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WORKING PAPER 29

BILATERAL DEVELOPMENT FINANCE INSTITUTIONS IN EUROPE

A Comparative Analysis of DEG, CDC, FMO and Norfund with Recommendations for Development Policy

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in cooperation with Aljoscha Gütermann, Katharina Hammler and Nikolaus Schaefer

DECEMBER 2011

Study with financial support from AK WIEN & with funding from Austrian Development Cooperation

Contens

IMPRINT

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Preface

To the general public, little is known about bilateral development banks and their activities. This is true for all countries that have established such institutions – and it especially was true for Austria in 2008 when the government presented its plan to set up Austria's new development bank, the Oesterreichische Entwicklungsbank (OeEB). Hence, not only politicians and civil servants charged with drafting the legal framework, but also the social partners and civil society organizations in Austria were faced with a range of questions, e.g. concerning the DFI's specific function within the ensemble of development finance, their typical activities, their organizational form, as well as their accountability and transparency mechanisms.

Against this background, a research project with financial support from Arbeiterkammer Wien (Chamber of Labour for Vienna) was initiated in fall 2008 so as to help to fill these knowledge gaps. The project was coordinated by Univ.Prof. Dr. Ulrich Brand (Department of Political Sciences, University of Vienna) and Dr. Werner Raza (Austrian Research Foundation for Development Research – ÖFSE). Temporarily, the research team was advised by Dr. Thomas Sablowski (University of Vienna) and Mag[a]. Karin Küblböck (ÖFSE).

The present publication is substantially based on the findings of the diploma theses of Nikolaus Schaefer, Katharina Hammler, Agnes Gössinger and Aljoscha Gütermann, as well as on Alexander Ebhart's research on Norfund. In particular we adopted parts of a joint publication[1] comprising a comparison of DEG, FMO and CDC; we want to thank the authors for their consent. In a further step, however, we wanted to build upon the insights gained in the comparative study in order to deduce recommendations for Austrian development policies. In this context, we are particularly grateful to those Austrian development finance experts, who served as interview partners. These include Dr. Günther Schönleitner (BMF), Mag[a]. Andrea Hagmann and Mag. Michael Wancata (OeEB), Mag. Klaus Steiner (BMeiA), Dr. Gunther Schall (ADA), Dr. Carl de Colle und Mag. Michael Spalek (WKO), Mag[a]. Éva Dessewffy (AK Wien) as well as Mag[a]. Hilde Wipfel (KOO).

The responsibility for this publication and for all opinions expressed therein rests entirely with the authors.

1 Gössinger, A./Gütermann, A./Hammler, K./Schaefer, N.: Bilaterale Entwicklungsfinanzierungsinstitutionen in Europa. Eine vergleichende Untersuchung von DEG, FMO und CDC, Wien 2011.

List of Abbreviations

ADA	Austrian Development Agency
AG	public limited company
AK Wien	Chamber of Labour for Vienna
BIO	Belgian Investment Company for Development Countries
BMeiA	Federal Ministry of European and International Affairs (Austria)
BMF	Federal Ministry of Finance (Austria)
BMZ	Federal Ministry for economic cooperation & development (Germany)
BWI	Bretton Woods Institution
CDC	Formerly: Colonial Development Corporation, Commonwealth Development Corporation, Capital for Development Corporation
DEF	Development Effectiveness Framework
DEG	Deutsche Entwicklungs- und Investitionsgesellschaft mbH
DFI	Development Finance Institution
DfID	Department for International Development (United Kingdom)
DOTS	Development Outcome Tracking System
EBRD	European Bank for Reconstruction and Development
EDFI	European Development Finance Institutions
EDIS	Economic Development Impact Score
EU	European Union
FMO	Financing Company for Developing Countries (Financierings-Maatschappij voor Ontwikkelingslanden)
GDP	Gross Domestic Product
GmbH	Gesellschaft mit beschränkter Haftung (limited liability company)
GPR	Geschäftspolitisches Projektrating (Project Ratingtool of DEG)
IFC	International Finance Cooperation
IFU	The Industrialisation Fund for Developing Countries – The Investment Fund for Central and Eastern Europe
ILO	International Labour Organization
KfW	Kreditanstalt für Wiederaufbau
KOO	Coordination Office of the Austrian Bishop‘s Conference for International Development & Mission

KPI	Key Performance Indicator
LDC	Least Developed Country
LIC	Low Income Country
LMIC	Lower Middle Income Country
MDB	Multilateral Development Bank
MDG	Millennium Development Goal
MIC	Middle Income Country
NGO	Non-government organization
NOK	Norwegian Krone
NORFUND	Norwegian Investment Fund for Developing Countries
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OeEB	Oesterreichische Entwicklungsbank
PEF	Private Equity Funds
PPP	Public Private Partnership
PROPARCO	Société de Promotion et de Participation pour la Coopération Economique
PSD	Private Sector Development
RoR	Rate of Return
SBI/BMI	Belgian Corporation for International Investment
Sifem	Swiss Investment Fund for Emerging Markets
SIMEST	Società Italiana per le Imprese all'Estero
SME	Small- and medium-sized enterprises
SOFID	Sociedade para o Financiamento do Desenvolvimento
UNCTAD	United Nations Conference on Trade and Development
US	United States
WKO	Austrian Chamber of Commerce
WTO	World Trade Organization
WWF	World Wide Fund For Nature

Executive Summary

Since the early 1990ies, Private Sector Development has become a major issue within the field of development policies. Consequently, bi- and multilateral development banks, i.e. institutions that basically provide finance for projects in developing and emerging countries have been gaining in importance. The visions of these development finance institutions reflect their conviction that the private sector plays a crucial role in stimulating economic growth, creating employment and fostering overall socioeconomic development. In this view, the private sector is key to poverty reduction.

The respective implementing organizations are the *European Development Finance Institutions* (EDFI). This organization groups 15 member institutions, the youngest being the Austrian *Oesterreichische Entwicklungsbank* (OeEB) founded in 2008.

This report is based on case studies analyzing established development finance institutions (DFIs) in four European countries: DEG from Germany, CDC from the United Kingdom, FMO from the Netherlands, and Norfund from Norway. Katharina Hammler, Agnes Gössinger, Aljoscha Gütermann and Alexander Ebhard conducted field work in these countries, including numerous interviews with experts, and published the results in their diploma theses. This report is grounded on these individual studies, merging their findings and adding comparative conclusions and recommendations.

In all examined countries, the concept of Private Sector Development is becoming more important, yet it is only insufficiently embedded in superordinate developmental objectives. The authors describe the DFIs under study as *hybrid actors*, accentuating the area of tension between the institutions' public mandate and their private, commercial business model, the latter being geared towards the generation of profits. DFIs follow three business principles that act as their basis of legitimacy: (1) additionality, i.e. they only operate in areas or sectors where private investors are lacking; (2) catalytic effects, i.e. they seek to mobilize additional private funds; and (3) good governance. In their founding phase, export promotion was a key objective of DFIs, but this purpose has lost relevance in the recent past. Today, its significance hinges on national political interests. The evaluated DFIs embark on different country and sector strategies, some following guidelines decreed by the responsible ministry, some setting goals themselves, some following no clear strategy at all.

There is no uniform methodology for selecting investment projects. DEG uses a self-designed tool called *Geschäftspolitisches Projektrating* (GPR), FMO uses a scorecard based on DOTS system of the IFC, whereas CDC and Norfund chose their projects by and large without a standardized methodology. Each of the four DFIs has a system of internal project monitoring and evaluation.

The relations with shareholders and stakeholders vary widely between the DFIs. Most commonly, consultations with responsible ministries are formalized but there is little contact with parliaments. Only two of the examined DFIs (FMO and Norfund) are subjected to regular and institutionalized external evaluations. Furthermore, while most DFIs say they welcome impulses from civil society, non-governmental actors usually are not formally included in the DFIs' operations. Generally, NGOs usually criticize the DFIs' lack of transparency, as development finance institutions are not known to the general public.

Based on the analysis of the four DFIs and on interviews with Austrian experts in development finance a catalog of policy recommendations was formulated with the following main items:

- **Needs analysis and coherence**
  Before establishing a new DFI, the institution's positioning in the policy field has to be discussed and a needs analysis involving all relevant stakeholders has to be carried out. Already at this stage governance mechanisms have to be enshrined that ensure coherence with other development policies and that allow for cross-linkages with key actors in related policy fields.

- **Institutional arrangements**
  We regard the DFI's organizational form as crucial for achieving the highest possible developmental efficiency. By tendency, profitability as a goals is less important in institutions governed by public law, so that these show a bigger prospensity for high-risk/high-developmental-return projects. DFIs operating under private law need to be subjected to appropriate governance mechanisms so as to safeguard developmental objectives.

- **Consultative committee**
  A consultative committee for development policy has an important position within a DFI's institutional arrangement. The committee should either represent important social interests and contribute to the DFI's strategic decisions, or it should consist of experts who provide assessments for individual projects.

- **Sensitizing the staff for development policy**
  With regard to the operating business it is important to sensitize all employees (not only expert staff) for development policy. This is crucial as quantitative rating tools, while appearing to objectify a project's impact, have methodological deficiencies. Therefore, the ultimate judgment has to be rendered on a qualitative basis, underpinned by a comprehensive developmental expertise by the persons involved.

- **Improvement of the rating tools**
  Almost all DFIs currently use rating tools in order to assess and evaluate (potential) projects. These take various forms and all have methodological weaknesses. We recommend developing a common rating tool with a scientific foundation that should be used by all EDFI members, as such a tool would facilitate cooperation and comparability between different DFIs.

- **Improvements in transparency and accountability**
  The involvement of national as well as local stakeholders should be enhanced. A good way to achieve this is by instituting an ombudsman (similar to the one installed by the IFC) which facilitates communication with the local population. Furthermore, in order to address the lack of transparency it is advisable to introduce binding standards. The *OECD Consensus* on export credits international might provide a template for this.

- **Compulsory external evaluations**
  In addition to internal project evaluations, individual projects as well as the DFI itself should be evaluated by independent experts on a regular basis. The evaluation reports should be submitted to national parliaments.

- **Strategic focus on SMEs**
  From a development policy perspective it is desirable to focus more intensively on SME promotion. This however requires either a strenghtened capital base or the implementation of public support mechanisms for DFIs. A third possibility is the adoption of SME funds, yet this option is only desirable if adequate monitoring and governance mechanisms guarantee a clear focus on development policy criteria.

1. Introduction

1.1. A New Development Finance Institution

For decades, development funding was dominated by the Bretton Woods Institutions and by bilateral public sector donors. However, by the end of the 1980ies private capital flows started to gain importance. In the course of this process bilateral development finance institutions focusing on private sector development managed to increase their budgets and to become essential players in development finance.

Since 2008 Austria has its own „development bank": the *Oesterreichische Entwicklungsbank AG* (OeEB), which was set up as daughter of the *Oesterreichische Kontrollbank AG* [OeEB web]. With OeEB, Austria closes the gap to other Western European countries where specialized institutions concerned with private sector development have long been part of public development cooperation. Those bilateral development finance institutions (DFIs) operate in the area of tension between business orientation and their development mandate, between public mission and private rationality, between profit seeking and poverty reduction.

A recent study, commissioned by the Association of European Development Finance Institutions (EDFI), defines the DFIs' activities as follows:

„A bilateral development finance institution operates almost exclusively in developing countries and countries with transition economies. It is mandated by its respective government to provide long-term financing to the private sector, with specific value-added development objectives, but on a sustainable commercial basis" [Dalberg 2009, 8].

Can this balancing act succeed? Is the spread of DFIs' a consequence of their new approach to pursue development policy goals with the instruments of private business? Or is it that DFIs are first and foremost clever niche players which benefit from the strive to achive the Millennium Development Goals (MGDs), while in reality they pursue different, primarily commercial goals?

In our time of multiple crises the unconditional faith in the superiority of market-based development has started to deteriorate (when cross-border investments have lost their innocence even in Western societies). Against this background it is worth looking for answers for the questions posed above, reflecting upon the relationship between DFIs, politics and society, and examining the operating principles of the development finance institutions.

1.2. Research Question and Methodology

This study encompasses four case studies (DEG, FMO, Norfund, and CDC) and is structured along three blocks of questions. *First*, we ask for the methods used to assess a project's relevance for development policy and for the role of this assessments in deciding upon the project's eligibility. There are different assessment and rating systems used internationally; for instance, OeEB uses DEG's *Geschäftspolitisches Projektrating* (GPR). Central questions were (i) which tools, methods and instruments are used by comparable European DFIs; (ii) which advantages and disadvantages does each of these tools have when considering economic, social and ecological aspects; (iii) in which ways are standardized techniques combined with evaluations by experts and relevant advisory boards; and (iv) how is a project's developmental sustainability monitored.

Second, we studied the DFIs' funding priorities and the role of national export promotion. Questions posed were (i) which sectors and economic activities are primarily funded; (ii) which regions and countries are primarily founded, and which criteria are used in order to decide about a country's eligibility; (iii) whether funding is tied directly or indirectly to the involvement of national companies; and (iv) how closely is the choice of focus countries related to the interest of the national export sector.

The *third* area of interest is related to the DFIs' transparency and accountability, as these act as public entities. Research questions were (i) how DFIs are accountable to the public, in particular to parliaments, but also to civil society in the European Union; (ii) which information concerning business activities do the DFIs have to disclose to whom (government, parliament, general public), when, and how detailed; (iii) which formal and informal forms of consultation and participation do exist and which say do parliaments, enterprises, unions and the civil society have in public development finance; and (iv) whether the DFIs are evaluated externally and if so, how and how often.

The topic lacks scientific attention. Despite the fact that three out of the four analyzed DFIs (Germany's DEG, United Kingdom's CDC and Netherlands' FMO) have been active in the field for decades, no academic debate about their achievements and failures has evolved. There is not even an elaborate descriptive analysis about their business activities, much less a comprehensive body of literature. Be it for the topic's complexity, for lacking public perception or for other reasons: the state of research concerning bilateral DFIs, in general, and DEG, FMO, Norfund and CDC, in particular, is markedly sparse. This comes as a surprise considering the substantial magnitude of the funds involved. Thus, a literature analysis could only serve as a starting point for this study, and additional field work was indispensable. Thus, structured interviews with experts had to be carried out (by Aljoscha Gütermann in the Netherlands, by Katharina Hammler and Agnes Gössinger in Germany and the United Kingdom, and by Alexander Ebhart in Norway). Experts interviewed included staff members of the DFIs and of relevant ministries as well as representatives of other stakeholders (e.g. NGO-activists) and scientists.

Research results were processed to four diploma theses and supplemented with a theoretical overview of the conceptual and institutional basis of development finance by Nikolaus Schaefer, before being consolidated into a comprehensive volume published in the series *ÖFSE-Forum*. The present paper summarizes the studies' essential findings and complements them by development policy recommendations so as to provide fresh impetus for the European as well as the Austrian discussion. In the course of this last step, a number of interviews with Austrian experts were carried out, including representatives of the OeEB and of some of its stakeholders [Ministry of Finance, Ministry of European and International Affairs, Austrian Development Agency (ADA), Chamber of Labour (AK), Chamber of Commerce (WKO), as well as the Coordination Office of the Austrian Bishop‘s Conference for International Development & Mission (KOO)]. These interviews were used as an input for the recommendations.

The remainder of this paper is structured as follows: Chapter 2 provides an introduction to the field of development finance, focusing on private sector development as the conceptual basis of recent development finance. Subsequently, chapter 3 presents the main findings of the comparative case studies. Finally, chapter 4 contains development policy recommendations.

2. Financing for Development – an Introduction

In the following we shortly describe the different forms of financing development, starting with a definition of the concept. A first differentiation is made between private capital flows and public development finance (originating from bi- and multilateral development assistance). We focus on the former and analyze it briefly. Subsequently, we address the issue of Private Sector Development and of Public Private Partnerships. All underlying data concerning national and international ODA expenditures as well as private capital flows are from OECD's *Query Wizard for International Development Statistics* [OECD web]. This chapter is largely derived from Nikolaus Schaefer's diploma thesis. The remarks on Private Sector Development (chapter 2.4.) were written by Aljoscha Gütermann, Katharina Hammler and Agnes Gössinger.

2.1. Development Finance: Defining the Concept

Most basically, the concept development finance relates to financial assistance for development, referring to support for developing and emerging countries. Today, a special emphasize is put on economic and financial market development. Especially mainstream development economists view financial market development as a decisive factor, arguing that well operating financial markets are a basic requirement for an efficient market economy, yet that they are not very well developed in most developing and emerging countries. In this sense, financial institution building (focusing on the credit system) has become a crucial part of development finance in recent years [e.g. Schmidt/Winkler 1999]. It is thus not surprising that financial sector projects also make up for a large part of the analyzed DFIs' portfolios (see further below).

2.2. Public Development Finance

For decades, public development finance was the most important source of finance for development assistance. However, it has lost importance in recent years as private capital flows started to grow disproportionately. It therefore seems positive that many governments committed themselves to enhance their national ODA. For instance, the EU member countries agreed to raise their respective ODA quotas to 0.7% of GDP by 2015. It has to be stressed, though, that a strict separation between public development finance and private capital flows is not possible as there are some hybrid forms. In 2008, the most important donors in bilateral development assistance were the United States, Germany, the United Kingdom, France and Japan.

In recent years, expenditures on development assistance have been growing considerably and constantly. While in 2003, total ODA of all DAC states amounted to about 69 billion US dollars, the sum had almost doubled by 2010, amounting to almost 129 billion US dollars.

Public development finance can be classified into two groups: bilateral and multilateral financing. The former refers to development assistance taking place between two states. The donor government retains the decision making power, and there is a direct connection between donor and recipient country [Lachmann 1999, 60]. Many states dispose of a development ministry in order to manage their bilateral development projects; in most cases, bilateral development finance is controlled by national parliaments.

In contrast, multilateral development finance denotes financing channeled through international organizations (whose members are nation states). Lachmann [1999, 60f] defines multilateral development aid as capital assistance gathered by international organizations (either from various donor countries or from the organization's own resources) and forwarded to recipient countries in the form of projects and programs.

The most prominent actors in multilateral development finance are the Bretton Woods Institutions, (i.e. the World Bank and the International Monetary Fund), the United Nations Organization, the European Union (and its institutions), as well as various multilateral development banks. Multilateral development finance amounted to around 19 billion USD dollars in 2003 and doubled to around 38 billion US dollars in 2010. Thus, there have also been considerable increases in multilateral funding, yet the sums are relatively small compared to bilateral finance[2]. It would, however, be a mistake to underestimate the multilateral institution's importance just because of their minor funding volume; actually, they play a vital role in producing and propagating development policy knowledge and are a decisive factor in creating development policy consensuses.

2.3. Private Capital Flows

In recent years, private capital flows have become more important for development finance, just as the concept of private sector development has gained ground. Hence, not only has funding from private capital sources risen, but also public development finance has increasingly turned toward the private sector. From an academic perspective the key question certainly is: „cui bono?", as there is no mechanism that would guarantee that private capital flows will automatically lead to a win-win-situation in which both sides gain. There are at least some studies that suggest that private capital flows have sometimes failed to meet expectations [see e.g. UNCTAD 1999]. Today, private capital flows are seen as an integral part of development finance – maybe without deserving this title. In any case, a high amount of foreign direct investment cannot *per se* be seen as positive [Hausmann/Fernandez-Arias 2000]. However, private capital flows as an additional source for development finance have been promoted intensively by the international institutions concerned with development finance, that is to say by the Bretton Woods Institutions and the United Nations Organization. For instance, Betz [2001, 13] comments that the UN and especially UNCTAD would exhibit enthusiasm about transnational corporations' contributions to growth, technology transfer and increases in exports.

At any rate, the sum of foreign direct investment in developing countries today by far exceeds the sum of public development assistance. One may well ask, however, whether investing in the private sector can be viewed as development finance at all, as social and ecological aspects are often disregarded and as there is a lack of adequate control mechanisms.

Arguably, the benefits of private capital flows lie mainly in strengthening and integrating the developing countries' capital markets. Yet those capital flows are not evenly distributed among all developing countries. They concentrate on Middle Income Countries, in particular on emerging markets like China, India or Brazil, ignoring the poorest states because of lacking institutional and legal foundations. Moreover, there are regional disparities, that is to say private capital is more likely to flow to Latin America and parts of Asia than to Africa [Gruber 2008, 74].

Private capital flows amounted to around 4.7 billion US dollars in 1968 and have increased to 342 billion US dollars in 2007, taking off particularly since the early 1990ies. The surge is especially pronounced for foreign direct investment and portfolio investment [Grabel 2006, 327].

2 When comparing amounts of bi- and multilateral development finance one has to consider that multilateral projects very often have a higher leverage, as multilateral donors often manage to mobilize further investors, thus increasing the projects' total volume. Furthermore, there is a wide range of regulations concerning the computation of national ODA, e.g. a prohibition to include debt reliefs. Thus, one has to be careful when comparing these figures.

In many cases, private capital flows come along with extensive legal and political changes in developing countries – mostly to the benefit of the investing companies. Also, since the period the Bretton Woods Institutions as well as the WTO and the OECD have massively pushed for capital market liberalizations in developing countries.

2.4. Private Sector Development: Bringing Together Private and Public Objectives

2.4.1. Introduction to Private Sector Development

The main field of activity of both bi- and multilateral development banks is the financing of private sector projects in developing and emerging countries. The visions of these development finance institutions reflect their conviction that the private sector plays a crucial role in stimulating economic growth, creating employment and fostering overall socioeconomic development [FMO Web; IFC Web; etc.]. Thus, the activities and operations of DFIs are closely associated with the concept of PSD. For this reason we want to give a short overview of the concept's evolution so as to gain more insights into the work of DFIs.

Due to its omnipresence the concept of PSD today seems so natural that virtually none of the important institutions operating with the concept defines it in detail, even less deals thoroughly with its nature and its necessary preconditions. In this context, Schulpen and Gibbon [2002, 4] observe: „PSD's preconditions are formulated in the most abstract and general ways conceivable and on the implicit basis of an idealized model of the private sector".

Surely, the concept of PSD is not entirely new [Polte 2006, 162]. As early as 1969, when the policy field of development policy was emerging, the famous Pearson Commission report stated that a strong and dynamic private sector could make an important contribution to economic growth, and that a strong national private sector would attract investment from abroad that could greatly speed up the development process [Pearson 1969, 89]. However, this insight was not reflected in early development policy but was for a long time – and partly still is – exploited for national interests, while actual development cooperation remained paternalistic and aid-focused. Only gradually did a focus on the private sector for development policy reasons gain ground next to other strategies in development co-operation, and only since the 1980ies is this strategy pursued on a broader scale. In the course of this process, catchwords like privatization, deregulation, enhanced competition or redefinition of the role of the state increasingly appeared in the publications of diverse multilateral organizations and bilateral donors. This process has to be seen in the context of a decreasing confidence in a strong state [Schulpen/Gibbon 2002, 1], essentially due to the prevailing neoliberal school of thought and the penetration of economic patterns of thought and concepts of rationality into broader areas of society [Ulrich 1987]. In that period, the economic mainstream presumed that including the developing countries' private sector in development policies would trigger strong economic growth. Thus in the medium run, official development assistance would become increasingly redundant. International key-actors like the World Bank started to assume in the 1980ies that effective development would take place first and foremost in the private sector [Schulpen/Gibbon 2002, 1]. At the end of the decade, most other development institutions (among them bilateral organizations) had adopted this trend. Even the UN, having been skeptical about the concept in the beginning increasingly advocated PSD from the early 1990ies, onwards.

Without any doubt, the assumption that the private sector should be the motor of development is today a major paradigm in development policy and economics [Jimoh 2002, 1]. The logic behind this paradigm is relatively simple [see Schulpen/Gibbon 2002, 2]:

Poverty reduction is the main goal of development

↓

Development is triggered by economic growth

↓

Economic growth is most effectively generated by the private sector

↓

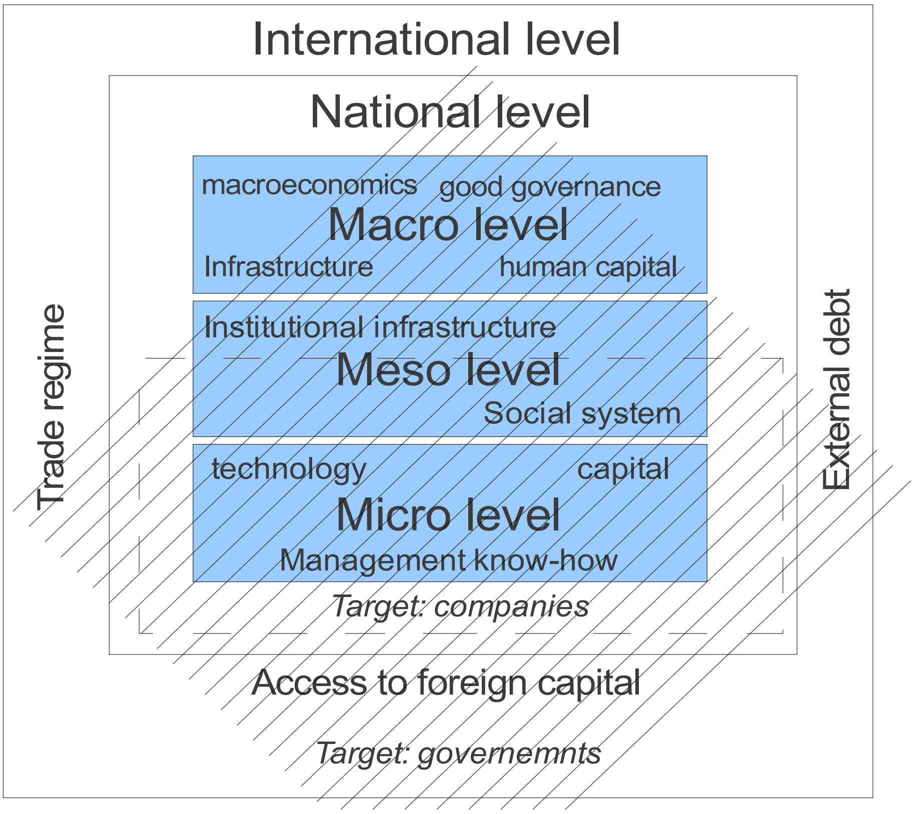
The private sector has thus to be promoted in order to reduce poverty

That these assumptions are taken for granted is well demonstrated by the British Department for International Development which states about its private sector strategy:

„The private sector is the engine of innovation, investment and growth. Vibrant, competitive markets populated by dynamic private companies offer the most effective way to create wealth, jobs and prosperity for all on a sustained basis.“ [DfID 2008, 5]

It is important to understand that this view of the private sector does not imply that public development assistance is obsolete. To the contrary, ODA should help to set up an appropriate institutional framework [Schulpen/Gibbon 2002, 2]. Thus, it would be wrong to equate the PSD concept with the Washington Consensus paradigm [Williamson 1989]. While the latter sees the private sector as the major force in the process of development, maintaining that the state should interfere as little as possible in this process (and thus privatize, liberalize and deregulate), the former accentuates the importance for the state in actively fostering the private sector and a favorable business environment, respectively. This „mixed-economy model" aims at creating an enabling (business) environment that is seen as the foundation of a prospering private sector [Estrup 2009, 10]. A quote from the Commission on Growth and Development's Growth Report illustrates this conception:

Figure 1: Classification of PSD instruments based on Schulpen/Gibbon 2002



„Government is not the proximate cause of growth. That role falls to the private sector, to investment and entrepreneurship responding to price signals and market forces. But stable, honest, and effective government is critical in the long run. The merit of the government, for example, includes maintaining price stability and fiscal responsibility, both of which influence the risks and returns faced by private investors.“ [CDG 2008, 4f]

Fostering the private sector can take various forms, and policies can target different levels (see figure 1). First, one needs to lay the foundations on the national or the international level. The latter refers, among others, to trade regimes, debt levels, or access to foreign investment. The national level can be further differentiated into a macro- and a meso level, the first encompassing macroeconomics, infrastructure, governance and human capital, the latter the institutional infrastructure. Thus, while PSD on the international and the macro level relates above all to governments and PSD on the micro level above all to policies directly linked to enterprises, the meso level constitutes a kind of bridge between those areas. It contains elements that address both governments and enterprises [Schulpen/Gibbon 2002, 3f]. According to this scheme, bilateral development finance institutions are located on the microlevel. This classification makes it obvious that PSD is a very broad and to a large extend elusive concept. Jimoh tries to add some clarity by first determining whether a specific policy benefits the recipient country's enterprises directly or indirectly [Jimoh 2002, 11f]. Measures with direct benefits include commercialization and privatization programs as well as enabling environment support programs (particularly macroeconomic policies, but also what Jimoh calls „second-generation interventions”, i.e. policies „[promoting] trust and business linkages, competition and generally aimed at creating a truly enabling environment” [Jimoh 2002, 12]). Donor governments can foster the development process in those areas with financial support, and particularly with technical assistance and knowledge transfer.

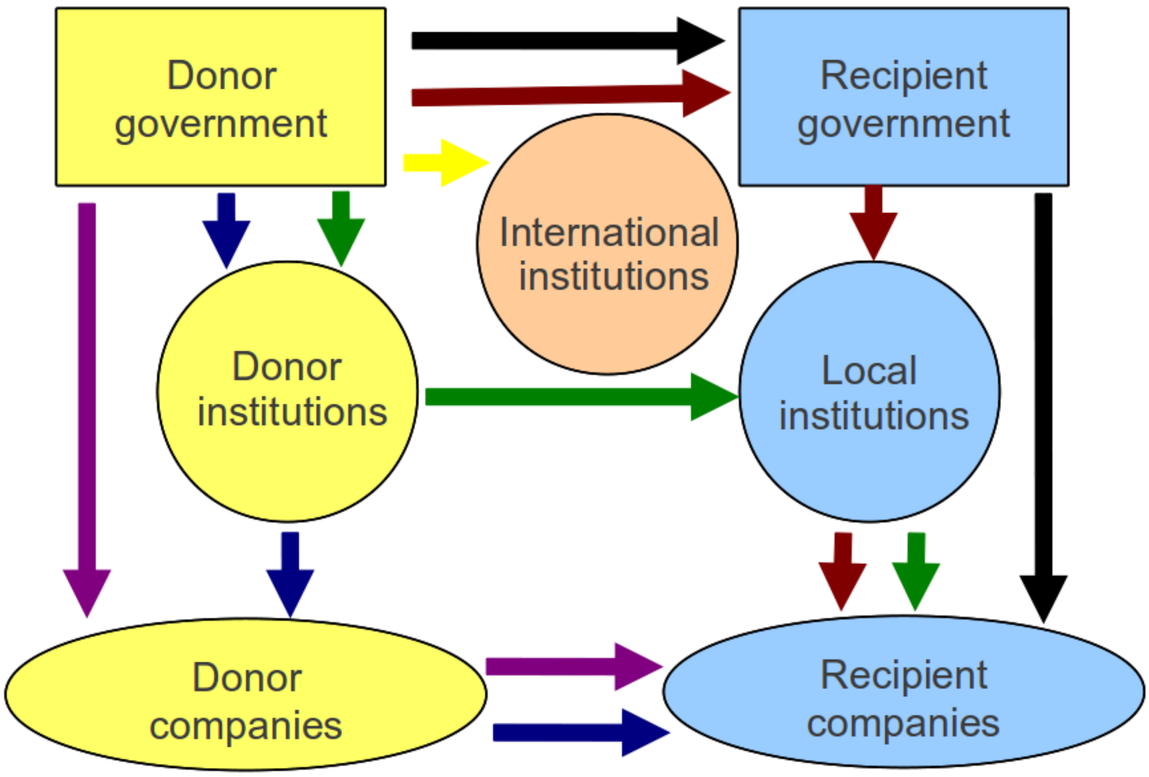
Furthermore, Jimoh [2002, 15] identifies three PSD instruments that benefit recipient enterprises indirectly, namely investment support programs, business partnership programs and mixed credit programs (i.e. measures including the transfer of knowledge but with a clear priority on finance). Jimoh concludes that it is necessary to improve the transfer of knowledge and technology even within the framework of finance-focused policies, as recipient countries often lack the know-how to implement the policies correctly. Also, there seem to be problems with the flow of information, with the result that the PSD instruments at times do not fit the recipient enterprises' needs [ibid, 18ff].

As a matter of fact, most ongoing PSD programs state knowledge transfer and close cooperation with partner countries as top priorities. For instance, DfID says it wants to ensure a positive impact of its PSD programs in three ways: firstly by cooperating with international and national (local) companies; secondly, by acting in concert with the partner countries' governments and with international organizations so as to create a fertile environment for the private sector; and thirdly, by investing in research and knowledge management so as to be able to back the private sector [DfID 2008, 5]. PSD is a priority in German development co-operation, too. The responsible ministry BMZ describes cooperating with private businesses as a key strategy in its policies [BMZ: web].

An instrument that is often associated with PSD but that has to be separated from it analytically are Public Private Partnerships (PPPs). This concept refers to the cooperation between governments and private businesses in individual projects with the goal of providing public services (road constructions, water service etc). Clear definitions are scarce, but generally the notion PPP describes a joint venture, a structure, a contract or a business relation that tie the public and the private sector into a common organizational structure [Weber 2004, 7].

The critical difference between PPPs and PSD is that while the primary goal of the latter is fostering the private sector, the former aims at supplying specific services to the local population. This does not necessarily involve partnerships with local companies. However, in the course of this study it became clear that this differentiation sometimes is blurred on empirical grounds: Germany, for instance, sees its PPP projects as part of its PSD strategy. As PPPs are only of minor importance in the context of DEG, FMO, Norfund and CDC, a separation does not produce additional insights with regard to the research question, we will not sharply differentiate between the two concepts in the empirical part of this paper.

Figure 2: Channels of micro level PSD, based on Jimoh [2002]



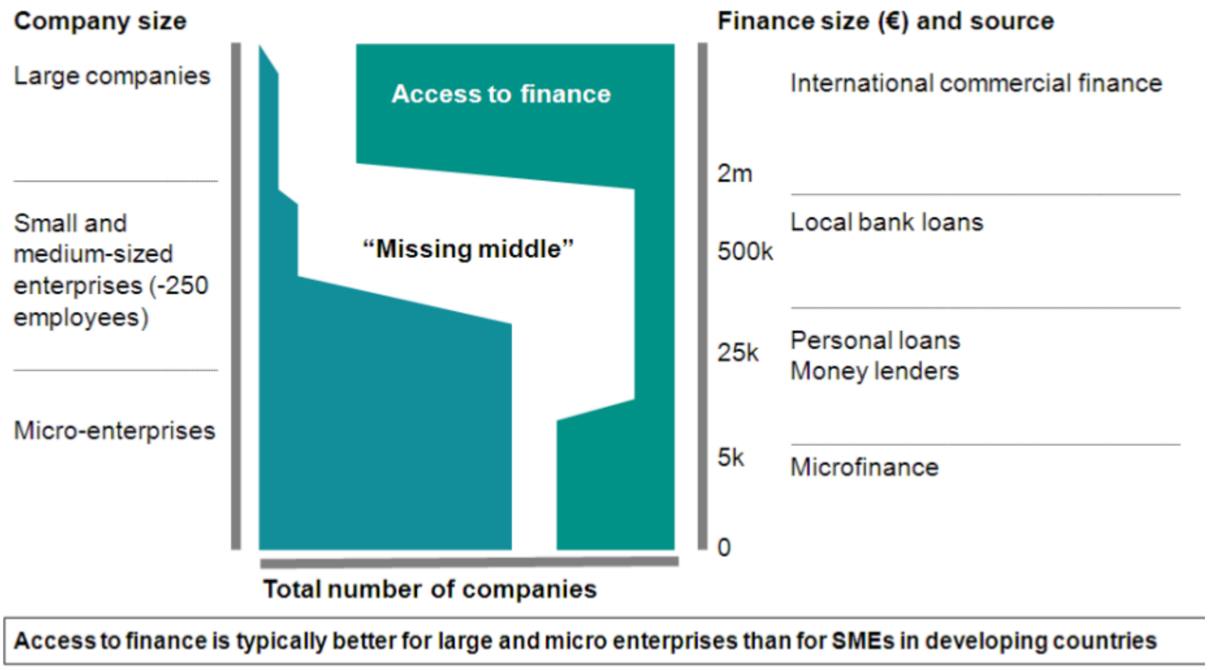
When looking at the micro level, there again are various forms to reach the recipient companies. Jimoh [2002, 2ff] identifies different ways to officially promote PSD on the micro level (see figure 2). It is important to note that by donor and local institutions, Jimoh mainly means NGOs; this definition does not seem helpful for the sake of our study, therefore we include on the donor side implementing organizations and on the recipient side local, regional and supra-regional funds. Furthermore it has to be stressed that there is no such thing as a *perfect* promotion channel; but rather that each channel has its advantages and disadvantages. For instance, there is a trade-off between the negative and the positive effects of employing intermediate institutions. On the one hand, specialized local institutions might have a better knowledge of the regional market and a more trustful access to recipient enterprises; on the other hand, each additional institution means additional costs and an increasing loss of control over the appropriate use of funds. In that respect, it is necessary to look for the most suitable promotion channel for each single policy. By establishing bilateral development finance institutions, the governments of Germany, the Netherlands, Norway and the United Kingdom have decided to employ highly specialized implementing agencies; those, in turn, support recipient enterprises both directly and indirectly via local institutions or companies in donor countries.

From the DFIs' perspective, the functional chain of PSD is characterized as follows:

„By investing in the private sector companies can grow. Companies that grow create jobs. People with steady job create a middle-class which is important for political stability. Companies and people pay taxes which can be invested for instance in infrastructure, education and health – all of which leads to lasting self sufficiency" (FMO corporate movie).

This sequence corresponds in essence to the basic PSD assumptions. Thus, essentially the line of argument employed by European DFIs matches to the consensus described above. In a first step, the strong correlation between economic growth and poverty reduction is stressed. Subsequently, it is argued that private investment has stronger growth effects than public investments. Thus, a flourishing private sector is seen as a motor for both economic and social development. The basic impediment for this process is restricted access to capital for companies from developing and emerging countries. Here, the DFIs enter the scene by providing finance for enterprises and projects lacking access to private capital. This mechanism is described as „Development finance for the missing middle“ [Dalberg 2010, 10f], meaning that small and medium-sized enterprises (SMEs) are hindered in their access to investment capital: While micro enterprises can turn to specialized micro finance institutions and large scale enterprises to international commercial banks, SMEs often fall by the wayside as funding them is usually considered risky and cost-intensive. Figure 3 graphically illustrates this argument.

Figure 3: The „missing middle“ [Dalberg 2009, 7]



In her book *Money and Power* Sarah Bracking [2009] comes to very different conclusions. In her eyes, DFIs are not the solution but rather the cause of the described *missing middle* problem. Bracking argues that the concentration of bi- and multilateral DFIs on big, profitable businesses in developing and emerging countries constrains the evolution of medium-sized enterprises. This creates a gap between a few big enterprises that control the economies (for instance in Africa), and a myriad of small and micro enterprises hat are trapped in the informal sector. The bottom line of Bracking's criticism is that PSD as currently undertaken by DFIs exacerbates existing problems rather than alleviating them [Bracking 2009, 158].

The central question arising against this background thus is whether PSD is per se beneficial for a country's socioeconomic development or whether adequate accompanying measures have to be taken so as to prevent existing imbalances to aggravate. According to Schulpen/Gibbon [2002, 12f], PSD interventions have to satisfy five requirements in order to make the grade:

a) PSD instruments have to be aligned more carefully with the core aims of development cooperation. It is not sufficient to just theoretically formulate a link between PSD and poverty reduction.

b) Existing implementing organizations have to be better integrated into the institutional structure so as to avoid incoherences.

c) Western business interests have to be banned from PSD programs as they might result in the selection of partner countries, sectors and companies by the commercial (and strategic) interests of donors.

d) PSD programs should focus less on financing and technical knowledge transfer and more on fostering the build-up of essential institutions capable of effectively regulating the private sector.

e) Individual country programs have to look deeper into the local circumstances (risks, potentials, dynamics). The current „one size fits all" approach does not respond to the pending challenges.

2.4.2. The Downside of Private Sector Development

Many researchers doubt the straightforward relation between economic growth (via private sector development) and poverty reduction (constituting a cardinal goal of development finance):

„Strong criticisms on the MDBs' [multilateral development banks] investment in private sector projects have been widely raised for their lack of direct, measurable benefits on development and poverty reduction, as well as problems around adverse social and environmental impacts of the funded projects" [Widadgo 2000, 1].

Some prerequisites have to be met in order for PSD to be a promising approach, most notably (i) proper institutional and legal foundations, (ii) privatizations, (iii) developed national capital markets, and (iv) the availability of capital [Stern 1997, 3]. Developing countries need a legal framework that can support and stabilize the private sector. For instance, national constitutions and statutory provisions have to permit privatizations and protect foreign investor's interests with regard to property rights and insolvency proceedings. Yet very often those legal foundations were set up within a very short period of time, which give enterprises ample leeway. Along with the set-up of the legal framework, the practical implementation of the rules has to be guaranteed and protected, since the implementation process has often turned out to be the decisive and most challenging factor. Therefore, an efficient judicial system is indispensable.

Privatizations can be seen as a further requirement for PSD, as in many developing countries the private sector is small. However, many of the privatizations carried out over the past 20 years have caused diverse problems, and the economic success was often limited as benefits were in many cases reaped by national elites. On these grounds the economic effects of privatizations are meanwhile looked at in a more nuanced way. To give an example, Hall and Lobina [2006] show that privatizing water supply services does not contribute to the MDGs[3] but rather deteriorates the situation.

Another negative aspect of this trend is the fact that developing countries have seen many pseudo-privatizations involving a clear growth in corruption and the further enrichment of the elites [Frankel 2005, 187]. Despite these experiences, many international organizations have supported the dismantling of the public sector and the simultaneous surge in privatizations.

3 MDG target 7C: to halve the proportion of the population without sustainable access to safe drinking water and basic sanitation

However, the negative consequences of privatizations have led to a wave of re-nationalizations of privatized companies, particularly in Latin America. In those countries, privatizations and PSD are today oftentimes looked at very critically (see, for instance, the re-nationalization of public services in Bolivia and Argentina).

A further prerequisite for PSD is the availability of capital. Most commercial banks do not provide investment capital for developing countries. Thus it is left to foreign direct investment to fill the resulting gap. In addition to national there are also international requirements concerning international trade and investment, for instance regulations enforced by the WTO [Schulpen/Gibbon 2002, 2]. It is important to see, however, that PSD postulates the existence of a functioning market – yet as can be learned from the current financial crisis such markets often do not exist. Furthermore one should not disregard the fact that via PSD many donor countries exert substantial influence on the recipient countries' legal and institutional structures.

To sum it up, it is difficult to make generalizations about PSD as it can take place via many different channels. Firstly, the financing can run from donor country or donor organization to the recipient government which in turn fosters the build-up of the private sector. This process can founder on corruption and thus might bring little success. Secondly, PSD can also work without the recipient country's government, i.e. the financing goes through NGOs and private enterprises [Jimoh 2002, 4-11]. However, here as well problems of transparency and corruption might emerge, and the question of these programs' developmental impacts arises. Thus, the fact that it is not only the legal and institutional prerequisites that have to be looked at but also the financing channels, makes the problems of this form of development finance obvious.

The „Private Sector Development Strategy" published by the World Bank is a key document on the issue. The paper describes the current discourse of the Bretton Woods Institutions and is the basis of the World Bank group's PSD strategy. It depicts PSD as an effective instrument for reducing poverty via the stimulation of economic growth; the result is a higher standard and quality of living for the local population [Weltbank 2002, i]. However, the document emphasizes that one should not exclusively expedite privatizations but that governments play an important role. Notwithstanding this assertion, the strategy mainly deals with the legal and institutional prerequisites for PSD. The concept remains rather vague, though, and demonstrates that the strategy's focus lies on providing the best possible conditions for private investors and on increasing the influence of private business interests on national development strategies, while many other important aspects of PSD are neglected [Küblböck 2004, 13]. For example, it is not discussed how one can assure positive developmental effects of foreign direct investments, and considerations regarding the political, social and cultural embedding are lacking. Küblböck proposes the employment of local key personnel non-preferential treatment in tax matters, the use of inputs from local enterprises, as well as safeguarding environmental and social standards.

An important issue within the field of development finance is whether PSD programs are coherent with other development policy measures. Proponents of PSD see the poverty reducing effect of PSD via induced economic growth as a proof for coherence. Opponents underline overwhelming negative effects and see a lack of coherence [Schulpen/Gibbon 2002, 9]. An important aspect in this respect are market liberalizations that are a prerequisite for PSD: while most programs (implicitly or explicitly) ask developing countries to substantially liberalize their markets for foreign products, market liberalizations by donor countries remain limited [Schulpen/Gibbon 2002, 10f].

All told, whether or not PSD is an effective instrument for stimulating development is not clear from a theoretical perspective and can thus only be an answered empirically. All the more astonishing is the fact that there are hardly any large-scale studies evaluating PSD programs. So far, the big players (e.g. the World Bank) have only evaluated very few and rather small projects [McKenzie 2009], concluding that the programs are successful – yet that there are some problems. There are practically no independent large-scale studies. Hence, a lot of research still has to be done in this area.

2.4.3. The European Development Finance Institutions (EDFI)

DEG, FMO, Norfund and CDC all are members of the Association of European Development Finance Institutions (EDFI), a group of fifteen bilateral development finance institutions founded in 1992 in Brussels. Most members are under state control and operate on a commercial basis [EDFI 2006, 1]. The cumulative EDFI portfolio currently sums up to EUR 21.7 billion and to about 4,000 projects in developing and emerging countries; commitments in 2010 amounted to EUR 4.7 billion [EDFI: web].

The association's principal objectives are to promote PSD and a better cooperation between the DFIs, and to connect with the European Union (in particular with the European Commission and the European Investment Bank). The network is intended to help harmonizing environmental and social standards (as envisioned at the conferences of Paris and Accra), and some improvements have already been achieved in this area, helping clients to collaborate with several European DFIs at the same time. With harmonizations in place, a client only has to deal with the rules of a single financier and thus saves time and transaction costs. A further step towards harmonization was taken in May 2009 when the EDFI members signed a declaration concerning responsible investment, proclaiming in essence that all investments have to respect human rights and the environment. Furthermore, there are agreements on investment black lists, on common definitions of ecological and social categories, on due diligence mechanisms as well as on the monitoring of these conventions. EDFI here draws upon the UN declaration of Human Rights, the ILO Core Conventions and the IFC Performance Standards on Economic and Social Sustainability (including the corresponding guidelines on health and safety) [EDFI 2009].

Apart from networking and the promotion of harmonizations the association also wants to foster the exchange of information and the learning from each other [interview IL]. For instance, a number of EDFIs utilize the *Geschäftspolitisches Ratingtool* (GPR) developed by DEG. This facilitates the comparison of overall economic and developmental effects of projects.

Last but not least, EDFI lobbies for the DFIs at the European level: EDFI's office is located in Brussels and is endowed with 1.5 full-time positions [interview IL].

Assessing the importance of the EDFI group as an autonomous player in the field of development finance is ambiguous. On the one hand, there are efforts of alignment between the single DFIs, and this process is coordinated by the association. Harmonized standards could definitely change the project selection process of individual DFIs. On the other hand, the group was founded only relatively recently and by DFIs that were already well-established. In this respect, an influence on the founding procedures of new DFIs and on the formulation of basic principles of already existing DFIs seems unlikely. Also, the association's resources are very limited (only 1.5 full-time positions), which also points towards minor significance.

Table 1: The European Development Finance Institutions (EDFI)

Name	Country	Name	Country
BIO	Belgium	CDC	United Kingdom
COFIDES	Spain	DEG	Germany
Finnfund	Finland	FMO	Netherlands
IFU/IØ	Denmark	Norfund	Norway
OeEB	Austria	PROPARCO	France
SBI/BMI	Belgium	Sifem	Switzerland
SIMEST	Italy	SOFID	Portugal
Swedfund	Sweden		

2.4.4. Introducing the investigated DFIs

DEG – Deutsche Investitions- und Entwicklungsgesellschaft

On September 14, 1962, the Federal Republic of Germany launched the Deutsche Gesellschaft für wirtschaftliche Zusammenarbeit/Deutsche Entwicklungsgesellschaft, today operating as Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG). Its initial objective was the promotion of West German companies' investments [Hein 2006, 47], yet the aims have changed over the years. Today, DEG also assists foreign companies, and the main objective is the promotion of the private sector in developing and emerging countries, thereby contributing to sustainable growth and subsequently to an improvement in local living conditions [DEG: web].

For most of its history DEG was owned by the state, only in 2001 it was sold to KfW Bankengruppe. Public influence however, is still present, as KfW's shareholders are the German federation (80%) and the German Länder (20%). DEG receives hardly any public funds but rather operates with its own equity capital and at its own risk [interview HT].

DEG's headquarter is located in Cologne with a staff of around 400 persons; additionally it maintains several representative offices in priority countries. Its equity capital amounts to EUR 1.34 billion, its portfolio to EUR 4.7 billion. New commitments continuously increased up to 2008 when they reached EUR 1.2 billion (comparing to 464 millions in 2002); in 2009 they decreased slightly [DEG: web].

Investment instruments include different forms of equity capital, mezzanine finance, credits and investment guarantees. The most important instrument by volume are credits. Instead of pursuing a specific sector strategy DEG is open for investment cooperations in nearly all economic sectors as DEG asserts that all sectors are necessary for successful development [interview TK]. There are, however, certain focus sectors, namely agriculture, infrastructure, manufacturing and the financial sector [DEG: web].

The current portfolio includes 512 companies in 84 partner countries [DEG 2009, 4]. There are no guidelines regulating which proportion of the funds has to be invested in high-risk/low-income countries, so that the current ratio of 40% is more of a „coincidence" than planned. Generally DEG wants to orientate itself towards BMZ's country strategy (i.e. focus on Africa). Yet as it is bound to its private investment partner's preferences, it is not entirely free to choose the regional distribution of its funds [interview HT].

For the selection of new projects DEG has developed its own rating tool. The latter evaluates projects by awarding points with regard to development impact and commercial categories. The tool called *Geschäftspolitisches Projektrating* (GPR) is popular with other DFIs as well: several European DFIs, amongst them the Austrian OeEB, have adopted it (in slightly modified ways).

FMO

The Dutch development bank was founded in 1970 and is called *Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.* (Netherlands Development Finance Company – FMO). Since 1977 the finance ministry of the Netherlands owns 51% of the limited liability company; further shareholders include private banks (42%), employer associations, trade unions, and individual investors [FMO Web; FMO 2010, 5]. FMO has its office in Den Haag. Contrary to most other EDFIs FMO has a banking license that it obtained in March 2008.

FMO states as its principal goal the promotion of entrepreneurship in emerging economies, by which it aims at fostering sustainable development. Its core business is the promotion of the financial sector in developing and emerging countries, focusing on relatively risky long-term financing. Financial products include credits and guarantees as well as equity investments and syndicated loans [FMO: web]. FMO has two sources of funds for new investments: 82% of its portfolio is financed with its own funds and at its own risk (called FMO-A); the remaining 18% are taken from Government funds. FMO is one of the biggest bilateral DFIs, reflected in an investment portfolio of almost EUR 4.6 billion (2009); the portfolio had increased by almost 10% compared to the preceding year (it amounted to EUR 4.2 billion in 2008). Against the background of the world financial crisis, this increase is seen as a success, notwithstanding the fact that growth rates had amounted to more than 20% in 2007 and 2008. In absolute terms, the sum of new investments in 2009 was EUR 911 million, which means a fall of EUR 400 million compared to the year 2008.

FMO's strategy for the years 2009-2012 is based on two pillars [FMO 2008, 17]:

1. Sector strategy: a stronger focus on finance, energy and housing
2. Country strategy: a stronger focus on low and lower-middle income countries

For selecting investment projects, FMO has developed its own ratingtool, the Scorecard Model, the latter being similar to IFC's rating tool.

CDC

CDC group plc is 100% owned by the Department for International Development (DfID), the UKs development ministry and structured as a fund of funds; the direct investment arm was spun off some years ago. In contrast to other European DFIs, CDC thus does not directly provide finance for projects in developing countries, but rather invests only in funds which, in turn, invest in individual projects or companies [interview RL]. It is argued that this is particularly valuable for development policy as it is the most efficient form to attract additional private capital [interview SP]. CDC looks back at a long history. It was founded in 1948 and has modified its mission various times since then. The current mission dates back to 2004 when CDC was restructured and is defined as follows: „Our mission is to generate wealth, broadly shared, in emerging markets, particularly in poorer countries, by providing capital for investment in sustainable and responsibly managed private sector businesses“ [CDC 2008, cover page].

CDC currently employs around 45 people, all of them in its London office. In the course of the past years it has lost a huge part of its staff, on the one hand due to lay-offs and retirements, on the other hand because the now spun-off funds managers Actis, Aureos and Globeleq have taken over large parts of the operative business. In 2000, 664 persons had worked for CDC, in 2003 only 241 were left; the majority was transferred to Actis in 2004 [Brain/Cable 2008, 191]. CDC's portfolio in 2009 was BP 1.3 billion, new commitments amounted to 360 million [CDC 2009].

CDC asserts that enterprises of all sizes and operating in all sectors are necessary for sustainable development. Therefore, CDC provides financing for all sectors (with a focus on finance that accounts for 20% of the portfolio). In contrast, CDC follows a country strategy specified by DfID. The ministry revises these guidelines every five years. From 2004 to 2008, 50% of CDC's new investment had to go to sub-Saharan Africa, 70% to the „poorest countries" (with a GDP per capita of under 1750 USD in 2001). In order to assure that CDC is more active in the poorest countries where a lack of capital is a serious impediment to growth, guidelines were made more strict in 2009: since then, 75% of new investments have to go to countries with a GDP per capita of less than 905 USD in 2006 (the 50% mark for sub-Saharan Africa stays the same).

For selecting investment projects, CDC does not use a standardized rating tool; it does use a rating tool for ex post project evaluations, which is however clearly focusing on qualitative aspects.

Norfund

Norfund (Norwegian Investment Fund for Developing Countries) is owned by the Norwegian government (more exactly, by the foreign ministry). Compared to FMO, DEG and CDC, Norfund is relatively young: it was founded only in 1997, at the beginning with a mandate to promote exports. This has changed, so that the involvement of Norwegian companies in all of Norfund's projects is not necessary any more. A flourishing private sector is seen as crucial for economic development; by fostering PSD Norfund aims of reducing poverty.

FMO maintains a headquarter in Oslo, representative offices in Johannesburg, Nairobi and San José (Costa Rica) and has a staff of around 45 people. By the end of 2009, Norfund's portfolio amounted to NOK 5.3 billion (EUR 670 million). New investments added up to NOK 944 million (EUR 120 million), of which 28% went to sub-Saharan Africa.

Norfund's focus regions are Southern and Eastern Africa, Central America and several Southeast Asian countries (Bangladesh, Laos, Cambodia, Vietnam). Its investment decisions are based on four pillars: the build-up of infrastructure, investments in SMEs (mainly via SME funds), development of energy supply systems (mainly via investments in renewable energies), and industrial partnerships (i.e. capital for projects with particularly strong development impacts). For selecting its projects, Norfund does not use a rating tool; for evaluating projects, it uses an instrument based on DEG's GPR.

3. Results of the Study

3.1. Overview

The following table summarizes the findings of the four case studies of DEG, CDC, Norfund and FMO. The latter are compared along several dimensions. The analysis is based on field work, analysis of documents and expert interviews.

Dimension	DEG	CDC	Norfund	FMO
Policy field	Development policy is only of minor importance in German politics. PSD has entered the field in the 1990ies but still is a side issue.	Importance and institutional importance depend heavily on the governing party. PSD is an important concept.	Norway is one of the most important donor countries; its high ODA is based on a general consensus about the policy field's importance. PSD is of minor but growing importance.	The Netherlands traditionally see themselves as a generous donor country. Many of the PSD instruments established in the 1990ies are aimed at promoting Dutch companies.
Organization and business principles	DEG is organized as a limited liability company (GmbH) and is owned by KfW since 2002. It refers to itself as an institution serving the public good by focusing more on development policy than on commercial interests. Its main mandate is the long-term financing of private sector projects in developing countries; these operations have to be self-sustaining.	CDC plc is a fund of funds subordinated to the DfID. Its direct investment arm was privatized and spun off. Achieving high rates of return is the central aim of its operations, as it is assumed that a high RoR equals a good development impact.	Norfund is a hybrid organization with both a public mandate and commercial goals. Norfund is owned by the Norwegian government (foreign ministry) and provided with capital by its owner. Norfund's mandate is regulated by law and aims at additionality, thus reducing poverty and maximizing its profits at the same time.	FMO is a private company; its main stakeholder is the state (51%), further shares are owned by big banks (42%), employer organizations, trade unions and individual investors. FMO provides finance for private sector projects in developing countries, aspiring to both development impacts and profitability.
Investment policies	Promoting the private sector is crucial for development. For this reason DEG provides capital at market conditions, usually in cooperation with other financiers.	As successful companies are the key to development CDC equates developmental effects with profitability. Being a fund of funds CDC does not finance projects directly.	The development of the private sector is essential for economic development. Norfund always cooperates with financial partners and never provides more than 50% of total project funding.	FMO is persuaded that fostering the private sector is the most sustainable way to fight poverty. The bank mostly works at its own risk, but several cooperations with different ministries allow to take higher risks.

Dimension	DEG	CDC	Norfund	FMO
Project selection	DEG neither has a specific sector nor country strategy. Export promotion has a minor role for historic reasons. Projects are selected via a standardized procedure.	DfID prescribes a country strategy, but there are no sector guidelines. Export promotion is not an issue. Projects (funds) are selected without a standardized tool but after an individual, qualitative assessment.	In Norfund's first years of existence (from 1997) involving Norwegian companies was central for the choice of projects. However today export promotion is no object anymore; now Norfund pursues a country strategy (South- and East Africa, Central America, Southeast Asia) as well as a sector strategy (renewable energies, finance, other direct investments).	FMO has three clear focus sectors (finance, energy, housing). Export promotion plays a minor role (2-2.5% of the portfolio). FMO has developed a special tool for selecting its projects.
Rating tool	DEG has developed its own quantitative rating tool (Geschäftspolitisches Projektrating, GPR) which it uses for selecting, monitoring and evaluating its projects. The tool assesses four dimensions (long term profitability, development effects, special role of DEG, return on equity). Advantages are comparability of the projects and the wide field of application, major disadvantages are the delusion of objectivity (when assessments actually are subjective) and the required resources.	CDC uses a qualitative rating tool based on IFC's DOTS system for monitoring its projects. The two areas assessed are „development outcome" and „CDC effectiveness". Major advantage is the low resource intensity, major disadvantages are the minor importance of development effects (or the strong focus on financial and management ratios) and the superficial, in-transparent appraisal.	Norfund does not have its own rating tool. Internally a modified version of GPR is used. Individual projects are evaluated along several dimensions (anti-corruption, employment, good governance, demonstration effects, diversification, exports, promotion of women, equal opportunities, HIV/AIDS, infrastructure, capacity, CO^2-reduction, taxes, subcontractors. technology, training, competition). A disadvantage is the minor importance of qualitative assessments.	FMO developed a rating tool called Scorecard that looks at three dimensions: (1) Company Risk, (2) Development Impact, and (3) Facility Risk. As various impact indicators are used it is possible to get a detailed picture of potential positive and negative effects. The appraisals tend to avoid high financial risks.

Dimension	DEG	CDC	Norfund	FMO
Stakeholders	BMZ is chairing the supervisory board. While one NGO is member of this board, NGOs generally do not deal a lot with DEG – and vice versa. DEG is not directly accountable to the parliament and widely unknown to the general public. The affected local population is usually not involved in the projects; local NGOs' impulses possibly are.	Despite being the owner, DfID does not intervene in CDC's operative business but takes only strategic decisions. CDC is not directly responsible to the parliament. NGOs' influence is very small, and CDC feels they often misunderstand its operations. CDC is hardly known to the general public; it was in the media for a short time for its high executive salaries. The local population does not play any role.	The foreign ministry only prescribes the general strategy (there are quarterly consultations). Investment decisions are taken by the board. Due to a series of negative headlines Norfund is now more present in the public discussion. There are no regular and institutionalized consultations with other stakeholders.	The most important stakeholder is the DGIS (Netherlands Directorate-General for International Cooperation), associated with the foreign ministry. However, there is no government representative in the supervisory board, but many representatives of the Dutch private sector (esp. banks). NGOs are not very interested in FMO's activities.
Evaluation and monitoring	Projects are evaluated biennially by means of the GPR. There are no external evaluations on a regular basis.	CDC evaluates its projects quinquennially; additionally it prepares semiannual shortreports. There are no regular external evaluations.	The GPR is used for internal project monitoring and ex-post evaluations. Investment proposals, however, are not rated with the GPR. Norfund is audited by the national audit office at irregular intervals. Since 2008, parts of Norfund's operations are subject to the Public Disclosure Act.	Since 2001 projects are evaluated by an internal evaluation department with a standardized procedure. Quinquennially, the bank is evaluated externally (by a private enterprise on behalf of the government).
Additionality and Catalytic Effects	DEG wants to invest in regions and sectors short of private investors; at the same time, it wants to mobilize additional private capital. Empirically, these goals do not always seem to be accomplished (example: Hilton hotel in Hanoi).	CDC wants to attract third party capital and to show to private investors that it is possible to make profits in areas they are not yet active in. However, critics claim that CDC behaves just like any private investor and does not take additionality and demonstration effects into account.	Additionality and catalytic effects are said to be crucial principles; also, Norfund wants to make sure not to crowd out private investors. Nevertheless, critics point towards Norfund's risk aversion and its focus on profitability.	Additionality is a core principle for FMO. Interviews have let to the supposition, that additionality is sometimes outranked by the avoidance of risks.

Dimension	DEG	CDC	Norfund	FMO
Risk mitigation	With its involvement, DEG wants to lower private investor's perception of risk, as it keeps to its commitments in times of crisis. Empirically, this seems to work in many cases.	CDC says it wants to lower private investor's perception of risks. However, there are doubts about such an effect as CDC avoids high risk investments and mostly invests in already established, commercial funds.	Theoretically Norfund wants to accept higher risks than private investors and thus act as a catalyst for additional private capital and expertise. Empirically it is hard to measure let alone affirm these effects.	FMO often is initiator or part of big financial syndicates that also include private banks. Frequently, FMO accepts the highest risks so as to attract more private capital. However, the vast number of private investors could also be an indicator for minor additionality.
Developmental impacts	DEG's development impact arises from PSD effects and from including developmental benchmarks in the rating tool. However, impacts are partly controversial (for instance there have been discussions about the negative consequences of a soybean cultivation project).	CDC believes that investing in developing countries per se contributes to poverty reduction; it is not necessary to take additional measures. NGOs criticize that some of CDC's projects even have adverse effects (for instance, discussion about CDC financed privatization of electricity supply in Africa).	Developmental impact is assessed via tax revenues, employment, and profits generated. Those values, however, are not related to the investment volume. Since 2007, Norfund publishes a separate development impact report.	In FMO's eyes only financially stable projects can contribute to economic growth and social development. The bank often equates development with economic growth, thus developmental impacts are implied in financially successful projects.
Transparency	DEG regards itself as very transparent but is perceived otherwise by some stakeholders. DEG argues that it can provide information only up to a certain degree because it is subject to banking confidentiality.	Although CDC's policy commits it to transparency and accountability, it is even hard for its owner DfID to get detailed information on a project. This is due to the complex structure of CDC's investments and to confidentiality of the data.	Norfund justifies its partly in-transparency with safeguarding commercial interests (of itself and of co-investors). Disclosure is only possible with the agreement of its commercial partners. Even Norfund's owner criticizes a lack of transparency.	FMO regards itself as highly transparent, pointing to the supervisory board's composition (employers and employees associations, environmental expert). However, FMO does not disclose detailed information about individual projects due to secrecy obligations.

3.2. Comparative Conclusions

In the following comparative conclusions from the case studies by Schaefer (2010), Gütermann (2011), and Gössinger/Hammler (2010) are presented in detail.

3.2.1. Development Policy Background

Conclusion 1: There is no causal relationship between the institutional structure and the policy field's quantitative importance.

While Norway and the Netherlands do not feature an independent ministry for development they have high ODA ratios (1.06% and 0.82%, respectively). In the United Kingdom and in Germany, the situation is inverse (independent ministries, but ODA ratios of only 0.52% and 0.35%, respectively).

Conclusion 2: Within the policy field, PSD has gained importance in all countries.

Development finance institutions play a crucial role in implementing PSD in all analyzed countries. FMO is a good example for the increase of PSD's importance: The DFI's financial and institutional reorganization in the beginning of the 1990ies coincides with the emergence of the concept PSD. Thus, the strategic orientation of the 1991 service contract between FMO and the Dutch state has to be seen in the light of this trend. Both the government allowances for FMO's equity capital and the DFI's increased functional autonomy (less government influence) can be seen as evidence for FMO's new role as an implementing organization for PSD. Concentration on the financial sector induced a phase of rapid growth from the beginning of the 1990ies (in particular with regard to investment volumes)[4]. Thus, FMO's institutional development in the past 15 to 20 years was highly linked to the international development discourse. Leading this process were once more – the BWIs, here especially the International Finance Corporation (IFC). The latter's publications were often taken up by the strategy papers of national ministries or by advisory boards [see e.g. the AIV report on PSD, AIV 2003].

While market liberal policies dominated British politics throughout the 20th century, PSD has been on the political agenda only since the 1990ies. Although, the United Kingdom had had its own institution for promoting the private sector, the CDC, since the 1960ies, its mandate and operations have changed substantially over the years. Its mandate has not always been PSD in the current sense. Only when finally the plan evolved to establish PSD as a distinct instrument of development policy, the British government gave this new role to CDC. In the late 1990ies, ambitions for autonomy and privatization gained ground in the institution. New Labour supported these efforts and therefore pressed for a higher profitability as a precondition. In the end CDC was not sold. It was only in 2004 when a part of the institution (the direct investment arm) was finally privatized, yet the DFI itself remained under public ownership.

Similarly, Germany has had a bilateral development institution for a long time. As in the case of the United Kingdom, this does not necessarily prove an early focus on PSD, as DEG's mandate has changed over time, too. In the early years of DEG's existence, the emerging field of development politics was exploited for economic purposes, and foreign trade interests were considered as being compatible with development policy interests [Nohlen 2002, 236f]. Today, foreign trade promotion is not in the foreground anymore.

In general, all four analyzed DFIs regard IFC (the World Bank's private sector arm) as an important point of reference for their work.

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4 Two figures to illustrate this point: In the first 25 years of its existence (1970-1995), FMO's cumulative investment amounted to EUR 1.1 billion. This compares to new commitments of EUR 1.3 billion only in 2007 [FMO web].

Conclusion 3: PSD is only insufficiently embedded into the prescriptive framework of development policy.

Another possibility to assess PSD's importance within the policy field and to evaluate the DFI's role is to analyze whether the DFI's PSD promotion is coherent with overall development politics in Germany, the Netherlands, Norway and the United Kingdom (consult the individual diploma theses for a more elaborate discussion on coherence). Our studies show considerable incoherences in all analyzed countries.

Generally, an orientation towards PSD can be found in all countries (Germany, Netherlands, United Kingdom, Norway) in overall development cooperation, as private economic processes become more and more important in other development policy areas as well (e.g. micro credit projects in order to empower women, fair trade). However, our study shows that PSD is not an unambiguous, clearly defined concept and that thus the four analyzed DFIs differ greatly in their approaches as well as their performance.

British development assistance has focused on poverty reduction for some years. Yet, while literature suggests that SMEs play a central role in economic development processes and in mitigating poverty [e.g. Todaro/Smith 2006], CDC's funds mainly flow to big, partly even internationally active enterprises. Furthermore, there are even cases where not only coherence is lacking but CDC's activities even seem to counteract DfID's goals. This is for instance true for projects where the privatization of basic services marginalizes poor people, or where investing in off-shore funds deprives governments of much needed tax revenues. Therefore, despite DfID's strong business focus, coherence between CDC and DFID seems to be lacking.

Internal incoherences can also be found between DEG's operations and BMZ's policies. For instance, NGOs keep reporting time and again that some of DEG's projects harm the environment or local communities. Nevertheless, a relatively close cooperation with BMZ at the management level as well as the consultation of other ministries improves coherence, and so does the dialogue with NGOs. Hence, from this perspective it seems reasonable to include different stakeholders.

Conclusion 4: All analyzed DFIs can be characterized as hybrid players, operating in the area of tension between the development mandate of the government and their commercial business model.

The four DFIs have a public mandate to promote development policy, yet they are organized as private corporations and pursue commercial and profitability goals. The institutions do not see a strong trade-off between these goals, as their operations are based on the conviction that fostering the private sector is the most effective and efficient way to fight poverty. Economic growth is seen as prerequisite for sustainable development and for poverty reduction. For example, FMO describes the function of the private sector as follows:

„A flourishing private sector provides work and income to many, leads to the development of a stabilizing middle class, and provides a tax base that enables governments to attain and maintain adequate levels of spending on sectors like health and education, so that public and private sector development can reinforce each other and economic development becomes self-sustained“ [Stavenuiter 2008, 1].

The lack of developed capital markets is seen as the major impediment for the development of the private sector in developing countries. This is where the development banks come into play: with their investment activities they enhance access to credit and other financial products and services in developing countries, pursuing two guiding principles: „The rationale behind the DFI business model is to be additional and catalytic“ [Dalberg 2009, iii]. Consequently, DFIs look for sectors and regions characterized by a restricted access to financial products and get active only if private investors are missing in cooperation with private investors, they try to mobilize additional private capital.

Thus, the four DFIs can be seen as hybrid players with public and private elements: their organizational form is neither clearly public, nor independent and private. For instance, DEG is owned by KfW which, in turn, is owned by the German Federal State and the German Länder. FMO's shareholders are the state but also private entities; CDC is a public limited company yet owned by DfID. From our interviews the impression emerged that governments do not pay much attention to the DFIs' daily business – for example, hardly any of DfID's employees is concerned with CDC's day to day operations. Arguably supervising and state monitoring an organization, who's activities and internal processes are not well-known to the supervising authority, will prove to be a difficult task.

Thus, in our view it is important to make sure that the state does not withdraw from its responsibility for the operations of DFIs by the use of such hybrid constructions. After all, the development finance institutions are typically public organizations operating with public (seed) capital. Thus they do require public control.

Conclusion 5: Additionality, Catalytic Effects and Good Governance are the core business principles; from these, the DFIs derive their legitimacy.

The most important aim of the DFIs' operations is to achieve additionality, i.e. to get active only in regions and sectors where private investors are missing. Catalytic effects refer to mobilizing additional private capital. This is achieved on the one hand by reducing private investors' share of risk by assuming a major part of total investment risk, and on the other hand by generating demonstration effects. It is very hard to check empirically whether these goals are accomplished, but there is cause for doubts in many cases. For example, all analyzed DFIs exhibit a strong risk aversion in their investment behavior.

In recent years, many DFIs highlight the role of additionality. An example is FMO's 2009-2012 strategy that was presented in response to changing external conditions. As private investors increasingly open up fields that used to be DFIs' spheres of activity (e.g., infrastructure projects, telecommunication, mining,...) they „force" the development banks to look for new challenges[5]. FMO argues that in order to be able to keep acting additionally DFIs have to position themselves more clearly as niche players and penetrate new, unexploited markets. FMO's results for the accounting year 2009 seem to affirm the DFI's efforts: 50% of all new investments were realized in LICs. Despite the economic crisis, FMO was able to enlarge its investment portfolio to EUR 4.6 billion (2008: EUR 4.2 billion) and to make a profit of EUR 60 million [FMO 2010a, 6].

Likewise, implementing DfID's guidelines CDC has also adopted a new country strategy with a stronger focus on the poorest countries. After having made losses in the economic crisis it now once again realizes sizable profits.

A central question in the DFIs' operations concerns the relationship between project risk and expected rate of return, or, in other words, between a project's financial and developmental sustainability. It is important not to forget that DEG, FMO, Norfund and CDC are financial institutions that cannot operate far away from their typical field of activity. It is thus „natural" for banks to pursue commercial interests, i.e. to guide their investment decisions by profitability criteria. Furthermore, it is evident that failing investment projects do not only imperil the DFI's existence but also pay a disservice to its clients and their surroundings (e.g., job losses due to insolvencies, or, more indirectly, via negative demonstration effects). At the same time the question arises how DFIs thus should distinguish themselves from „ordinary" commercial banks in order to fulfill their development policy mandate. Policy principles that

5 This trend was slightly diluted by the global financial crisis.

are formulated by the DFIs themselves or in cooperation with the governments mainly have a theoretical and rhetorical impact; the operational business, however, is characterized by a high degree of risk aversion and differs only marginally from other market participants. This fact is helped by a strong investment volume orientation: a persisting pressure to continuously amplify investment volume and portfolio favors the selection of projects with easily identifiable risks and with little need for intense supervision. In this manner, it is impossible to act as a niche player. In fact what would be necessary is a more focused dedication to selected areas, e.g. to financing start-up enterprises.

The DFIs' risk aversion manifests itself in a strong emphasis on the projects' financial sustainability, when selecting new investment projects. Here a relation with the DFIs' staff becomes evident: Especially CDC seems to lack awareness for developmental effects – and especially CDC's staff comes from the private equity sector and does not have a development policy background. Also, CDC's strong commercial orientation is reflected in its self-perception („we are not civil servants") and in the preference for hiring private consulting firms like McKinsey. These points suggest that commercial targets and the avoidance of financial risks have clear priority. Also within FMO, most staff members are recruited from the finance or banking sector. Once an investment is approved, ongoing monitoring predominantly concerns financial indicators. The projects' development effects, in contrast, are usually only evaluated in the course of ex-post project evaluation.

Conclusion 6: From the perspective of the DFIs, only financially successful projects can contribute to economic growth and development.

Typically, DFIs equate economic growth with development. For this reason, development effects are implied in financially successful projects. DEG, FMO and Norfund argue that their investments also generate further development effects (e.g., women's equality, education, empowerment,...). The performance in these areas, however, is partly disputable.

From the DFIs' perspective, each additional Euro or Dollar invested implies an additional development effect. The investment sum is therefore an important indicator both in the development banks' external communication and as an internal benchmark for its staff.

Outside of the DFIs, opinions sometimes differ: For example, even the Dutch foreign ministry criticized the Development Impact Indicator used by FMO since 2005 because of its strong quantitative focus and the importance it attaches to the investment volume. As a consequence, in the course of formulating FMO's new strategy the Development Effectiveness Framework (DEF) was designed and is now an integral part of the scorecard methodology. By including economic, ecological and social effects and by evaluating its own role (in the implementation of its investments), FMO tries to get a more detailed picture of its development impact. In this context, the DEF's approach, not to simply aim at minimizing ecological and social risks, but instead to specifically choose projects with positive sustainability effects seems rather advanced. However, the most important development indicator stays without any doubt the Economic Development Impact Score (EDIS). This indicator evaluates economic effects (employment, additional tax revenues, etc.) for both share- and stakeholders and thus is central for the PSD logic. In contrast to other indicators included in the Scorecard, EDIS is used as Key Performance Indicator (KPI) for which a yearly benchmark is set.

This example illustrates the DFIs' difficulty to formulate targets other than financial ones. FMO tried to design a Key Performance Indicator for ecological and social effects, yet abolished the indicator after a short test phase. FMO explains this decision with the complexity of measuring the impact empirically: While it is tricky to evaluate economic effects in a sound way (e.g. how many jobs are created *because* of the DFI's involvement?) it is even more complicated to assess non-economic effects (e.g. gender effects) and to compare them with benchmark values.

3.2.2. Project Selection and Project Evaluation

Conclusion 7: The four analyzed DFIs pursue different country and sector strategies.

In Norway, the Netherlands and the United Kingdom the government specifies guidelines concerning country groups to invest in (usually LDCs, LICs, MICs). There are, however, no sanctions if these guidelines are not met (which is the case in general). DEG, in contrast, only „voluntarily" acts in accordance with BMZ's country strategy. While all DFIs are not bound by ministries in their choice of economic sectors, FMO and Norfund have deliberately chosen key sectors themselves (FMO: finance, housing, energy; Norfund: renewable energies, micro finance). In their portfolio, all four institutions show clear preferences for the financial sector.

Table 2 analyzes formal government influence on investment decisions. There are four ideal types of DFIs: The first type does not receive neither country nor sector guidelines and thus decides independently, the second type has to fulfill guidelines in both areas and can thus be considered under strong state influence. Moreover, there are mixed forms that only have to meet either sectoral or regional targets.

Table 2: Formal government influence on the DFI's investment decisions

		Official country guidelines	
		Yes	No
Official sector guidelines	Yes	Strong state influence	Sectoral focus
	No	Regional focus	independent

While DEG is free both in its sector and in its country decisions (an orientation towards BMZ's country strategy is „voluntary" and not institutionalized) and thus to be classified as independent, CDC has to fulfill regional guidelines: 75% of its investments have to go to LICs, 50% to sub-Saharan Africa. Thus, both DFIs have considerable freedom concerning the choice of sectors to invest in, which is in accordance with the PSD idea that an economy needs all sectors in order to flourish. However, both DFIs exhibit a clear empirical preference for the financial sector. From a development policy perspective, this strong focus can be questioned on sound theoretical and empirical grounds. Additionally, CDC's portfolio does not fulfill the government targets – the reason being that the guideline is only applicable for new investments, and the portfolio mainly consists of long-term investments.

FMO and Norfund both have to fulfill guidelines concerning country groups, but not concerning sectors. Here as well, country targets are not met accurately. As early as 1998 FMO and the Dutch ministry agreed on a „70/35 clause" (70% of the portfolio should consist of investments in LMICs and LICs, 35%-points thereof exclusively in LICs) which is fulfilled only with some reservations: the 35% goal for LICs has not been met so far. That said it is also important to note that these country classifications reflect national averages; development banks should not cherry-pick a development nation's richest regions but rather operate in disadvantaged (rural) regions.

As noted both FMO and Norfund are free to choose sectors to invest in, and both have chosen focus sectors themselves (FMO: finance housing, energy; Norfund: renewable energies, micro finance). In the case of FMO, the foreign ministry accepts FMO's choice but does not look at it favorably (the choice of the housing sector is not well understood; the ministry would prefer a focus on agriculture, yet FMO declines this focus for having made bad experiences (i.e. unprofitable investments). Thus, in this sense FMO might also be categorized as an „independent DFI", the more so, since it does not stick to the country guidelines as well. Norfund can be classified as having a regional policy focus.

Concentrating on a focus sector has, according to the DFIs, some advantages: it helps them to generate sector specific know-how and thus to provide better services for their clients. This argument is straightforward, especially when considering that better sector know-how allows for a more efficient risk management. In particular in the banking sector insufficient experience leads to strong risk aversion, and sound expertise permits to assess risks more accurately. Thus ideally, projects with an additional character will be selected (i.e. to invest in projects that lack private investments).

Conclusion 8: There is no standardized methodology for selecting investment projects.

All analyzed DFIs dispose of some type of rating tool, yet these differ strongly in their scope of application degree of standardization and dimensions analyzed. In contrast to the United Kingdom and Norway, the project selection process is highly standardized in Germany and the Netherlands.

DEG and FMO have developed their own rating tools [Geschäftspolitisches Projektrating (GPR) and Scorecard, respectively] and use it both for ex-ante and ex-post assessment. Norfund and CDC have adopted the GPR and IFCs Development Tracking System (DOTS), respectively, using them only for ex-post project evaluations. Most of the tools are quantitative, only CDC's tool is exclusively qualitative. However, as far as individual indicators are concerned, all DFIs use both quantitative and qualitative measures. All DFIs include the projects' financial sustainability, some measures of development effects and the role of the DFI in their rating. The exact method of measuring these dimensions and their overall relative weight differs among the individual DFIs; however, the DFIs' high level of risk aversion manifests itself in the low weights assigned to development effects compared to the assessment of financial performance.

Analyzing the rating tool's methodology is crucial for understanding development effects as it enshrines the DFI's definition of development. For instance, CDC puts a strong focus on key financial indicators and more specifically on a high rate of return when choosing its investment funds; whereas analyzing the expected development effects on an ex-ante basis has not been implemented so far.

In contrast to CDC, DEG utilizes a standardized rating tool (the *Geschäftspolitisches Projektrating*, GPR) which includes development effects. It thus seems that these are more important in DEG's operations than in CDC's. However, a closer look is needed in order to see whether DEG's theoretical head start indeed translates into better development outcomes. While at first sight the GPR seems to safeguard a development orientation, a closer analysis reveals that it is not necessary for a project to promise good development effects in order to achieve a very high rating. This has several reasons. Firstly, only 150 points of the GPR's total 500 points are assigned to the dimension „development effects/sustainability"; the remaining 350 points are related to commercial and financial criteria. True, 100 of these remaining points are awarded in the category „Strategic role of DEG" (particularly focusing on additionality), yet this dimension's indicators are highly business orientated, and summing up „development effects/sustainability" and „Strategic role of DEG" cannot yield more than half of total points. Second, the rating tool's design makes it possible for projects with poor development effects and promising financial performance to achieve a high overall rating. While there are thresholds, a project must achieve in each single dimension, these thresholds are relatively low (about one third of total points in each category). This means that a project that only scores 50 of the possible 150 points in the dimension „development effect/sustainability" still can be classified as a very good project and thus be selected. Considering the dimension's small weight, the threshold should be much higher in order to support the rating tool's credibility. Third – and possibly most importantly – strong criticism arises concerning the actual process of awarding points. A rating tool based on points might seem objective, yet how these points are awarded is uncertain and to a large degree subjective. Neither concerning its quantitative nor its qualitative aspects the rating procedures are convincing. To give some examples: the tool potentially assigns 15 points each for both gender and social effects. Both of them are highly complex concepts without any scientific consensus about how to define, let alone measure them. Therefore, the person awarding the points is given ample leeway as it is impossible to define on a general basis whether a project is „worth" 0 points, 15 points or something in between. Summing up, the highly elaborated GPR seems problematic, and several changes would be necessary in order to be able to classify a project on a reliable basis as far as its development effects are concerned. One could argue that CDC does not include development effects in its ex-ante project evaluation either, but at least it does not hide this fact behind a complicated rating tool.

FMO uses its Scorecard methodology for every project proposal; the tool thus is an integral component of the overall investment procedure. With the aid of various indicators, expected negative and positive effects are evaluated. FMO uses six different Scorecards covering the DFI's different fields of activity (financial sector projects, private equity funds, infrastructure projects, etc.). The Scorecard is also used in the course of monitoring the investment portfolio. At first glance the Scorecard seems diversified: by using various impact indicators it is possible to draw a rather detailed picture of potential positive and negative effects. Additionally, the Development Effectiveness Framework implemented in 2009 facilitates a more transparent listing of an investment's development effects. Predicted values are always put in relation to the investment volume so as to prevent that smaller sized projects are disadvantaged (DEG's GPR does not allow for this possibility). Indicators like the Corporate Sustainability Priorities seem to have the potential to positively impact future investment decisions. At large, FMO's primary intention does not appear to be risk mitigation but the search for sustainable projects. However, when looked at more carefully the Scorecard methodology cannot overcome the tension between financial and developmental sustainability: in general, the rating tool does not feature any thresholds for specific indicators. Therefore, a lot of responsibility stays with the person in charge of assessing a project. It seems that FMO's staff focuses its attention on the financial aspects – a behavior not exactly atypical for banks. Nevertheless, this focus is detrimental to the investments' additionality.

Evidently, the weight put on development and profitability criteria is an important indicator for the DFI's orientation and differs among individual institutions. We want to present a model to compare and classify the DFIs. The classification concerns the project selection process; for now the question remains unanswered whether one can draw conclusions from the institution's approach to project selection to the institution's general business model. Thus the classification represents „ideal-types". Nevertheless, an institution's methodology in project selection can be used as a proxy for that purpose.

Table 3: The area of tension between profitability and development orientation

		Development orientation		
		High	Medium	Low
Profitability orientation	High	Stars	Cash Cows	Profit Seekers
	Medium	Good Guys	Starlets	Development Needers
	Low	Developmentalists	Cash Needers	Poor Dogs

The classification includes nine ideal-types. On the top left corner are the Stars[6], characterized by both a high development orientation and a high profitability orientation. These DFIs systematically include development policy considerations in the project selection process and comprehensively measure expected development effects. By maintaining a high profitability orientation they make sure at the same time that their projects are economically sustainable and that the DFI's continuity is assured. On the other end of the spectrum are the Poor Dogs, which neither pursue strong development effects nor a high profitability. Such a behavior is possible if the institution has shifted its mandate and pursues other aims, e.g. if it regards itself rather as a lobbying institution or represents specific vested interests. Basically, Poor Dogs have lost their right to exist as DFIs. Similarly, the Profit Seekers' legitimacy is doubtful: they hardly orientate themselves towards development policy issues but strive for the highest profitability possible. This can happen officially (by arguing that both aims are congruent) or unofficially (by pretending a higher than actual development orientation). The fourth „corner category” are the Developmentalists: they primarily focus on development outcomes, profitability is a subordinate goals. In the long run, this orientation might be problematic, as well, if losing sight of profitability leads to unsustainable losses and no financial support from the government can be secured.

It is easy to rank the analyzed DFIs according to this classification: CDC, being a Profit Seeker mainly orientates its investment decisions towards securing profit goals and only shows a minor interest in development questions: it presents its strive for profitability as a manifestation of its development orientation. In contrast to CDC, DEG and FMO appear to be stars – yet our work shows that these DFIs, too, have a lot of catching-up to do concerning development orientation. Therefore, we classify them as Starlets: both exhibit a medium development orientation and a medium profitability orientation and have the potential to develop into a variety of directions. In fact, FMO itself stresses its position „in the middle” and the difficulty to maneuver along this fine line. Ideal-typically the DFI operates very closely to the boundary drawn by private investors for profitability considerations. In order to be successful in this segment a very accurate assessment of implied chances and risks is necessary; this is especially true for independent DFIs which operate at their own risk. Against this background, it is only possible to finance „near bankable investments”, i.e. investments not compromising the institution's continued existence and financial stability. At the same time, in FMO's case there are policy principles (and investment criteria, respectively) ensuring that FMO's investment activities differ from private ones.

6 The denotations Stars, Cash Cows and Poor Dogs are borrowed from the BCG-Matrix for strategic management [Kotler/Keller 2008].

3.2.3. Transparency and Accountability

Conclusion 9: Formal consultations with governments are common, parliaments are hardly involved.

All DFIs meet with the responsible ministries in regular intervals for the sake of formalized consultations and strategic decision making. In addition, Norfund consults with the parliament's development policy commission once a year. In the cases of DEG and FMO, civil society representatives (NGOs, businesses, advocacy groups) have seats in the supervisory board and thus have some formal voice.

Parliaments have no possibility to directly control the DFIs' operations. In the case of DEG and CDC, the parliaments can intervene only indirectly via addressing the responsible ministries. All DFIs (DEG, CDC, FMO and Norfund) are indirectly owned by the state, but only CDC is directly subordinated to the development ministry (which holds 100% of the society's shares). In contrast, DEG is owned by KfW Bankengruppe, which in turn is owned by the German Federal State and the German Länder. Hence, there is an indirect link to the government but no direct connection to BMZ. However, while formally only being a stakeholder, BMZ has more formal influence on DEG than DfID – despite being shareholder – has on CDC. For instance, BMZ chooses the chairman of the supervisory board, DfID can only nominate two non-executive directors for CDC's board. Both ministries perform control tasks and specify a strategic framework, yet BMZ seems to have more interest in a close collaboration than DfID does (which apparently suits CDC).

When analyzing the British development ministry one rapidly concludes that DfID's influence and monitoring possibilities concerning CDC's operative business are very limited. In fact, there is a clear principle-agent-problem arising for all DFIs: the agents (i.e. the DFIs) can use their informational advantage in order to implement the principle's (i.e. the ministry's) programs at their own discretion, potentially clashing with or even counteracting the principle's intentions.

FMO's most important stakeholder is the Dutch foreign ministry. Despite the DFI's institutional and operative autonomy the two institutions are in close contact, for example regularly discussing questions concerning general policies. As can be noted, the actual degree of interest for FMO's activities critically depends on the particular foreign minister and his or her policy priorities. Furthermore, FMO and the foreign ministry are not always in complete agreement, yet this does not necessarily have consequences, as FMO's focus on the housing sector demonstrates. Interestingly, it is the finance ministry that holds the government's share of FMO; for this reason, this ministry is mainly concerned with the DFI's financial stability. In order to facilitate the finance ministry's effective control of FMO, the DFI is bound by contract to regularly submit key performance figures. Additionally, representatives of the two ministries meet at least twice a year with FMO's representatives in order to discuss policies. Apart from the finance and the foreign ministry, the ministry of economic affairs has also a stake in the DFI's operations: by cooperating with FMO it tries to stimulate Dutch investments in developing and emerging countries. As far as accountability is concerned, FMO has to respond first and foremost to its shareholders. Consultations with them take place primarily at the annual general meetings, where the financial report is accepted or dismissed.

Conclusion 10: Consultations with civil society are not formalized.

DEG, FMO and Norfund do not exhibit any proactive interest in informally consulting with their stakeholders, CDC does not have any interest in doing so. The former three DFIs declare to be receptive for informal inputs from NGOs and other stakeholders. However, only very few NGOs explicitly deal with DFIs and the associated issues. If activities affect the interests or agendas of other ministries, DEG and FMO initiate consultations with these ministries.

Various of DEG's stakeholders are involved in its activities by heaving a seat in the supervisory board, and the DFI states to pro-actively seek the dialogue with NGOs. In fact, DEG's supervisory board includes an NGO (currently WWF). Projects with a high investment volume or otherwise deemed problematic have to be approved by the supervisory board. BMZ is included in this board. If specific questions arise other ministries are included in DEG's decision making. DEG states that there are possibilities for people affected by DEG's projects to participate, yet these are not formalized.

Similarly, FMO's supervisory board includes major stakeholders, e.g. a trade union representative, an expert on development and an employer's representative. Strikingly, the Dutch government is not represented in the supervisory board, despite arguably being its most important shareholder and stakeholder. FMO says it includes civil society groups in its discussions, yet in practice the exchange is marginal. Nevertheless FMO stresses to have a sympathetic ear for these groups and points to its transparent publication policies, e.g. on its web page.

CDC regards its fund managers as the most important stakeholders; the local population, civil society or other relevant players are not systematically involved. It is possible to direct inquiries to CDC, but the institution is not obliged to answer them if this were financially too expensive.

All DFIs identify international finance institutions and bi- and multilateral DFIs as further important cooperation partners.

As public discussion can reveal undesirable developments and induce a reformulation of deficient policies, it is important to give special attention to the civil society and to the population at home and in the target countries. In this respect, all DFIs show important deficits. The detailed analysis of the DFIs' shareholder- and stakeholder relations shows that they are accountable to these groups only to a limited degree. However, in order to achieve positive outcomes it is indispensable to include all parties concerned.

Conclusion 11: Transparency vis-a-vis the general public is severely limited.

Generally, DFIs are perceived as intransparent from the outside, yet they regard themselves as sufficiently transparent. The lack of information is justified with the banking secrecy and with the protection of their own and their business partners' commercial interests.

Disclosure requirements for public institutions differ greatly among countries, and so does social acceptance of these regulations. None of the analyzed DFIs has duties to directly inform the parliament, nor to provide project specific information to its share- or stakeholders. However, the responsible Dutch, Norwegian and (to a lesser extend) German ministries as well as the Norwegian parliament have qualified access to information concerning the DFI's operational business.

The DFIs point to their web pages and their annual reports as the main media of transparency. On their web sites, the institutions publish some documents concerning their activities; informations about individual projects are generally lacking, though – again because of confidentiality duties and for protecting commercial interests. However, the institutions do publish some best practice cases which contain more detailed project descriptions. Naturally, their selection and level of detail are determined by the DFIs themselves. Therefore, civil society groups' (media, NGOs) ability to effectively exercise external control is constrained.

In general, the IFC is considered a pioneer with respect to transparency: it publishes relevant project data in good time prior to board meetings so that the general public can study them and express an opinion in the decision making process. However, IFC has the possibility to hold back sensible information, which obviously triggers the question how transparency is dealt with in practice.

Conclusion 12: Integrated ex-post project evaluations and project monitoring are standard practice.

All analyzed DFIs evaluate their projects in regular intervals ex-post, using the methods described above (GPR, Scorecard, CDC-DOTS). DEG evaluates its projects biennially, FMO and CDC quinquennially (whereas the former provides yearly updates for several indicators and the latter prepares biannual short reports). Norfund currently evaluates its projects every year, but due to scarce resources this practice is called into question. Furthermore, all DFIs carry out evaluation at exit; no DFI evaluates its projects after having terminated its investment activity.

Conclusion 13: External evaluations are only institutionalized in the case of FMO and Norfund.

While FMO is evaluated every five years by private consulting firms after a tendering procedure initiated by the foreign ministry, Norfund is audited by the audit court at irregular intervals (specific areas are evaluated by other public development institutions). In the case of DEG and CDC, a public external evaluation can only be carried out by making a „detour" via the responsible ministries, i.e. by auditing the ministries' control of the DFIs. This happened in the United Kingdom in 2008 when the National Audit Office examined DfID's oversight of CDC. There are no external evaluations by NGOs, both because of the DFIs' restrictive information policy and because of NGOs' divergent priorities. There are hardly any media reports; if any, they concern scandals or other problematic events (cases of child labor, high executive salaries,…). All DFIs have their annual financial statements audited by private accountants.

As noted, FMO is evaluated every five years by a private consulting firm. The foreign ministry complements the respective final reports with a policy statement and presents them to the parliament. Dutch NGOs argue that a more intense public problematization of FMO's operations would be desirable, yet this does not happen – on the one hand because FMO's activities are impalpable for the general public, and on the other hand because NGOs with a development mandate set other priorities in view of a general shortage of resources and a highly restricted information flow.

While several media, NGOs and government agencies occasionally shed light on some of the DFIs' activities, there is no organizational entity disposing of a broad overview and thus able to provide a comprehensive evaluation of their operations. Yet there is consensus in the academic literature about the relevance of external evaluations, particularly because those concerned with implementing programmes sometimes lack the incentive to learn which instruments work and how they take effect [Blum/Schubert 2009, 126]. Such a tendency can be observed for all DFIs, especially in the case of organizations such as DEG and CDC, which are not evaluated externally.

Since NGOs and media are hardly able to effectively evaluate the DFIs for lack of capacities and access to information the question arises whether governments should consider it their responsibility to take care of more external evaluations. Furthermore, the question how evaluation results are dealt with in those countries where external evaluations are institutionalized, need to be investigated in more detail.

Conclusion 14: Export promotion plays a minor role

Historically, export promotion was an integral element of the official mandate of all analyzed DFIs. Today, this mandate has disappeared for the most part (DEG, Norfund, FMO) or completely (CDC) and is officially negated. Nevertheless, for the former three DFIs, some civil society groups still see an entanglement with national export industries.

4. Recommendations for Development Policy

Today, the association of European Development Finance Institutions (EDFI) counts 15 members, the youngest being the Austrian Oesterreichische Entwicklungbank AG (OeEB) established in March 2008 on behalf of the Austrian ministry of finance (BMF) and the foreign ministry (BMeiA). Thus, with OeEB's foundation Austria now also has a special financing facility for private sector development. Despite the steady rise in importance of this form of development finance since the beginning of the 1990ies scientific analyses about the bilateral DFIs' activities and impacts have been hardly available.

On the basis of our comparative study of DEG, FMO, Norfund and CDC, in the following policy recommendations will be proposed, that an ideal-typical bilateral development finance institution should comply with. With this we mean an organization, the aim of which is to generate the highest possible development effect and, which at the same time, adheres to high standards of transparency and accountability. Our recommendations can be used before establishing a new DFI, but also as suggestions for the evaluation of already existing ones.

Setting the framework

- **Evaluating the need for a new institution**

  The first consideration has to be whether establishing a new DFI is necessary. For answering this question, a public discussion involving all potential relevant future stakeholders is indispensable. An important aspect of this discussion is to debate whether establishing an additional DFI might lead to a further fragmentation of the development policy field.

- **Coherence and Interconnectedness**

  A lack of coherence within national development policies and between development policies and other policy fields, respectively, has been a longstanding issue of debate. Ensuring coherence is seen as crucial for the success of development policy. For this reason, it is important to account for this from the outset by designing suitable governance structures, e.g. concerning the constitution of the supervisory board or of other advisory bodies. Furthermore, interconnections with other related agencies have to be a major concern. Possible ways to achieve this include regular round table discussions, or installing different agencies' offices in the same building so as to facilitate the exchange of ideas. This seems particularly important for newly founded DFIs.

Institutional Arrangements

In the course of this study, we once and again encountered the area of tension between profitability and development policy, which seems to be favored by the DFIs' hybrid construction (see comparative conclusions). Gössinger/Hammler [2010] conclude that „pursuing development policy at the DFI's own risk" cannot always yield satisfactory results as it leads to risk aversion and a declining willingness to act on the basis of additionality. Pursuing profitability goals reduces the number of potential projects. Thus, in order to increase the DFIs' development effect an appropriate organizational form has to be found. Two possibilities seem practicable in order to resolve this area of tension:

1. **Public form of organization** and stronger involvement of the state: Within the framework of a public form of organization it is possible to manage the profitability orientation in a more variable form. In the most extreme case it would be possible to completely abandon it, as this allows for a stronger focus on maximizing development effects and thus for choosing from a wider circle of projects with potentially high development effects. Hence, it might be easier for the DFIs to comply with the criterion of additionality. However, such a change would naturally increase the probability of losses because of failing projects. Those losses would have to be covered by the government, either by providing the banks with commensurate equity capital, or by issuing default guarantees. Hence in order to achieve higher additionality the government has to be willing to provide additional financial resources. A public form of organization has some further advantages, especially the possibility to directly control the DFI's activities and to directly influence supervisory and decision making boards. This would alleviate the principle-agent-problem and increase the potential to safeguard the DFI's coherence with other development policies.
2. **Private form of organization**: If a public form of organization does not seem viable, e.g. for financial reasons, the question arises how to ensure the highest possible development effectiveness within a private form of organization. Generally, the private form requires pursuing some type of profitability goal. Therefore, the state has to safeguard the institution's development effects by contractually implementing precise goals and guidelines as well as suitable governance mechanisms. A good case in point is the contract between FMO and the Dutch government, although it would be necessary to focus more on concisely formulated investment criteria (policy principles). Such a contract can also include guidelines concerning country and sector strategies. As far as governance mechanisms are concerned a committee monitoring compliance with the mandated development goals would seem advisable. For this purpose it is important to pay particular attention to the representativity of the committee's composition (see below).

Regular external evaluations are important for both organizational forms, but they seem particularly important for the private form since state representatives lack alternative forms of influence.

Development Policy Focus and Operational Business

- **Sensitizing staff for development policy**

  In order to safeguard a sustainable and development orientated investment policy, establishing supervisory committees will not be sufficient. Targetting the staff of DFIs is of particular importance: beside the big group of employees with a background in finance, DFIs should reinforce their recruitment of development experts. In order to strengthen the awareness for development issues within the institution it is important that part of the staff has a development studies or development economics background

(CDC gives us an example of how it should not be as virtually all of its employees come from the private equity sector). These development experts should not only be working in advisory capacity but should also play a role in financing operations and in the process of project selection. That way it would be possible to counteract prevalent simplifications, e.g. the widely spread belief that each additionally invested Euro or Dollar would automatically lead to greater development impacts. All members of staff without experience in the field should attend advanced training in development, as it is already the case in some DFIs (e.g. DEG). In this context we want to point towards the possibility to implement job rotation programs on an inter-institutional basis, e.g. involving various public development agencies, as an integral element of traineeships for new employees.

- **No export promotion**

  Of course it is possible that involving donor country enterprises in the projects of DFIs has beneficial development effects, yet the participation of national companies must not favorably influence investment decisions. Development finance institutions must not be instruments of export promotion.

- **Innovative range of products**

  DFIs should not focus on immediate profits (e.g. relating to equity investments), but on innovative financial products which distinguish the DFIs from other investors. A positive example is provided by FMO which offers local currency credits, thus helping small, local financial institutions to eliminate exchange rate risks and to pass this advantage on to final customers. It seems reasonable for FMO to firstly gain experience with the help of ODA-ear-marked government funds and to adopt this know-how for its „own" investments. If applied appropriately, these government funds lead to innovative, sustainable financing solutions that are apt to reach niche segments.

Project Evaluation: Between the quest for objectivity and the relevance of solid qualitative expertise

- **Prioritizing development effects in rating tools**

  Increasingly, standardized rating tools are used in order to evaluate a project's financial and development effects. These tools have several advantages. First, they try to quantify development impacts and thus arguably increase objectivity. Second, practitioners stress that they increase comparability not only amongst projects but also amongst DFIs. Especially in view of the increasing number of investment cooperations this seems to be a big advantage. Nevertheless, it is important to check whether a rating tool is capable of evaluating whether the respective development objectives are to be achieved. For instance, in order to assess the employment effects of a SME promotion program, a tool is needed which is capable of measuring these effects in a methodically correct manner. This statement is not as trivial as it may sound; as a matter of fact, some of the existing rating tools are unfit to do so. For example, DEG's GPR has a built-in bias, through which bigger projects can achieve higher employment effects than small projects (i.e. employment effects are not measured per Euro invested). Equally relevant is the question what fraction of total points achievable in a rating should be reserved for development (i.e. how many points does a project have to score at least on development effects in order to be realized), and how development effects should be weighted against other desirable effects (e.g. profitability). Hence, it is important to think about these issues before selecting a rating tool. In the ideal case, a rating tool should perfectly comply with development objectives, yet this is usually not attainable because of methodological limitations and practical reasons. Therefore, utilizing quantitative rating tools always is a compromise between scientific accuracy and operative practicability, and between development objectives and operational costs of the rating. From this perspective it is indispensable that DFIs are aware of their tools' limitations. An evaluation provided by these tools can only be one – and not even necessarily the most important – element in the process of assessing a project. The final responsibility for a project rating must always rest with the development expertise of the decision-makers.

- **Accounting for the local context**

  It is essential to allow for flexibility when designing a rating tool. It seems that some rating tools are based on an idealized, Western idea of the private sector, yet a private sector of this type does not exist in most target countries. Thus, the scoring algorithm has to be adapted to e.g. the small-scale structure of the private sector in developing countries. For instance when assigning weights for business volumes, the number of employees or expected profitability.

- **The case for a harmonized rating tool for all EDFIs based on sound scientific standards**

  Today, there is a fragmentation in the EDFIs' use of rating tools. A number of DFIs utilize DEG's GPR, FMO uses its self-designed Scorecard, other DFIs do not use any quantitative tool at all. The main reasons for the increasing adoption of DEG's GPR by other DFIs seem to be a lack of alternatives, the size and importance of DEG and the tool's good manageability (esp. compared to IFC's DOTS-system). Additionally, newly established institutions are actively encouraged to use the tool. Acquiring the GPR helps smaller DFIs to reduce transaction costs and to facilitate cooperations. Having said that we want to highlight that details about the GPR are kept confidential to the general public, and that up to now it is not accessible to independent researchers for a critical analysis.

  In order to improve communication and cooperation between the European DFIs, while safeguarding scientifically validated standards, it seems advisable to develop a harmonized EDFI rating tool. Such a tool should be designed in active collaboration with independent academic experts. It could significantly improve inter-institutional comparability and transparency. The tool should be constantly revised and refined, factoring in past experiences and the ongoing scientific discourse. On all accounts, the DFIs' current practice of regarding their rating tools as company secrets and of refusing to put them under public scrutiny is in strong contrast to their public mandate.

- **Comprehensive appraisal by a panel of experts**

  It has become prevalent in some DFIs to supplement the internal project evaluation (with or without deploying a rating tool) with an assessment by a panel of experts. Basically, there are two options for such a panel's constitution: either one tries to assemble all relevant socio-political interests and includes representatives of these groups, or, alternatively, one tries to obtain the best possible specialist expertise. In practice, the panels' constitutions reveal a mingling of these two options. This, however, is associated with a trade-off, as a higher degree of representativity comes along with a loss of expertise and vice versa. Therefore it is recommendable to settle clearly for one of the two options. If one prefers representativity, it is sensible not to focus the panel's activities on the evaluation of individual projects as the committee's members lack the necessary know-how. Rather, the panel should discuss strategic issues, set policy guidelines and monitor their compliance. If, on the contrary, one prefers to access the best available technical expertise, the panel's activities should focus on evaluating the development effects of individual projects. In this case, the committee should consist of independent experts and be involved already in the early stages of the project selection process. As an expert committee does not have the democratic legitimacy to decide about strategic priorities, these decisions would have to be taken either by a representative supervisory board. This however, will probably require a public form of organization. Or alternatively the responsible ministry and/or the parliament will have to perform this task. In any case, the expert committee should not be subject to the ministry's directives. Additionally, „regular" DFI staff members should discuss problems and setbacks in ongoing projects with the committee – regardless of whether a representative or an expert panel was chosen.

Role of External Stakeholders, Monitoring and Transparency

- **Ensuring political control**

  Adequate public monitoring has to be ensured. This includes the employment of skilled personnel in sufficient numbers in the responsible ministries (or in any other competent authority) and the transfer of competences to enable them to audit the operations of DFIs. Public monitoring does not end with involving the responsible executive authorities, however. In order to check whether a country's development objectives are implemented by the respective DFI, extensive information obligations and duties to report to the parliament are required; so are periodic screenings by the national audit courts.

- **Involving the local population**

  Involving all relevant stakeholders is a crucial prerequisite for a successful and effective DFI. This claim does not only include donor country stakeholders but also the recipient country's population. Frequently, the local population is neglected or disregarded. Therefore, when evaluating projects or DFIs it is important to systematically include the perspective of recipient country stakeholders.

- **Disclosure obligations and the case for involving society**

  As civil society groups have different perspectives on problems, involving them in development policy processes is crucial in order to gain a comprehensive picture. Sure enough, relevant organizations often do not keep track of the DFIs' operations, the reasons being a lack of capacities and a shortage of information about the DFIs' activities. It is important to make it possible for civil-society actors to fulfill their watchdog function and to constantly monitor the DFIs without an exuberant need of resources in terms of time and money. In this context, disclosure obligations relating to operational activities are crucial. Unlike the area of export promotion, which is regulated by OECD arrangements[7], there are no international disclosure standards for development finance. Certainly, with the *EDFI Principles for Responsible Financing* the European DFIs commit themselves to certain standards, yet these are formulated rather unspecifically and fall behind corresponding transparency and disclosure duties specified in the OECD Consensus on export promotion. Therefore, extending transparency duties in line with to the OECD Consensus – especially as far as a project's social and environmental effects are concerned – would be a sensible step. This could happen in the form of expanding the EDFI principles or in the form of an agreement at EU or OECD level.

- **Disclosure policy and office of ombudsman**

  Involving stakeholders requires the institution to be transparent and accountable. In this respect, IFC provides an example for transparency: it established an independent ombudsman which is in charge of communicating with the affected local population and of monitoring and scrutinizing the development impact of projects[8]. While it seems difficult for each single European DFI to establish a separate ombudsman, it certainly would be possible to do so on the European level, e.g. within the EDFI framework.

7 See http://www.oecd.org/department/0,3355,en_2649_34171_1_1_1_1_1,00.html

8 See http://www.cao-ombudsman.org/

- **External evaluation of institutional performance**

  Generally, an independent external evaluation of DFIs is necessary and should be carried out in regular intervals. Complementary to the yearly auditing by independent accountants, every five years a „social auditing" including the evaluation of social, ecological and developmental aspects should be carried out [Storey/Williams 2006, 15]. These measures can help to avoid that DFIs focus too much on profitability considerations and thus diverge from their development objectives.

- **External project evaluation**

  In addition to evaluating DFIs institutionally, individual projects above a certain threshold should also be evaluated externally, i.e. by independent reviewers on an ex-post basis. The latter could serve as a complementary information for the institutional evaluations.

SME Promotion and Investment in Funds

- **Focusing on additionality and catalytic effects**

  In order to clearly distinguish themselves from private investors, DFIs have to strictly enforce their central policy principles of additionality and catalytic effects. Specifically, this means increasing commitments to small investment projects with allegedly complicated and demanding clients. Without any doubt, providing funds for small, young enterprises requires more resources, yet at the same time potential development effects are high. Additionality and catalytic effects have to be understood as a two step process. First, DFIs should focus more on initiating investment instead of just acting as followers. Proactive development finance means moving into areas which are not yet targetted by commercial financial service providers. Obviously, this approach involves higher risks, yet equipped with the necessary finance and development expertise and the readiness to provide time-intensive costumer service, the likelihood for an investment to fail can be reduced. In any case, when implementing such a strategy, average project size will fall; as a result, the follower function will be taken over by private investors which are encouraged by the leading role of DFIs.

- **Focus on SMEs**

  DFIs should focus more on small and medium-sized enterprises, since investments in SMEs tend to have stronger development effects. SMEs generally have less access to capital and suffer from unfavorable financing conditions. Additionally, promoting SMEs should be done on the basis of guidelines regarding types of enterprises to invest in or regarding focus regions. DFIs should be obliged to report on their operations in the annual report to parliament in order to avoid that they select projects with minor development effects (negative examples from the past include funding for Bank of Nigeria, or investments in golf courses).

  However, the current business model of most DFIs is hardly compatible with SME promotion. Financing the latter usually generates a low return and a high workload in comparison to large projects. This brings us back to the discussion about the optimal form of organizational for DFIs. Focusing on SMEs is generally easier within a public framework (involving a smaller emphasis on profitability), yet an adequate capital base is required in order to cover higher transaction costs and possible failures. In contrast, within a private framework DFIs have to be given a clear mandate and most notably financial incentives for promoting SMEs. Such an incentive could come in the form of a fixed premium, the government pays for each SME project. Thus, higher transaction costs of SME projects could be covered.

- **Not all fonds are equal**

  DFIs usually counter criticism relating to their failure to provide financing for SMEs with the argument that they do invest in Microcredit funds; these funds would be better suited for investing in small projects and SMEs. Arguably, using funds for promoting SMEs makes it easier to cooperate with local project partners and to draw upon specialized know-how about local markets. However, this decrease in transaction costs also implies a loss of direct control over investment activities. Factors determining a funds' development effects are its business model (in particular the importance of profitability goals vs other goals and its fields of activity) and its governance structure (in particular the degree of influence of DFIs). If a DFI cooperates with a commercial fund it is important to implement strict monitoring and evaluation procedures in order to avoid adverse effects on development (e.g. through very high interest rates). An alternative approach is to set up funds in cooperation with other DFIs, an example being the EFSE (European Fund for Southeast Europe) This approach might be better suited for promoting a development focus, and monitoring can take a more direct form (i.e. DFIs can be directly represented in the supervisory board). In general, we do however think that a pure „fund of funds"-business model à la CDC is not desirable for DFIs.

  Funds, in particular those operating on a non-commercial basis, might be a complementary element in the portfolio of a DFI, but DFIs need to be directly engaged in development finance. Only by this they are able to fulfill their mandate.

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