million (12)</p>	<p>Total operating costs and operating cost-to-portfolio size ratio (figure in brackets is number of Euros invested in portfolio companies per Euro spent on operating costs – a higher number implies greater operational efficiency):</p> <p>2016/17: €7.9 million (46)</p> <p>2011/12: €8.5 million (32)</p> <p>2007/08: €6.6 million (36)</p>

Annex 6: Consistency with OECD/DAC guidelines

As the assignment falls under the mandate of the MFA, the evaluation will broadly follow the guidance provided in the institution's Evaluation Manual (MFA, 2018). This guidance requires evaluations to apply the principles, standards and criteria of development evaluation agreed upon by the OECD-DAC and the European Union (EU). The three most important aspects in the MFA guidance are that evaluations must be (1) impartial, (2) independent, and (3) credible. In addition, usefulness, the use of participatory approaches and partnerships, and joint working with other donors are principles to consider when carrying out evaluations.

While the evaluation will adhere to the three key principles, we propose a more flexible approach in respect of the other principles, with some more appropriate and feasible for this evaluation than others. Table 40 details our proposed approach to the OECD-DAC and EU Evaluation Principle, as interpreted by the MFA.

Table 40 Measures taken in the Finnfund evaluation to comply with MFA evaluation guidance

MFA Evaluation Manual Guidance		How the Finnfund evaluation complies with MFA evaluation guidance
Evaluation Principle	How to apply in practice	
Impartiality and independence	<p>Evaluations are conducted by external experts who are selected through a competitive process, using transparent criteria</p> <p>The Evaluation Unit is an operationally independent function under direct supervision of the Under-Secretary of State for development policy</p>	<p>The evaluation is channelled through the Evaluation Management Services (EMS) Framework Contract managed by the Development Evaluation Unit, an independent entity within the MFA. The service provider companies of the EMS have been selected through a competitive bid. The evaluation team members are external experts who have no conflict of interest with the MFA or Finnfund. They have been chosen against predefined criteria and approved by the Unit for Development Finance and Private Sector Cooperation as well as by the Development Evaluation Unit.</p>
Credibility	<p>Evaluation teams are formed by highly skilled, independent professionals.</p> <p>Conclusions and recommendations of evaluations are based on a sound and transparent analysis of findings, covering both successes and failures.</p> <p>Evaluation reports are made publicly available.</p> <p>The competency of evaluation management in the MFA is ensured through continuous staff training.</p>	<p>The evaluation team consists of skilled, independent professionals. Expertise is provided on all competencies required by the Terms of Reference: i) team leadership in evaluations of at least a similar magnitude; ii) experience of private sector development evaluation; iii) experience of corporate finance, and iv) experience of managing environmental, social and human rights risks. Furthermore, the team includes two members who possess in-depth knowledge of Finland's development cooperation policy and context.</p> <p>The quality of deliverables is ensured through the following steps:</p> <p>Evaluation team members review each other's work prior to the submission of the deliverables into further quality assurance (QA) process; The final report is independently peer-reviewed prior to submission;</p> <p>The Evaluation Management Services Coordinator ensures products correspond to expectations of the Client using an MFA checklist;</p> <p>The Project Manager assigned by the Evaluation Manager</p>

MFA Evaluation Manual Guidance		How the Finnfund evaluation complies with MFA evaluation guidance
Evaluation Principle	How to apply in practice	
		<p>provides close follow up to the team during implementation to ensure the assignment adheres to required quality standards throughout;</p> <p>The evaluation is based on evidence using mixed methods (both qualitative and quantitative). Limitations of the study will be explained in a transparent manner in the evaluation report.</p> <p>The report will be published and a seminar open to the public will be organised at the end of the evaluation;</p> <p>The Development Evaluation Unit will provide steering to the Unit for Development Finance and Private Sector Cooperation throughout the process.</p>
Usefulness	<p>Users of evaluation results are consulted during programming and planning of evaluations.</p> <p>Stakeholders have an opportunity to participate throughout the evaluation process.</p> <p>Programming of evaluations ensures that the results are available on time for decision-making.</p> <p>Writers of evaluation reports are familiar with the quality standards and guidelines concerning the contents of evaluation report, including clear structure and concise wording.</p> <p>The management response system entails that management report back on the implementation of the evaluation.</p> <p>Evaluation reports, including presentations and discussions, are widely disseminated.</p>	<p>The usefulness of this evaluation is paramount. This is evident in the overall design, research process and communications plan. First, the inclusion of ex-post and appraisal phases ensures that the future Finnfund strategy can be directly informed by evaluation findings. To that end, the report will include a table of findings, conclusions, and recommendations which the MFA can draw upon when formulating its response.</p> <p>In addition, the evaluation timeframe is closely aligned with MFA's policy planning and decisions schedule to ensure results are available to decision-makers in a timely fashion.</p> <p>Second, the methodology includes a stakeholder analysis based on which relevant actors will be identified for individual or group consultations.</p> <p>Third, the evaluation team is highly experienced in development evaluation, including evaluations of Development Finance Institutions (DFIs) and the use of OECD-DAC criteria in evaluation.</p> <p>Finally, a series of communications events are planned. The report will be made available online, be written in an accessible and readable style and the evaluation will conclude with a public seminar.</p>
Participation of all stakeholders	<p>Consultative process with the partner countries on evaluation timing and Terms of Reference (ToR) preparation, and wide dissemination of the evaluation results</p> <p>Partner institutions and stakeholders are actively consulted in all phases of an evaluation</p> <p>Finland supports evaluation capacity development for strengthening of national evaluation systems</p>	<p>The evaluation includes field visits to three countries in which Finnfund has an important project portfolio. Evaluation team members, accompanied by independent local advisors, will visit the sites and consult with representatives of relevant stakeholder groups, to the extent possible within the scope and time of the evaluation.</p> <p>The evaluation team will also seek to engage stakeholders in Finland, including members of the NGO community.</p>
Donor	Joint evaluations undertaken particularly	While this point is not applicable to the Finnfund evaluation, it

MFA Evaluation Manual Guidance		How the Finnfund evaluation complies with MFA evaluation guidance
Evaluation Principle	How to apply in practice	
cooperation	<p>in joint programmes, such as sector programmes, budget support etc.</p> <p>Donors are informed and consulted in upcoming programme evaluations</p> <p>Donors give input to the evaluation process by holding joint meetings, participating in debriefings and commenting on evaluation results</p>	<p>is worth mentioning that the evaluation Team Leader, Stephen Spratt, has recently completed a similar evaluation of the Swedish DFI, the Swedfund. His experience combined with a benchmarking exercise between Finnfund and other Nordic and/or European DFIs, provides an opportunity for learning across the Nordic and/or European countries.</p>

Evaluations based on OECD-DAC guidance typically follow the seven evaluation criteria of relevance, impact, effectiveness, efficiency, aid effectiveness, coherence and sustainability. Evaluation reports are often structured around these elements, which is also the approach adopted in the MFA Evaluation Manual. In this evaluation, however, we think it will be more appropriate and useful to structure the data from an issue-based perspective, which means that the report table of contents will follow the topics identified in the evaluation Terms of Reference and distilled in the research questions above, rather than the OECD-DAC criteria for development evaluation. More generally, it should be noted that, while the MFA evaluation unit may provide advice, the evaluation falls fully within the mandate of the Unit for Development Finance and Private Sector Cooperation.

The seven criteria will thus be used mainly as an analytical tool and applied as an overall framework in the background of the study. To illustrate this, Table 41 sets out an evaluation matrix as recommended in the MFA Evaluation Manual.

As we can see, our revised research questions provide good coverage of the criteria and should enable us, where data permits, to address each with respect to Finnfund's work. As discussed above, the only criterion we will not address is sustainability, as it is out of scope.

Table 41 Evaluation matrix

Criteria	Evaluation question relating to each criterion in the TOR	Detailing the TOR evaluation questions (and research questions)
Relevance	The evaluation should assess the relevance of Finnfund's activities from the perspective of the company, including the objectives and targets set in the Ownership guidance by the MFA, and if they might be improved or added to.	<p>What is the theory of change for the future programme?</p> <p>Have Finnfund's activities aligned with annual guidance?</p> <p>Has Finnfund followed DFI best practice on social, environmental and commercial risk management?</p>
Impact	The evaluation should therefore provide an overview of Finnfund's additionality vis-à-vis commercial financing.	Have Finnfund's investments been additional?

Criteria	Evaluation question relating to each criterion in the TOR	Detailing the TOR evaluation questions (and research questions)
Effectiveness	The evaluation is to assess to what degree the investments of Finnfund contribute to positive development outcomes in the societies of developing countries.	<p>Have Finnfund's investments been additional?</p> <p>Have Finnfund's investments generated attributable development effects (outputs)?</p> <p>What evidence is there that the programme design is likely to achieve its strategy goals?</p> <p>What evidence is there that Finnfund is institutionally set up to achieve its strategic goals?</p>
Efficiency	The evaluation should, using benchmarks where possible, assess the cost efficiency of Finnfund in meeting its' policy objectives.	<p>What evidence is there that Finnfund is institutionally set up to achieve its strategic goals?</p> <p>To what extent does the future programme/Finnfund institutional structure need to be revised to increase the likelihood that the theory of change is realized?</p>
Aid Effectiveness	As for effectiveness	As for effectiveness
Coherence	The evaluation is to assess how well ESG) risks are managed as a part of the due diligence process before an investment decision and how they are monitored throughout the lifetime of the investment. Also, the adequacy of risk mitigation strategies and resources are to be assessed.	Has Finnfund followed DFI best practice on social, environmental and commercial risk management?

Annex 7: Evidence of compliance with international best practice on E&S risk management

Table 42 Summary of Finnfund response to EDFI ES policy

ES Policy	Detailed objectives	Finnfund response	Evidence						
Adoption of the EDFI Principles for Responsible Financing (PRF)		<p>Yes - ES policy and signed EDFI PRFs (on webpage)</p> <p>https://www.finnfund.fi/yritys/sustainability/en_GB/edfi_responsible_financing/</p>	<p>The ES handbook describes the ES processes and refers to the EDFI harmonized environmental and social standards for Direct Investments, for Fund Investments and for Financial Institutions</p> <p>The E&S reviews state that the EDFI standards are the minimum level of ES requirements for the clients</p> <p>The E&S reviews, the ESAPs and ES requirements included in the investment agreements with the clients confirm adherence to the PRF</p> <p>Business Integrity and corporate governance issues are addressed by the legal and investment teams</p>						
Due diligence	<table border="1"> <tr> <td>Clearance in Principle (CIP)</td> <td rowspan="4">Yes -ES process above</td> <td rowspan="4">ES Review, ES summary EthioChicken ESAP Africado ESAP Investment agreements</td> </tr> <tr> <td>Project Approval</td> </tr> <tr> <td>Contractual Agreement</td> </tr> <tr> <td>Monitoring</td> </tr> </table>	Clearance in Principle (CIP)	Yes -ES process above	ES Review, ES summary EthioChicken ESAP Africado ESAP Investment agreements	Project Approval	Contractual Agreement	Monitoring		
Clearance in Principle (CIP)	Yes -ES process above	ES Review, ES summary EthioChicken ESAP Africado ESAP Investment agreements							
Project Approval									
Contractual Agreement									
Monitoring									
Ongoing monitoring of risks		Yes – ES policy	Yes but more for high risks projects						
Compliance with exclusion list		Yes	<p>Investment officer / ES expert checks that the project is not on FF’s project exclusion before categorisation of the investment i.e. before the clearance in principle.</p> <p>Finnfund’s exclusion list is more restrictive than the EDFI and IFC exclusion list. Although not explicitly on the exclusion list investments adhere to Finnish Government policies regarding certain types of investments e.g. large dams and fossil fuels</p>						
Stakeholder engagement	<table border="1"> <tr> <td>Client</td> <td rowspan="3">FF reports that it has open interaction with their own stakeholders (Finnish industry, authorities)</td> <td rowspan="3">EthioChicken ESAP Goal 1 Africado ESAP No 1A</td> </tr> <tr> <td>Workers</td> </tr> <tr> <td>Affected Community</td> </tr> </table>	Client	FF reports that it has open interaction with their own stakeholders (Finnish industry, authorities)	EthioChicken ESAP Goal 1 Africado ESAP No 1A	Workers	Affected Community			
Client	FF reports that it has open interaction with their own stakeholders (Finnish industry, authorities)	EthioChicken ESAP Goal 1 Africado ESAP No 1A							
Workers									
Affected Community									

ES Policy	Detailed objectives	Finnfund response	Evidence
	<p>ies</p> <p>Other</p>	<p>in Finland and in target countries, clients, other financiers) and the stakeholders of its clients where possible</p> <p>It expects its clients to develop and maintain a meaningful engagement and dialogue with their stakeholders</p>	<p>NFC ESAP PS 1.3</p>
Grievance procedure		<p>Finnfund has its own whistleblowing mechanisms, accessible to all stakeholders on Finnfund’s website. FF also requires its clients to have their own internal grievance mechanisms (for workers) as well as external grievance mechanism (where applicable – for project affected communities).</p>	<p>EthioChicken ESAP Goal 2.8</p> <p>Africado ESAP No 1B</p> <p>NFC ESAP (All)</p> <p>Being a category C project, grievance procedure has not been required from M-Birr</p>
Local laws		<p>All projects financed by Finnfund are required to comply with the local legislation.</p> <p>Projects having medium to high ES impacts and risks are required to comply also with international standards in addition to local legislation</p>	<p>Minimum standard for ES category C projects</p> <p>Evidence for M-Birr</p>
Continuous improvement		<p>Yes</p> <p>FF’s clients with medium to high ES impacts are required to develop and implement</p>	<p>Finnfund report that approximately 30% of FF’s investments/clients (banks, MF, funds and SMEs) need continuous guidance and support at some point.</p> <p>See Appraisal section for more data on continuous</p>

ES Policy	Detailed objectives	Finnfund response	Evidence
		environmental and social management systems complying with international standards. These management systems are based on the principle of continuous improvement.	improvement
Reporting/accountability/ internal quality control		Finnfund aims towards transparency in communication by publishing information on environmental and social aspects of its projects as possible and required by law, but still accounting for bank secrecy laws and the need to protect confidential client information	Good evidence of transparency and accountability throughout this evaluation. However, this may reflect a policy shift in Finnfund (previous PSD evaluation)

Table 43 Evidence for adherence to IFC standards

IFC ES Performance standards	Detailed objectives	Evidence
Performance Standard 1: Assessment and management of Environmental and Social risks and impacts	Identify and evaluate risks / environmental and social management systems	All ESAPs All ES reviews All ES requirements in investment/financing agreements (except for FI-C and C category projects)
	Mitigation hierarchy	Bespoke approach for each project
	Promote improved client performance thru effective use of environmental and social management systems	EthioChicken ESAP Goal 2 Africado ESAP Nos 6, 7, 8.
	Grievances	EthioChicken ESAP Goal 2.8 NFC ESAP (Uganda, Rwanda)
	Adequate engagement	EthioChicken ESAP Goal 1 NFC ESAP (Uganda, Rwanda)
	Third party certification of clients' ESMS	EthioChicken ESAP Goal 5 NFC ESAP (Tanzania)

IFC ES Performance standards	Detailed objectives	Evidence
Performance standard 2: Labour and Working Conditions (additional to ILO. NOTE that the IFC Performance standard 2 is based on the ILO core labour standards and Basic terms and conditions at work)	Worker-management relationship.	EthioChicken ESAP Goal 3 NFC ESAP PS 1.6 E&S reviews and E&S conditions of the financing agreements
	Compliance with national employment and labour laws.	ES policy and procedures EthioChicken ESAP Goal 3
	Third party/supply chain	
	Safe and healthy working conditions	WB EHS guidelines in ESAPs EthioChicken ESAP Goal 3 NFC ESAP PS 1.6 NFC ESAP (All)
Performance standard 3: Resource Efficiency and pollution prevention	Minimise pollution	EthioChicken ESAP Goal 4
	More sustainable use of resources, including energy and water	NFC ESAP PS 1.4 NFC ESAP PS 1.9 NFC ESAP (Rwanda, Tanzania)
	Reduce project-related GHG emissions	E&S Reviews
Performance standard 4: Community Health, Safety, and Security	Health and safety	WB EHS guidelines in ESAPs
	Safeguarding of personnel and property and human rights principles	NFC ESAP (Rwanda) ES reviews of projects
Performance standard 5: Land Acquisition and Involuntary Resettlement	Avoid or minimise displacement	Interviews claim to have fairer land acquisition
	Avoid forced eviction	EthioChicken ESAP Goal 1
	Minimise negative impacts of land acquisition	Africado ESAP Nos. 2, 3 , 4 and 5 NFC ESAP (Uganda, Rwanda)
	Improve or restore livelihoods	
	improve living conditions among physically displaced persons	
Biodiversity Conservation and Sustainable Management of Living Natural Resources	To protect and conserve biodiversity.	EthioChicken ESAP Goal 1
	To maintain the benefits from ecosystem services.	NFC ESAP PS 1.4 NFC ESAP (Uganda, Rwanda)
	Adopt practices that integrate conservation needs and development	

IFC ES Performance standards	Detailed objectives	Evidence
	priorities.	
Performance standard 7: Indigenous peoples	Rights and livelihoods of indigenous peoples	Pre-investment data collection of the topics, stakeholder engagement (FF interview), use of specific experts
	Minimise adverse impacts	
	Promote culturally appropriate opportunities	
	Informed Consultation and Participation (ICP) with the Indigenous Peoples	
	Obtain Free, Prior, and Informed Consent (FPIC)	
	Respect and preserve culture	
Cultural heritage	Protect cultural heritage	Pre-investment data collection of the topics, stakeholder engagement (FF interview) NFC ESAP (Uganda) A chance find procedure is required as a minimum for projects that have potential impacts on cultural heritage. The clients are often required to have the impact on cultural heritage covered by the ESIA
	Equitable sharing of benefits from cultural heritage	

Annex 8: Analysis of compliance with annual guidance and mandate

	Baseline	2011	2012	2013	2014	2015	2016	2017
Target 1: The positive development impacts of FF investments grow and ability to assess development impact of investments and report on them improves.								
Proportion of projects good or excellent in light of their development impacts, out of all new investment decisions (%)	na (60 created in 2016 [88 ⁱ])	na ⁱⁱ	na ⁱⁱⁱ	na ^{iv}	A baseline will be created for 2015 ^v	60 ^{vi}	60	60
Proportion of projects in which the participation of FF influenced significantly the generation of development impacts (significant added value) (%)	60 (= 72 2014; 80 2015)	60	60	60	60 ^{vii}	60 ^{viii}		
Progress in the systematic assessment of development impacts: more precise impact evaluation criteria will be defined, which can put into practice in 2012;	x	√	√	√	Will be developed so projects can be divided into 3 categories ^{ix}	Projects are divided into 3 categories. ^x		
<i>Reporting on development impacts with available data (at least with 3 EDFI indicators)</i>								
Jobs created by the invested projects ^{xi}	2764 (= 1860 2013; 1670 2014; 2500 2015)	3000 [2700 ^{xii}]	3000	3000	3000	3000	To be reported	To be reported at end of year ^{xiii} (25600 FF est. end 2016)
Net tax income generated by projects ^{xiv}	8.3mn (= 3mn in	9mn	8.5mn	8.5mn	8.5mn	10mn		

	Baseline	2011	2012	2013	2014	2015	2016	2017
	2013; 4.5mn 2014; 15mn 2015)							
Tax receipts and payments	New indicator 2016	-	-	-	-	To be reported at end of year	To be reported at end of year FF est. end 2016)	To be reported at end of year (285mn FF est. end 2016)
Farmers benefiting from project	New indicator 2016	-	-	-	-	To be reported ^{xv}	To be reported at end of year	To be reported at end of year (15812 FF est. end 2016)
Net export earnings generated by projects (= effect on the CA balance of the financed project)	41.1mn (=3.7 mn 2013; 39mn 2014; 35mn 2015)	40mn	45mn	20mn	20mn	20mn		
Target: Finnfund's investments help create broad based and poverty reducing economic development in those countries in which their own economic institutions are weak								
<i>Investments to LIC/LMIC countries, as a proportion of new investment decisions</i>								
Number of investments (%)	71 (=61 2014; 67 2015)	Not in OSM	>71	>71	71	71	Not in OSM	Not in OSM
Amount in Euros (%) ^{xvi}	73 (64 2014; 67 2015; 75 2016)	Not in OSM	>75	>75	75	71	75	75
The share of investments directly benefitting poor demographic groups out of all decisions (%)	35 (= 36 2013; 56 2014; 53 2015; >40 2016)	Not in OSM	40	>40	>40	>40	40	40
Additionality of financing; the share of risk	New indicator 2016	-	-	-	-	-	To be reported	40

	Baseline	2011	2012	2013	2014	2015	2016	2017
financing out of financing decisions ^{xvii}	(40% 2017)							
The sector spread of new investments (%) ^{xviii}	New indicator 2016	-	-	-	-	-	To be reported	To be reported (50 FF est. end 2016)
Climate change mitigation	New indicator 2016	-	-	-	-	-	To be reported (avoided CO2)	To be reported at end of year (907112000 FF est. end 2016)
Produced energy	New Indicator 2016	-	-	-	-	-	To be reported (kWh)	To be reported at end of year (3124 GWh FF est. end 2016)
Target: FF strengthens collaboration with Finnish companies.			Not in OSM	Not in OSM	Not in OSM	Not in OSM	Not in OSM	Not in OSM
No of meetings between FF experts and Finnish companies, of which specific objective is to promote the participation of Finnish companies in FF projects (not general collaboration meetings)	282 ^{xix}	60	-	-	-	-	-	-
<i>-Proportion of projects done with Finnish companies of all investment decisions</i>			-	-	-	-	-	-
Projects (%)	45	60	-	-	-	-	-	-
Euros amount %	39	50	-	-	-	-	-	-
Target 3: FF works in a cost-effective way (+ from 2014: and develops tools for defining cost-efficiency based on international comparisons)								
Share of administrative costs (%)	2.8 (= 1.7 2012; 1.5 2014; 1.6 2015)	<2.8	<2	<2	<2	<2		

	Baseline	2011	2012	2013	2014	2015	2016	2017
Share of operating expenses out of investment capital (new 2016) ^{xx}	<2 [1.4]	-	-	-	-	-	<2	<2
Proportion of profits (%)	47.6 (=51 in 2013)	<50	<50	<75	Not in OSM	Not in OSM	Not in OSM	Not in OSM
Operating costs to value of investment decisions (%)	6.9 (= 7.1 2012; 19.6 2013; 12 2014; 9.2 2015)	<7	7	<10	<10	<10	Not in OSM	Not in OSM
Target: FF operates self-sufficiently								
Return on equity in reference year	0,8 (5.3 2013)	>0	>0	>0	Not in OSM	Not in OSM	Not In OSM	Not in OSM
Return on equity as a sliding average of the past five years (%)	5.5 (5.8 2013; 2.2 2014; 1.4 2015; >2 2016)	>3.9	>3.9	>3.9	>2	<2 ^{xxi}	>2	>2
Net impairments in the reference year (% of portfolio)	6.5mn	2.3nm	Not in OSM	Not in OSM	Not in OSM	Not in OSM	Not in OSM	Not in OSM
Net impairments as a sliding average in the past five years; (% of investment capital)	2.8 (= 1.3 in 2013; 1.5 in 2014)	<2.8	<2.8	<2.8	<2.8	<2	Not in OSM	Not in OSM
FF's equity ratio (%) (own equity / sum of the annual balance sheet)	58.6 (67 2013; 65 2015; 76 2015; 50-70 in 2016)	50-70	50-70	50-70	50-70	50-70	To be reported	To be reported (50 FF est. end 2016)
HRBA integrated in the project cycle Principles have been written and executed as a part of the preparation of new projects ^{xxii}	New indicator 2016						To be reported	To be reported (pilot underway)

Annex 9: Theories of Change

Figure 31 Theory of change for renewables

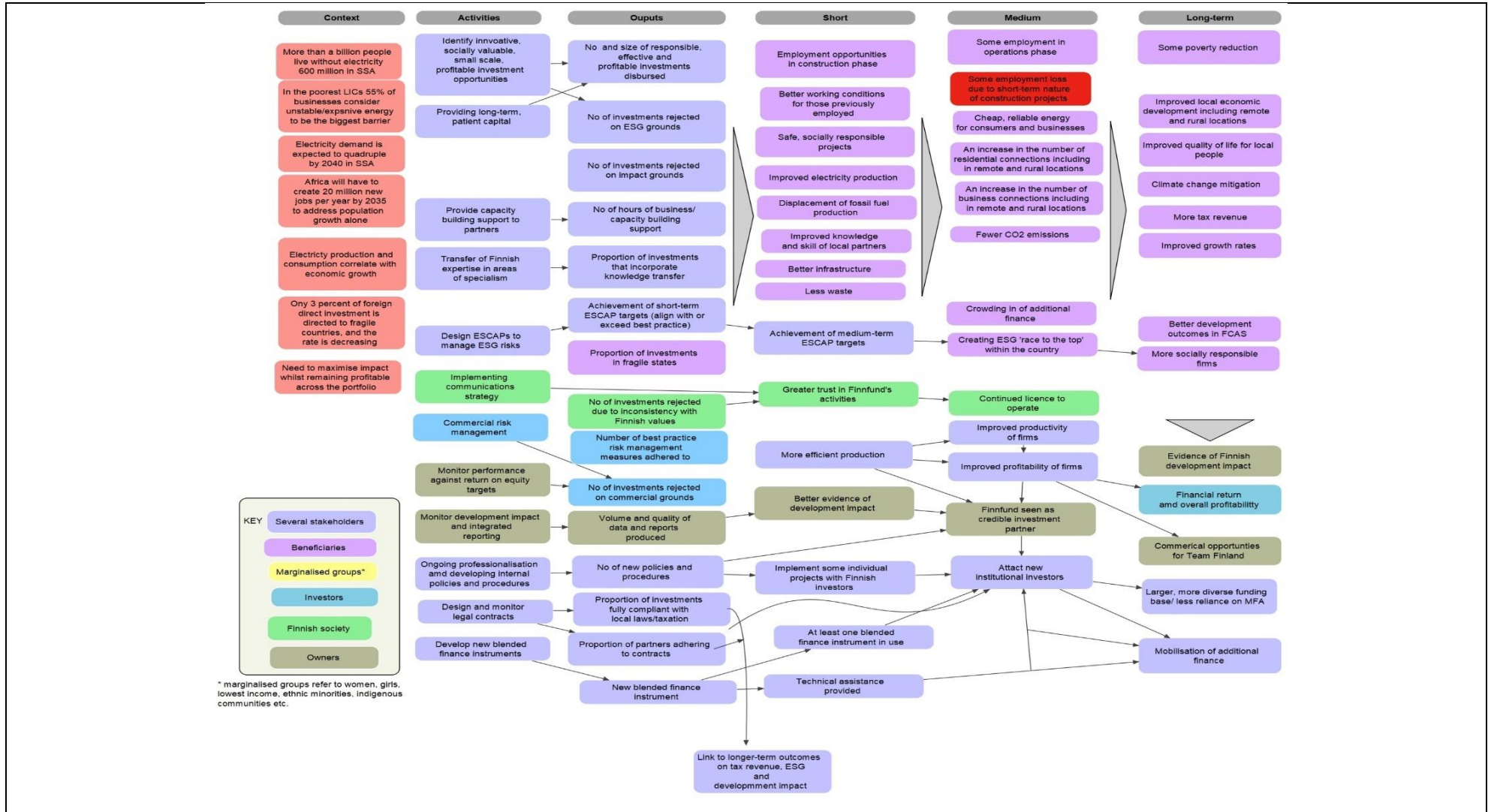


Figure 32 Theory of change for finance

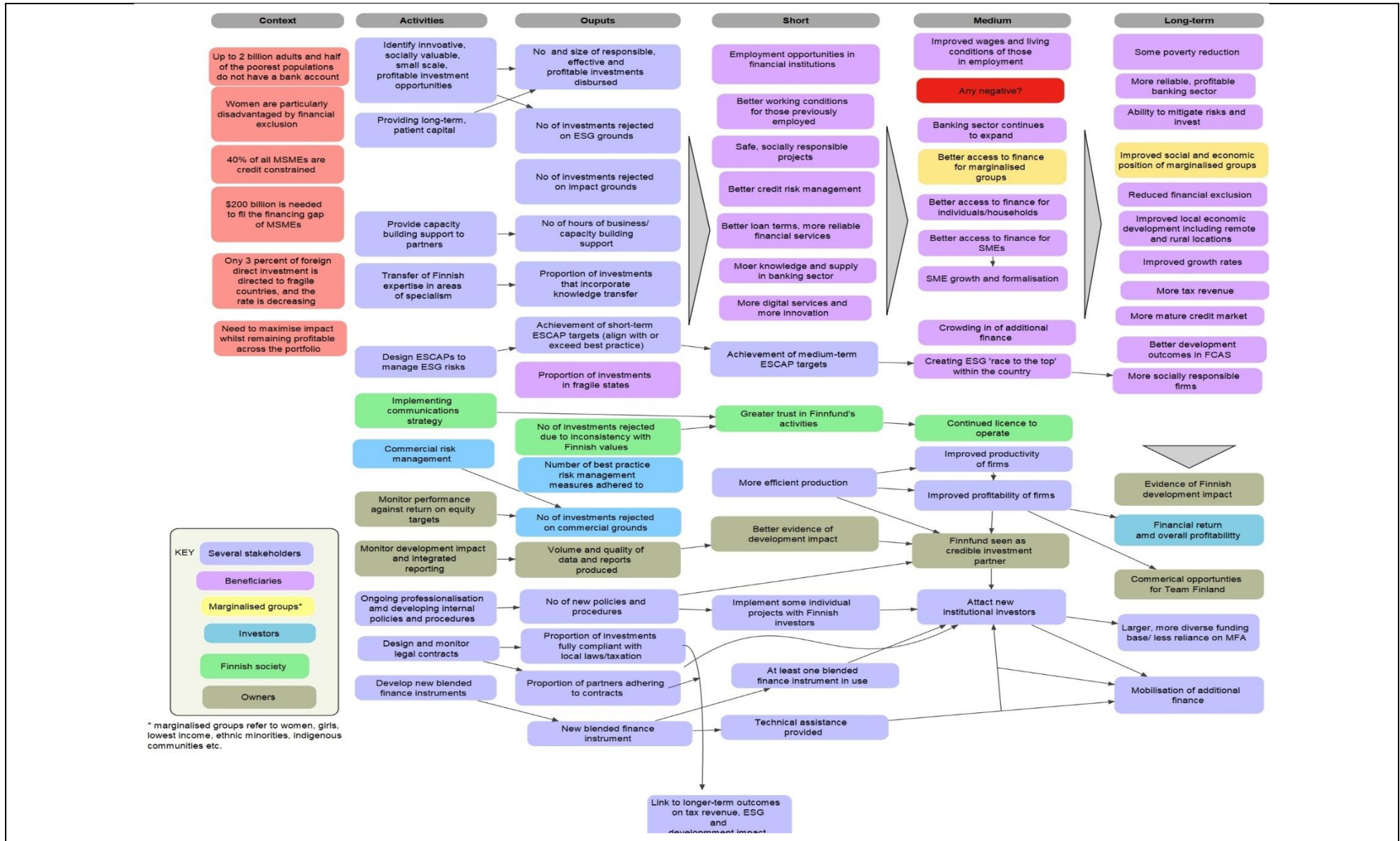


Figure 33 Theory of change for agriculture

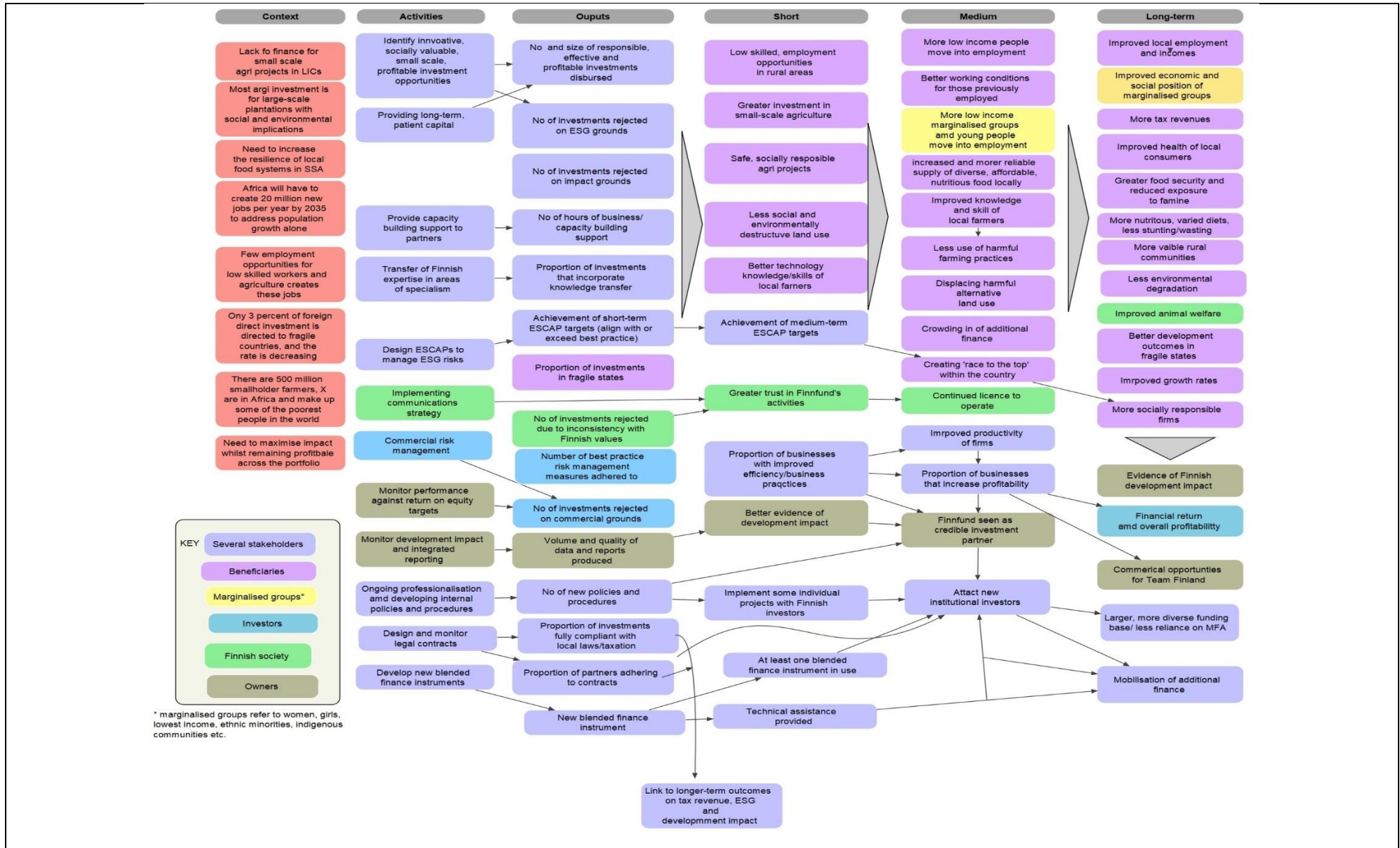
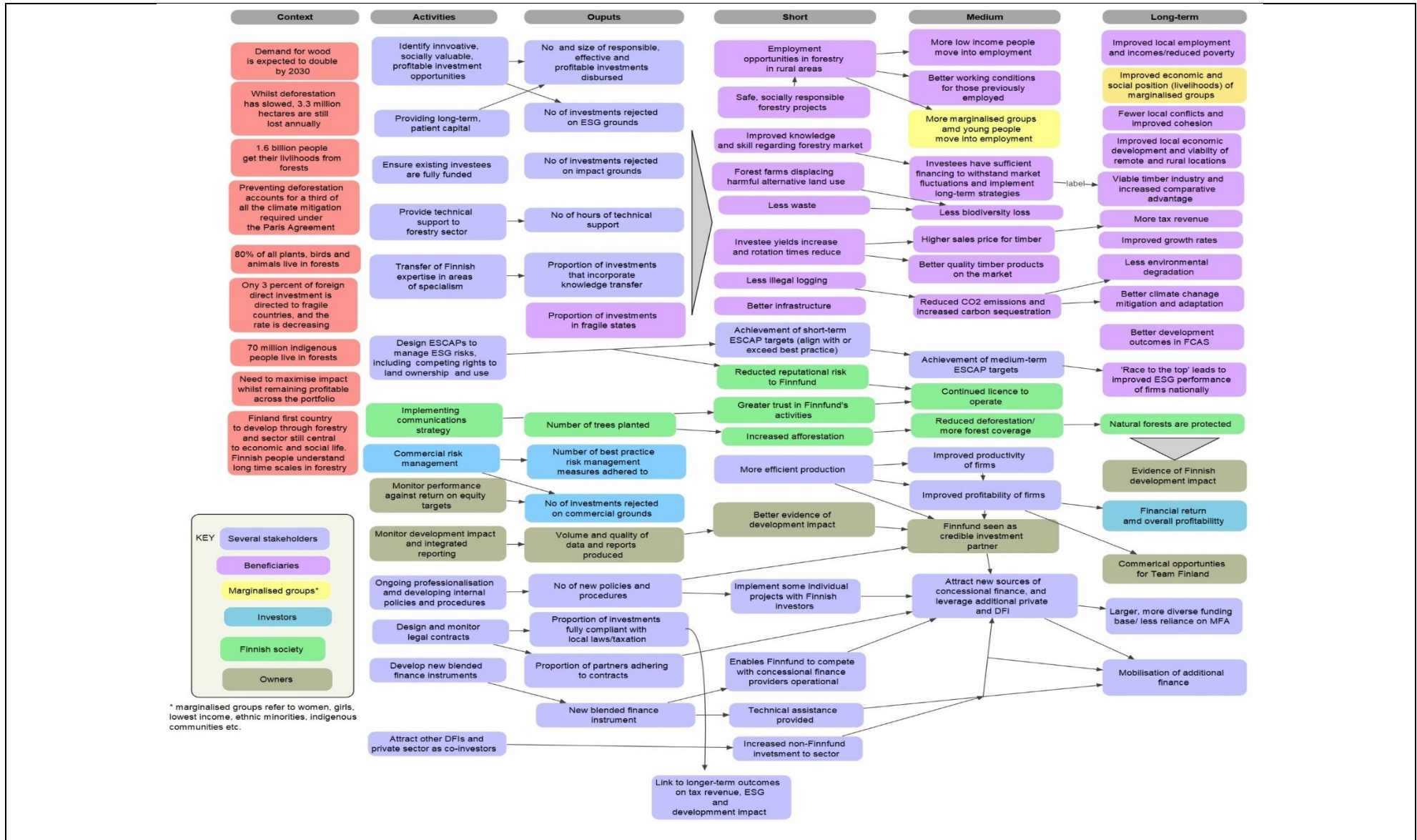


Figure 34 Theory of change for forestry



Annex 10: Employment impacts

Table 44 Employment impacts in renewables

Question	Valle Solar	La Vegona	Los Laurales	Mezapa
How many jobs have been created?	42 direct employees. 50% from local communities. 1,200 hired during for construction.	32 full time employees	36 direct employees. 200 people employed during construction.	22 permanent employees, ~10-20 temporary workers;
What kinds of jobs are these? (skill levels)	Mostly manual (cleaning solar panels)	Mostly skilled engineers full-time. Temporary maintenance etc. labour.	50% site maintenance (low-to-mid skill), 50% Tegucigalpa offices (mid-to-high skill).	Technical plant management and maintenance, data collection, civil works
Permanent/temporary/seasonal (percentages)	(see above)	Permanent	(see above)	(see above)
Do you employ local people in management?	Some. Where higher skills are needed (engineers etc.), try to draw these from nearby towns in the region.	Head of E&S at the plant has been trained up and promoted from within the community – big success story.	Community members have been trained up and promoted to more senior positions.	19 of 22 permanent staff are from local community. Capacity development provided for local community members, many have become technicians now.
Opportunities for progression	..		(see above)	(see above)
Marginalised groups (rural, women, low income etc.)	4% women	7% women	14% women	Very few women
Average pay	Competitive	Competitive	Competitive	Competitive
Average pay locally (if known)	(see above)	(see above)	(see above)	(see above)
Other benefits (healthcare, housing, education?)	Health insurance, housing on site, pension fund, family events	Health insurance, pension fund, family events, bonuses, housing		Private health insurance (inc. families), pension,

Question	Valle Solar	La Vegona	Los Laurales	Mezapa
Rights/conditions (hours, unions, holiday, sick leave etc.)	Workers reported excellent working conditions (gave the comparison of recent strikes / disputes at a different plant).	Paid leave, sick leave, 48 hour working week (legal limit is 60).	Comply with all labour laws, minimum wage, benefits	Comply with all labour laws, minimum wage, benefits
Have any employment related issues improved in your company since receiving the Finnfund investment?	No	Poyry (2012) report found no evidence of labour disputes or grievances.	No	No

Table 45 Employment impacts in forestry

Question	GRAS	KVTC	NFC
How many jobs have been created?	328+229=557 in Tanzania only	315	In FY2017, 242 in Tanzania.
What kinds of jobs are these? (skill levels)	management local, management expat, supervisors local, supervisors expat, temporary	152 permanent jobs (138 male, 14 female) of which all are skilled labour. 163 seasonal jobs (126 male, 37 female) of which 5 positions are occupied by international skills (male) workers. Therefore 158 male and 37 female jobs have been created on a seasonal basis for the surrounding communities (in terms of unskilled labour).	See figure below.
Permanent/temporary/seasonal (percentages)	328 permanent (of which 52 women), 229 seasonal	Permanent 48% Seasonal 52%	See figure below.
Do you employ local people in management?	Yes	Yes	Yes
Opportunities for progression	Yes	Yes	Yes
Marginalised groups (rural, women, low income etc.)	52 out of 328 permanent staff are women	See above	See figure below
Average pay	Redacted on grounds of commercial confidentiality	Redacted on grounds of commercial confidentiality	Redacted on grounds of commercial confidentiality

Question	GRAS	KVTC	NFC
Average pay locally (if known)	See above	In 2017, KVTC had 366 employees in total. The company spent USD 687 442 for salaries of local staff = USD 1878 / year / person, i.e. USD 157 / month /person in average	See above
Other benefits (healthcare, housing, education?)	The evaluation team did not obtain a full HR manual or similar. However, the salary survey carried out by KVTC shows that GRAS provides at least leave allowance, funeral expenses (for self, spouse/kid, and parents) as well as maternity leave (100 days) and paternity leave 3 days).	Collective agreement includes provisions for wage increase, working hours, annual leave, travel assistance, compassionate leave, maternity and paternity leave, housing allowance, medical services, termination/lay-off, burial expenses, gratuity, out of station allowance, and personal protective equipment.	According to NFC staff and KVTC salary and benefits survey (KVTC, 2018c), other benefits include leave allowance, as well as maternity and paternity leave of 84 (legal requirement) and 3 days respectively.
Rights/conditions (hours, unions, holiday, sick leave etc.)	GRAS has its own trade union. According to the ESG Manager, since 2016 GRAS has established a grievance handling mechanism through which employees can express their complaints. To ensure protection of people with complaints, there are several channels workers can express their complaints; these include hotlines, email, suggestion box, physical encounter, and trade union's meetings.	See above	The relationship between employees and the company management is good. Where workers have problems they could express them through a grievance addressing mechanism in place and could send their grievances to the Workers' Union to which employees are free to join.
Have any employment related issues improved in your company since receiving the Finnfund investment?	The role of Finnfund as a DFI involved in GRAS has not been significant when it comes to employment situation. Between September 2014 and May 2017 in total 562 people were retrenched from GRAS's payroll in Tanzania alone. The financiers were unable to detect existence of ghost workers and other unnecessary positions in the company.	Rather yes than no	Rather yes than no but lacking concrete examples

Table 46 Employment impacts in agriculture and finance

Question	EthioChicken	Africado	M-Birr	ETFG
How many jobs have been created?		Before Finnfund investment, Africado has created 160 permanent and 170 part-time jobs. The estimated number of new jobs after Finnfund investment is 150 permanent and 200 part-time positions. In addition, the company engages with a few commercial farmers and roughly 2000 outgrowers (Finnfund, 2016g).	24.5 direct employees (15 men, 9.5 women) (M-Birr ICT Services PLC, 2016)	National Cement Share company: 1446 Flipper International School PLC: 192 Jalannera Coffee Export and Coffee Farm plc: 79 Kaliti Food Share Company: 379 Sa-Med PLC: 25 MB PLC (“FAMILY MILK”): 178 Origin Water: 100 TOTAL: 2399 employees
What kinds of jobs are these? (skill levels)	The jobs include professional, vocational and labourers. There are also sales agents out growing day-old chicks in different districts. The total number of agents has reached more than 2,000. The agents are being continuously recruited, with up to 50 being recruited every week (interview).		Out of the 24.5 employees, 12 are management level and other workers are 12.5 individuals (M-Birr ICT Services PLC, 2016)	Not knows
Permanent/temporary/seasonal (percentages)	Not known		All jobs are full-time permanent (M-Birr ICT Services PLC, 2016)	Not known
Do you employ local people in management?	Yes	Yes/No	Yes	Yes

Question	EthioChicken	Africado	M-Birr	ETFG
Opportunities for progression	Yes	Yes/No	Yes	Not known
Marginalised groups (rural, women, low income etc.)	40% are women, see business model	Currently, 36 % of permanent and 45% of seasonal employees are women. The outgrower program currently encompasses around 2000 local farmers. All employees except 5 expats (1 English, 4 Kenyans) are Tanzanian.	3 females are occupying management positions, 9 in qualified positions (M-Birr ICT Services PLC, 2016)	Not known
Average pay	Not known	Average pay not known but Africado pays better than average companies in the agriculture and forestry sector in Tanzania (KVTC, 2018c)	Now known	Not known
Average pay locally (if known)	Not known	See above	Not known	Not known
Other benefits (healthcare, housing, education?)	According to staff interviews, excellent benefits, but we did not receive a staff manual or equivalent (e.g. medical insurance, possibility to take a zero-interest loan from the company, group life insurance, bonuses etc.)		According to the interview in Addis Ababa, the company fulfils Ethiopian labour law requirements but does not aim at higher benefits.	Health care and sick leave etc. in line with Ethiopian law, standard holidays
Rights/conditions (hours, unions, holiday, sick leave etc.)	The holiday, sick pay and annual leave are provided in the same manner as required by the local law.		According to Ethiopian labour law. The company does not have a workers' union (M-Birr ICT Services PLC, 2016). This aspect was confirmed during the field visit. Matters are discussed only in regular staff meetings.	No workers' union
Have any employment related issues improved in your company since	No, stayed the same	Yes/No	The evaluation team's understanding is that the issues	Not known

Question	EthioChicken	Africado	M-Birr	ETFG
receiving the Finnfund investment?			have remained the same given that the reference point is the Ethiopian labour law.	