HOUSE OF COMMONS

International Development Sub-Committee on the Work of the Independent Commission for Aid Impact

Oral evidence: ICAI's review on CDC's investments in low-income and fragile states, HC 1975

Wednesday 22 May 2019

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Watch the meeting

Members present: Paul Scully (Chair); Richard Burden; Mr Ivan Lewis; Stephen Twigg.

Questions 1 - 33

Witnesses

I: Nick Dyer, Director General for Economic Development, Department for International Development; Graham Wrigley, Chairman, CDC Group; Nick O'Donohoe, Chief Executive Officer, CDC Group; Richard Gledhill, Lead Commissioner, Independent Commission for Aid Impact; Jonathan France, Team Leader, Independent Commission for Aid Impact.

Examination of Witnesses

Witnesses: Nick Dyer, Graham Wrigley, Nick O'Donohoe, Richard Gledhill and Jonathan France.

Q1 **Chair:** Thank you very much, gentlemen, for coming along. We are discussing ICAI's review of CDC's investments in low-income and fragile states. I will kick off. There are quite a few questions to go through in the time we have together. Feel free in your opening remarks to give us a brief outline, but please make it brief, because we will go into the detail as we go through. I will ask CDC first. In ICAI's view, CDC is still not doing enough to make poverty reduction its top priority. This issue was also highlighted in previous reports of the Committee and in the Public Accounts Committee. Why has it taken so long to prioritise poverty reduction?

Graham Wrigley: First, we would like to thank the ICAI team for their work. We think they work really hard, we completely understand the scrutiny and we will learn from this process, as we have from all the others. Overall, we agreed with all the recommendations and the ambition they have set out for us, going forward.

To the specific question you raise on how long things are taking, we would like to make one generic point. We will talk about what we are doing on development impact in a minute; Nick will follow. The first point is that we have been through a huge transformation, largely driven by the recommendations of this Committee. If you look at page 14, figure 4, it shows the huge growth we have had in the organisation. There has been a massive pivot: back in 2012, this organisation was a single-product one-office organisation, investing $300 million per year. Now we are an organisation with multiple products in multiple sectors and nine locations, committing over $1.5 billion per year. That has been a huge transformation. We have moved from a broad geography, at the recommendation of this Committee and the Andrew Mitchell reforms, to focus purely on sub-Saharan Africa and south Asia. That has been evidenced. We now have 88% of our portfolio in those geographies, compared to 30% for most other multilateral DFIs, such as IFC, the World Bank's multilateral development finance institution.

When working on that transformation over the last seven years, we have been thinking many things. First, we have shared the desire to move quickly to achieve the SDGs, but we have also been cognisant that we have to execute thoughtfully and work to create an organisation that has cohesion and strong culture, and manages risk and cost appropriately. Therefore, particularly in those initial phases, we looked to come up with clarity and a simple structure. The grid is one example of that and is profoundly important. It has had a massive impact, following exactly the recommendations of this Committee.

That is not to say we have done everything right. There are lots of things we could have done better, and I said to this Committee last year, on the

specific point you raised about development impact, that, while the grid has been fantastic and is an important tool for us, we should have started work on that maybe a year or so earlier. The ICAI report made that clear.

Q2 **Chair:** Nick, can I come to you before I broaden it to the overall report with Richard? Can you follow on about global poverty and the same question, basically?

Nick Dyer: Let me start by welcoming the report. I particularly welcome the report's recognition of the relevance of CDC and the transformational change it has gone through. My take-away from the effectiveness and evaluation/learning side of the report is that the transformation we are undertaking is on the right track. The key thing we need to do now is to double-down and make sure we continue to deliver on it. As a shareholder, we will be holding CDC to account on that.

On the poverty side, I will make two points. First, we need to be careful not to conflate the desire for a more nuanced understanding of the poverty impact, both before and after an investment is made, and the desire to aggregate that understanding, with saying there has been no poverty impact. The whole premise of CDC has been jobs, and that was the basis of the business case that underpinned the scale-up. Any developing country will tell you that what it needs and wants is jobs. With 18 million jobs needed in Africa per year, that is absolutely right. The World Bank studies tell us that the principal route out of poverty is higher incomes, so jobs is a development impact. We just have to recognise that, plus the £3.5 billion in tax revenue raised has a development impact, so I challenge any contention that this has not had a development impact. Yes, there needs to be and we are on a journey to recognise that we now need a more nuanced understanding of the direct impact we are having.

Back in 2008, the NAO said that CDC was in the wrong places, doing the wrong things. We corrected that by using the grid. In 2016, the NAO said, "Yes, you have done well on that, but now you need to shift to have a deeper and more nuanced understanding". We think that the plans we are putting in place through the 2017 strategy are doing that, and this report reinforces and recognises that, and tells us we are on the right track.

Q3 **Chair:** Richard, first on global poverty, what are your views on what you just heard?

Richard Gledhill: I buy the argument about jobs being an important aim in their own right, but there is a need to take a much broader view of impact. From looking at the plans of the individual investment teams, the new strategy for the direct equity team has a strong focus on serving the poor and work in poor regions. There is not the same strategic focus in the other product areas. Clearly, CDC has made a successful transition to invest in low-income and fragile states but, generally, it has been in the less difficult states within those categories and within the less difficult

geographies of those countries. This is something that CDC continues to need to push hard and work on.

It is partly about investment selection, but also about how CDC works with companies once it has made an investment, encouraging their pro-poor actions, both from a corporate social responsibility perspective, but also in their services and products. We saw some really good examples of work that was being done by investees. One that comes to mind is an agricultural aggregator, which was paying more for products it was buying from smallholder farmers where they were educating a girl child. That is an interesting corporate social responsibility action that could have a real impact on poverty reduction in its local area. It goes further than that; it is about using the levers CDC has, particularly as a direct equity investor, to encourage more ambition from its investees in providing services and products to the poor. That was the focus of our second recommendation.

Q4 **Chair:** You came up with an amber/red rating for the overall report. Do you want to outline the broader reason for that?

Richard Gledhill: This was a challenging review to score. CDC is a fairly unique organisation within UK aid. Even within the development finance industry it only has a few peers of its scale, and the review covered an extended period when CDC was making a very significant transformation. In determining what good looks like, which is key for assessing scoring, we had to have regard to the scale of CDC's operations and, in particular, to the significant capital contribution made by DfID during the review period.

We look at scoring against the three questions. Against the credibility of its strategy and approach, we scored CDC green/amber. It has successfully redirected its investments towards lower-income and fragile states, and into its priority sectors. It has diversified its investment products to include direct equity and debt, and piloted some innovative new financial instruments. It has introduced the catalyst portfolio with a greater focus on riskier markets. There is more to do, particularly to strengthen the in-country resources, particularly in Africa, and accelerate the work on sector strategies and geographic plans.

The areas we were more concerned about were the effectiveness of investments in low-income and fragile states. In particular, we felt not enough has been done to ensure or monitor development impact, so we gave an amber/red score for the effectiveness and impact of its investments. We also gave an amber/red score for learning. CDC has done some great research and has a number of important mechanisms for sharing learning within the organisation, but we did not see the application of learning to specific investments for much of the review period. The fundamental weaknesses and gaps in evaluation throughout most of the period meant that we had to score learning amber/red.

Overall, we scored CDC amber/red. I know they were disappointed by that score and we have been encouraged by the response we have had to the report and the recommendations, in particular. There is a lot of work now underway in some really important areas, particularly on impact. We were talking to the chief impact officer outside, as we were waiting to come in. I hope that, when we come back to CDC in a year's time for the follow-up review, we will see some important progress.

Q5 **Chair:** Can I ask Richard about the methodology? You have said that the sample of 19 investments is not representative. Does that weaken your overall findings and conclusions, as a result?

Richard Gledhill: The review of the sample of investments was only part of the overall methodology. As with all ICAI reviews, we did a literature review looking at the information available about CDC and the development finance industry's best practice in the sector. We reviewed corporate strategy documents, and product strategies and plans. We looked at 19 investments out of a total of 345 investments made during the period, which is about 5.5%, but we also looked at some investments that did not happen and proposals that did not go through. We also engaged actively with investee companies and other stakeholders, as part of our country visits. We made four country visits. While we cannot draw conclusions about individual investments beyond the ones we looked at, I am confident that the overall conclusions we have reached are fair and valid.

It is fair to say that the majority of the investments we looked at were made in the first four years of the review period, so that we had a chance to look at the development impact that had come from the investments. We have reviewed changes in systems and processes and, in particular, the plans on impact and evaluation in the last year.

Q6 **Chair:** You looked at investments in Kenya, Malawi, Nigeria and Tanzania. Do you think they offer a fully representative picture of the overall investments?

Richard Gledhill: Those countries were chosen purposely to give us a sufficient scale of investment in priority sectors and difficult geographies. Jonathan, do you want to comment?

Jonathan France: Kenya and Nigeria are two of CDC's biggest markets in Africa, with a range of sectors and different investment products. Tanzania and Malawi were picked specifically to look at two high-impact investments in the power sector and the impact accelerator. Overall, we looked at six out of 12 of CDC's investment teams, which allowed us to look from top to bottom, from strategic investment team level down to individual investments. We think we had a thorough look at CDC's investments across the piece.

Q7 **Stephen Twigg:** From looking at the capital disbursement graph on page 30 of the review, we saw big increases in total amounts in 2015 and

2016, but the quantum spent in the most difficult countries, category A, was pretty stable at 15%, 16% or 17%, despite a big increase overall across those years. Graham, can you talk more about why that is? Is it just really hard to invest in those countries or does this suggest there has not been enough focus on getting investment into those countries?

Graham Wrigley: Nick should answer.

Nick O'Donohoe: You are right to highlight that there was a significant increase in the percentage going into fragile and conflict states once the development grid was adopted, but it has stabilised in the last four or five years. If you look at Africa alone, you will find 60% in fragile or what we call A and B states. As Graham noted in his introductory remarks, that is a high percentage by any standards and certainly by the standards of other development finance institutions.

When you drill down into it, you find investments in places like Malawi, which the ICAI team looked at, which is an area almost no other development finance institution had gone to. In agriculture, you find investments in Sierra Leone, which is another A state, and we went to Sierra Leone at the heart of the Ebola crisis and provided critical funding to keep companies going. You see Zimbabwe, which is an A state. We are pretty much the only development finance institution invested in those states. Those numbers tell a story of a significant focus by CDC on A and B. It will never be entirely 100% A and B states, partly because the C and D countries, which include Kenya, for example, have significant developmental needs, and partly because there are some countries on the A and B list that are genuinely very difficult to invest in, South Sudan for example.

Q8 **Stephen Twigg:** Do you have a figure for 2018 yet? It was 66% A and B in 2015. It fell to 56%, then to 49%. Is that a trend?

Nick O'Donohoe: No, we have not reported yet. I believe the number will be about 49%, say 50%. It will be at that level.

Stephen Twigg: It will be roughly half. ICAI, do you have a response to that?

Richard Gledhill: We understand the challenge of finding a pipeline of investable opportunities in these countries. CDC has done better in the power and financial services sectors, and it is absolutely right to invest in those. Access to power and to credit are significant challenges to businesses and people in these difficult markets, and addressing them is critical to development.

CDC has found it harder in other sectors critical to economic development, particularly agriculture and manufacturing. There is potentially a need to recalibrate risk appetite and impact ambitions in these areas. Within the growth portfolio, which is the main portfolio, CDC's hurdle score for development impact is 2.4 out of a possible 4 on the grid. We think that is a little unambitious. CDC has exceeded its

performance on this in the past, but has retained that score. There is also a need to have a more clearly differentiated and communicated risk appetite for the catalyst portfolio. Within the marketplace, we found that investees and other stakeholders were less clear about the differences in CDC's strategies.

Q9 **Stephen Twigg:** I will come to DfID with a slightly different question. The Department has given great priority to additional capital for CDC in recent years, but ICAI reports that CDC drew down only £735 million of this additional capital in 2017 and 2018. Are you satisfied with that or would you have expected them to draw down more?

Nick Dyer: We need to distinguish two things here. One is how many commitments CDC needs to make, which we cover by making a promissory note. In the business case, we said that, on average, there will be about £700 million per year of capital in CDC. In fact, we always expected it to be more of a hockey stick, in that this would scale up as CDC built up its capability. The fact that they have not asked for £700 million of promissory notes per year is fine from our perspective, because it reflects how CDC is doing its job in the right way.

Q10 **Richard Burden:** Having been involved in the Committee's report into CDC quite a few years ago, I can see the refocusing and it is welcome. With that said, the NAO and a number of reports from others are still saying there tends to be a concentration of CDC investments in middle-income countries. In the 2017 annual report, CDC's top-five highest country exposures included China, India and South Africa, representing 57% of the portfolio. Is that simply a hangover from previous investments or can something be done to mark a more significant shift towards poorer countries? If so, when do you expect that to be actioned?

Nick O'Donohoe: Some of it is a hangover from previous investments. Some 15% of the portfolio is still in pre-2012 investments, and a specific and reasonable decision was made in 2012 not to try to exit them in too rapid a manner, but to keep them and let them roll out over time. That was perfectly appropriate, but it means it takes a while, because these are long-term investments. As I said, we still have 15% of the investment portfolio outside of our geographic areas of focus today.

We talked before about investment in A and B states. Specifically, 60% of our investment in Africa goes into A and B states and those are, by definition, the most difficult places. As I said before, it is important for us not to seek to put 100% into those states, because there is an enormous amount to do in countries such as Kenya, Zambia or Ghana, all of which are C states. From our perspective, we feel the balance is probably appropriate, with 50% overall, and 60% in Africa, in A and B states.

Graham Wrigley: When we launched the grid, many of our DFI colleagues thought our strategy was unexecutable, because it was so narrowly focused. Despite the figure here, it is still regarded as the most narrowly focused strategy of any development finance institution in the

world. We are proud to execute it, by the way. We want A and B to be higher. It is great.

Richard Burden: You are still investing in India.

Graham Wrigley: In India, we have agreed the limit in the last strategy as 30% of our portfolio. There are more poor people living in India than there are in sub-Saharan Africa.

Nick O'Donohoe: We subdivide India into individual states and our strategy is specifically focused on trying to get capital and investment into the poorest states.

Nick Dyer: Can I add one thing on India? Clearly, CDC is part of DfID's strategy towards India. We are trying to reduce and exit from grants. We see support to private capital as part of our strategy. There is obviously a lot of capital in India, but it is in the wrong places and of the wrong type. That is where CDC adds value, in getting capital to the right places, in the poorest states, with a type of capital that just does not exist in the market.

Q11 **Richard Burden:** Do you have anything to add on the more general issue of the pace of the shift towards poorer countries?

Nick Dyer: DfID's entire approach to CDC over the last seven years has been to give it incentives and push it to work in more difficult places and on more difficult things, and to take more risk. That was the point of the grid and of the 2017 strategy. We all know that, by 2030, 90% of the world's poor are going to be in 25 African countries. We need CDC and the whole international community to give more attention to those countries.

The reality is that, at the moment, CDC is an outlier in the development finance community. I was at the European Development Finance Institutions conference last week, and CDC puts 43% of its funding into fragile and conflict states. The next highest, as the report said, is the French, who do about 28%. We know this is really, really hard. CDC co-chaired a conference in Oxford with Paul Collier, on fragile and conflict states, which I was at. The basic message that came out there was that you can do it, but it is difficult, risky and requires changes in your risk appetite and HR policies. It requires you to understand pipeline and work better together, so this is hard stuff. We are continuing, and will continue, to push CDC to go in that direction.

Richard Burden: Does ICAI have anything to add to that?

Richard Gledhill: One point worth mentioning here is the gaps in the in-country presence that CDC has in Africa. I am sure you will come on to question more about this in due course, but we think one of the things that could have helped accelerate the scale-up of investment in these much harder-to-reach countries is an in-country presence to help identify

a pipeline of potential investments and work with potential investees to help them become investment ready.

Jonathan France: The other thing is stronger links with DfID in country. CDC faces increasing constraints on its pipeline for direct investments, particularly in Africa. Part of that is because of the stringent environmental and social governance standards that CDC expects of its investees, quite rightly, but it presents challenges in generating a pipeline. We think part of the solution is to work more closely with DfID and DfID private sector development programmes in country to help generate that future pipeline.

Q12 **Richard Burden:** What are the constraints to that happening now?

Graham Wrigley: I will give a couple of words on context and a few other points, and then Nick will follow up. First on country offices, we totally agree. That has always been part of our strategy. We made a conscious decision, as we built out from 2012, to build from London to begin with. As you are building an investment organisation, it is incredibly important to have the culture together. Then we thoughtfully added offices in the markets, beginning with regional directors. Nick will talk in a minute about the acceleration underneath that.

In these last few years, we have tried to strengthen our relationship with DfID. We think of it on two levels: DfID as a shareholder and DfID as a partner. As Nick said, DfID owns the shares in CDC and has directed CDC and these directors towards a development impact focus on jobs, in the first strategy phase, and it is now upping that at a whole variety of levels in the new strategy phase. We have embraced that. At the same time, we have been building up relationships with DfID as a partner in the country offices. I will now hand over to Nick to talk about those two things.

Nick O'Donohoe: Graham set the context exactly right. In 2012, I believe CDC's approach was totally appropriate. We are managing large amounts of UK taxpayers' money. You have to do that carefully, prudently, properly and with the appropriate risk and investment processes. You need to build an appropriate culture for an organisation like CDC. We all felt, and the previous reviews of CDC highlighted, that we needed a significant culture change. There has been a significant culture change, beginning in 2012, but those things are easier to build from the centre. When it is appropriate and you have reached a certain scale, you move in country.

It is completely appropriate to say that, for CDC, that point was two or three years ago. Two years ago when the strategic framework was launched, we had fewer than five people internationally. Today we have about 40 people and will have 50 by the end of the year. We have gone from having a couple of people in Johannesburg to having offices in Nairobi and Lagos, people in Ethiopia and Zambia. We have an office in Pakistan now and will shortly have one in Bangladesh.

We have had debates with ICAI about the appropriate pace of growth for something like this. It brings with it significant risks and the same issues around culture, investment processes and risk management. These things all have to be done across the whole organisation in multiple locations. It is a lot more difficult and it needs to be done prudently. To go from fewer than five people in the last two years to 40 people is an appropriate rate of growth. ICAI is completely right to point out that we need to continue to accelerate that growth over the next year or two.

Q13 **Richard Burden:** We may come back to that issue of co-operation a bit later. In the meantime, when you invest in low-income and fragile states, there seems to be a concentration on a few of the larger economies in the category. As far as sectors are concerned, it is principally in financial and power. Do you think that is where you are going to have most impact in helping the poor? Maybe you can say something about a criticism ICAI made that more could be done to address specific development challenges and capital constraints in sectors like healthcare, agriculture and affordable housing. Are you overlooking those sectors and, if so, how will you address that?

Nick O'Donohoe: It is entirely appropriate and logical for a development finance institution to have a significant weighting of its portfolio in infrastructure and financial services. If you look at all the other development finance organisations, whether they are bilateral or multilateral, that is what you will find. The reason is that infrastructure, specifically power, which is where the vast majority of our investments are concentrated, is fundamental to driving economic growth in a country. If you do not have power, you cannot start and build a business. You cannot light your home or educate your children. You cannot run hospitals. It is always going to be a critical part of the development agenda for an organisation like ours. There are still 600 million people in Africa who do not have access to power, so we are reaching them through helping to build bigger generators and our ownership of M-KOPA. We are helping that company to provide home solar to 750,000 families in Kenya. This is a fundamental role for DFIs, and they require lots of capital.

Financial institutions are an equally important part of any portfolio, because they are the conduit through which an organisation like ours reaches small and medium-sized enterprises, which are central to growth in any of these economies. You will always find financial institutions making up a significant part of a portfolio. When we enter into those transactions or investments, we focus on institutions that reach small and medium-sized enterprises and are doing micro finance, so it is important to pick the right institutions. They will both be significant.

Q14 **Richard Burden:** How do you respond to what ICAI has said about healthcare, agriculture and affordable housing?

Nick O'Donohoe: They present separate challenges. Affordable housing is another asset-heavy, capital-heavy sector. It is something that CDC

would love to do more of in India, south Asia and Africa. The truth is that there are very few examples, particularly in Africa, of affordable housing models, but we are certainly focused on that area. Manufacturing, likewise, is a difficult area in which to invest, but one that is a significant job creator. We have done a lot on healthcare in India, but less in Africa. It is an area where we are currently looking at a couple of important transactions, but I suspect we will do more. Again, it is fundamental to economic growth to have a healthcare system that works.

Richard Burden: Does ICAI have anything to add to that?

Richard Gledhill: I agree on the importance of infrastructure and power. We have seen the challenges of investing in other sectors. The development of sector plans was only starting to happen at the end of the review period. There is a very good healthcare strategic plan. We just think there is more to do in planning, co-ordination and working with other partners and donors in these difficult markets and sectors to try to build this pipeline.

Graham Wrigley: We agree we want to do more in agriculture and affordable housing. Nick is creating a great team in these sectors, which will pay off in the years ahead.

Nick Dyer: From DfID's perspective, one of the reasons that these sectors are in the grid is that they are important both to economic growth and jobs. It would be unfair to say that CDC has had no sector strategies. CDC has thought carefully about how to make infrastructure and energy investments, but one of our challenges and criticisms of CDC is that it has been a bit too slow in doing the sector strategies that we asked for in the 2017 strategy. I look forward to seeing those sector strategies in the next quarterly shareholder meeting before the summer. They are just about to come, and that will help us to see what the opportunities are, going forward. The combination of that, the in-country presence and the realities of how hard some of these sectors are will define the future direction of investments in them.

Jonathan France: Within those two sectors, there are interesting things that CDC can do. In financial services, a partnership with Standard Chartered bank in Africa, explicitly encouraging lending to SMEs, will have an impact on the poor. Even within those priority sectors, it is about the mechanisms that CDC uses to drive a greater development impact, particularly in the financial services sector.

Graham Wrigley: A lot of these sectors are linked. With off-grid solar, which is one of the new strategies, we invest at a strategic level. We invest in 11 of the off-grid solar companies in sub-Saharan Africa. We have 1.5 million to 1.8 million homes, in largely rural environments, now with power. That has an impact on livelihood across sectors. We agree with the aspiration to do more in agriculture and the other sectors.

Q15 **Richard Burden:** The last area from me at the moment is about

additionality. One concern that arises out of ICAI's case study visits is whether, while CDC investments are no doubt a good thing, they have crowded out commercial investments that might have come in anyway. Is that a fair comment and, if so, what are you doing about it?

Graham Wrigley: I will set the context. One of your recommendations in 2011 was for us to have more focus on additionality. In 2013, we started a review of all the additionality policies of every DFI in the world, and we created an additionality policy. Maybe Nick can talk about how hard it is to execute.

Nick O'Donohoe: We completely agree that additionality is a critical element to development finance institutions' investment. Therefore, it has to be approached in very rigorous way. As Graham highlighted, post 2013, we developed an approach. Every investment committee memorandum has a full page on additionality.

It is not a simple concept. There is no way of ever proving you are additional, because you never really know what would have happened if you had not done what you did, so it is a difficult area. We think of it in two ways. We think of financial additionality: if we had not put our money in, would somebody else have done so? That is not an easy concept because, very often, the terms under which we put the money in—for example, the tenor or maturity of the loan we make—might be longer than other, more commercial organisations would give. For many projects, it is not just about getting money, but getting it over the right period. We assess all those things when we think about each of our investments.

The other critical element of additionality is what we call value additionality. That is the difference we make to companies as their owner. I had one experience in Nairobi of visiting a company in which we or one of our funds was about to invest, which manufactured springs for an automobile factory. They were the worst working conditions I have ever seen. People were walking around carrying molten hot rods, with trainers, no gloves, no helmets and no proper clothing, on rickety wooden floors. We went back a year later, once we had taken partial ownership of the company, and the health and safety standards had completely transformed. That would not have happened had many commercial investors invested, so it is important to look at additionality in a broad context.

Nick Dyer: I have two points. First, DfID cares a lot about additionality. This is fundamental to not squeezing out the private sector and ensuring that we only provide support and create that additionality, so we are not funding things that would otherwise be funded anyway.

This is going to be a bigger problem and challenge going forward because, if you look at the scale-up that is happening across DFIs, CDC, the US and the Europeans are scaling up. IFC is scaling up. We just need to hold the line on additionality and challenge our DFI colleagues to hold

that line. CDC has a role to play in raising and holding the standards of additionality across the whole sector, which will be important going forward.

The second thing to say is on value additionality. I confess I was a bit of a sceptic about this when I first took this job but, having seen the Auto Springs and what is going on with ESG standards, I think it adds value. There are some great examples of how CDC investments are changing all the standards of the sector. We saw a firm that is bringing world-class logistics standards into Kenya, which is lowering costs and demonstrating what you can do to the rest of the sector. That kind of value additionality holds.

Richard Gledhill: Funnily enough, I was also a sceptic about value additionality at the start of the review. We spoke to one interesting company that was originally grumbling about the ESG requirements and the reporting requirements for impact. As they started to produce the information and do the training required by CDC, they said to us the work they were doing was helping them demonstrate to other potential investors that they were investment ready. They moved from grumbling to being very positive about it, but we saw some other examples where investees claimed they could have raised money elsewhere, perhaps on less favourable terms or without the support that CDC had provided on environmental, social and governance issues. One private equity investor also told us it had been outbid by CDC on one transaction. Again, proving additionality or the absence of it in hindsight is difficult.

Jonathan France: From speaking to independent private equity investors, one more general point is that, if CDC can push investment into these more difficult sectors, whether health, education or even agriculture, by definition, what it does will be more additional. Secondly, towards the end of the period, some more detailed guidance on additionality was produced by various multilateral development banks and IFC. This may provide more guidance and information on how to look at additionally in a more rigorous way, but the team accepted that it is difficult to prove additionality scientifically.

Q16 **Chair:** I wonder if you can tell us a little about the catalyst portfolio, coming back to poverty reduction, where I started. It accounted for just 6% of CDC's new commitments and, in 2018, comprised less than 2% of the overall investment portfolio. Might that suggest that CDC is not being ambitious about targeting the poorest and most vulnerable specifically, through that mechanism? What are your ambitions for the portfolio?

Graham Wrigley: Maybe I will do the context of where catalyst is today and then Nick will take it forward. From rereading your report from 2011, you talked about a frontier strategy; catalyst is, in a sense, an attempt to take this on the balance sheet, and it was the first DFI in the world to do this. A key part of the new strategy for 2017-21 is to look for a series of sectors where we feel that patient capital with a high risk tolerance can be transformative, with additionality beyond question, in these areas,

whereby, on a time-bound basis, we can be a pathway to change and shape markets over a decade.

We reviewed 21 ideas through 2016, then focused on five or six strategies and created a policy, agreed with DfID and published on our website, about what this catalyst strategy would be. We were very clear with our shareholder that this is not something to rush; it must be done thoughtfully over time, because it is incredibly high risk by definition, but a lot has happened. Maybe Nick can give some colour about where we see the future going.

Nick O'Donohoe: From my perspective, the availability and existence of the catalyst portfolio is one of the chief reasons that I was keen to come to CDC. It gives us the opportunity to do things that are materially different, more developmental and riskier than the core growth portfolio. You have seen examples of that in Malawi, with the agricultural company we have invested in, and Virunga. Some of you have visited Virunga. It has given us the ability to build and provide hydroelectric power, so it is hugely valuable for us to have that money.

In terms of pace, I believe the total commitments under catalyst are almost $500 million. As Nick said earlier, there is a difference between committing the money and when the money goes out. When you commit to funds, it tends to go out over a period of years. When you look at the overall portfolio, it will take a while for it to become a meaningful part. Some strategies inevitably work better than others. For example, we are very proud of MedAccess, a hugely innovative company we have set up that does volume guarantees and helps make critical pharmaceutical and medical devices available in poor countries. Some of them have been slower. One of our strategies is in transmission and distribution. It is a difficult area in which to invest and find opportunities in Africa, so it is a balance.

We need to more actively look for new catalyst strategies. I hope and expect that, sometime in the next couple of months, we will approve one or possibly two more. Overall, I feel it is a unique capability that CDC has been given by DfID that helps us address key developmental issues in a way that the typical growth portfolio does not.

Q17 **Chair:** You have not set a specific target to grow it.

Graham Wrigley: We have.

Nick O'Donohoe: The ambition for catalyst is to have somewhere between £1.2 billion and £1.5 billion.

Nick Dyer: To reinforce what Nick and Graham have said, for DfID this is about changing the risk appetite. It is about having a form of capital that allows CDC to take more risk. Consequently, we have also changed the return requirement. It is not 3.5% but, overall, the portfolio just needs to cover costs. I would not want anybody to say that the catalyst portfolio is

the poverty portfolio. That would be an unfair description because, as we have said before, the growth portfolio is as much about development and poverty reduction. The transmission mechanisms, in some cases, are slightly different. I have seen both ends: I have seen Azito in Côte d'Ivoire, which is producing 33% of Côte d'Ivoire's entire energy production[1], and the delivery of water and sanitation to poor people in slum areas in Nairobi. It works at both ends, but both have an impact on poverty.

Q18 **Stephen Twigg:** ICAI's first recommendation is that CDC should incorporate a broader range of development impact criteria. Can I ask Graham specifically about two issues: disability inclusion and women's economic empowerment? How are they taken into account and are there plans to measure them?

Nick O'Donohoe: Let me start with women's economic empowerment. I think Nick mentioned he was at the European Development Finance Institutions meeting last week in the Netherlands, where we presented our gender strategy, which we developed and launched about a year ago. Of all the work we have done in the last two years at CDC, that is one of the things I am most proud of. We are thinking about the importance of women on boards, in management, in the workforce and how they are treated. We are thinking about the importance of the products that companies are producing. We lead the Gender Finance Collaborative, which is a collection of development finance institutions. We have done really excellent work in that area and I would commend it to anybody.

The disability question is more difficult. What we recognise as disability in the UK would not necessarily be recognised as disability in many of the countries we are in, but it is fundamental, when we are doing our due diligence pre-investment process, looking at the company and thinking about the environmental and social action plans, to think about the potential roles of disabled people.

Q19 **Stephen Twigg:** I do not understand that. What sorts of disabilities would we recognise that would not be recognised in the countries you are working in?

Nick O'Donohoe: Many mental health issues might not be.

Graham Wrigley: In the new strategy, we agreed some cross-cutting themes across all investments. Gender is one and is the most advanced. One was job quality, of which disability is part, and climate change was the other one.

Q20 **Stephen Twigg:** I am going to come to climate change in a moment. ICAI, that sounds like a very strong response on women, but not so strong on disability, to be honest. What do you think?

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[1] Correction from DFID, I have seen Azito in Cote d'Ivoire which is producing 25% of Cote d'Ivoire's entire energy production

Richard Gledhill: That is consistent with what we saw. We were impressed by the number of women in senior management positions we saw in many of the investments, particularly in Nigeria, where I visited. There is not the same clarity on the disability strategy, but there is a broader issue now that CDC is looking to have wider development impacts across a range of different challenges and issues, as to how they are brought together and systematically reviewed as part of the investment selection process and in subsequent monitoring. CDC has developed a development impact case, where it sets out the development impact story for an investment committee to help it weigh these up, but there is not yet a systematic approach to evaluate the different types of impacts against each other and against financial return. Some other development finance institutions have more systematic approaches. I can see pros and cons, but this is an issue to keep under review as the ambitions for development impact increase.

Stephen Twigg: Nick, do you agree with what Richard just said?

Nick Dyer: CDC is a leader in women and girls. I saw that last week in the Netherlands. DfID is finding disability hard. There are the two constraints on the disability side. One is visibility. People do not recognise and hide people with disability in many of the African countries we go to. If you go to a village in Africa, you never see any disabled people, despite them being there. Also, we just do not have the data to measure it. This is genuinely hard to do.

Q21 **Stephen Twigg:** More broadly on monitoring development impact, your annual review was critical in saying it was slower than expected. Have you seen a change of gear in that?

Nick Dyer: There were five things we said needed to happen in the new strategy in 2017. One is the development of development theses, theories of change for every single investment. CDC is advancing quite rapidly on that. The second is more sector strategies. I said they are slow, but I am expected to get those in now. The third is more people in country, which we have talked about already. The fourth is the catalyst programme, which we have also talked about. The fifth is the evaluation programme. I can talk about that now or later, if you want, but we are happy with the progress we are making in both more rapid reviews giving us ongoing information of what is happening and long-term longitudinal studies happening on the valuation side.

We are making good progress. I like the fact that, in 2017, in its annual report CDC had more aggregate indicators of impact, such as farmers reached, kids enrolled in school and patients served, which is good progress. I hope that, once we have the sector strategies and their metrics in place, we can improve that aggregate impact even more.

Q22 **Stephen Twigg:** I will ask CDC about a specific issue that was raised in ICAI's review, which is this affordable housing scheme you had invested in, which ICAI said ended up delivering products for wealthier groups.

Can you tell us the story of how that came about?

Nick O'Donohoe: I believe this is in reference to an investment we made through an investment fund in Nigeria.

Stephen Twigg: Is that right?

Jonathan France: No, it was Phatisa.

Stephen Twigg: I am sorry; I did not hear Jonathan's clarification.

Nick O'Donohoe: It was not Nigeria; it was Kenya, but I am familiar with the story and the fund. We have talked about the challenges of affordable housing everywhere, not just in Africa. This was an investment made. I believe there was a target range for affordable housing and, as we know, the definition of affordable housing is not easy. The company was unable to invest sustainably at the lower end of that range. We had a dialogue with Phatisa, which was the manager of the fund. We are constantly learning in these areas. Perhaps the initial targets set were frankly a little ambitious, of creating a sustain business at that level of cost. Our approach to that was, first, to learn and apply it in other places, then engage with the manager, as we did in that case. Ultimately, sustainability of businesses has to be a critical part of our investment process going in and as the investments develop.

Jonathan France: We saw a number of cases where changing economic conditions impacted on the aspirations for certain investments, beyond the control of CDC, but it is an important question for CDC in working out how, through its portfolio management and ongoing investment management, it can help to mitigate some of those risks and how it responds when those occurrences arise.

Q23 **Stephen Twigg:** Can I move now to climate change, the environment and low-carbon development? I will start with ICAI. In February, when we had your performance review on international climate finance aid, there was nothing in there about CDC. We were told that is because CDC is the subject of a separate review, which is the one we are addressing today, but this review does not have much focus on low-carbon development. What happened there? Why did ICAI not focus more on low-carbon development in this review?

Richard Gledhill: The ICF review looked at the overall investment that had been allocated through CDC and commented briefly on the absence of detailed reporting on climate change. As part of this review, we followed the CDC sector and investment team strategies, so gave a strong focus to energy and solar. As part of our review of individual investments, we looked at the assessment of impact around climate change but, as you say, did not report on that comprehensively.

Jonathan France: I do not have much to add, other than that it was a large and ambitious review. Our focus was on whether the capital is reaching low-income and fragile states, and reducing poverty. We looked

at some investments with a climate change focus, but it was not the primary focus of this review. To do that topic justice within CDC would almost have warranted a separate review.

Q24 **Stephen Twigg:** CDC, to its credit, gave evidence to our climate change inquiry, and that evidence was reflected in the report that was made. In 2014, CDC made a commitment to end coal investments. Are you able to update us on how that is going? Are you on track?

Graham Wrigley: We have done that. We have executed that, so I pass over to Nick on the future.

Nick O'Donohoe: As you know, our colleague Colin Buckley testified to this Committee on climate change. Investment in renewables in particular is a critical part to our overall investment portfolio. We have invested in the largest solar farm in the world in Egypt. As I said, we have invested in M-KOPA, which is bringing home solar at a retail level in Kenya. We have created a company called Ayana, which is developing solar in India. It is a key part of our investments.

Q25 **Stephen Twigg:** What proportion is renewables compared to others?

Nick O'Donohoe: We have invested $500 million in renewables in the last two years. That is a substantial part of our investment. I feel comfortable saying that we are looking at every serious renewable project in our geographies, and have invested in many of them. At the same time, climate is a cross-cutting theme across all our investments.

As Graham mentioned, there were three areas that we committed to in particular in the strategic framework: climate, gender and job quality. We are in the process of developing a specific climate strategy—this is a moving target—which we will publish sometime later this year. It will address both our ambitions in renewables and, importantly, our ambitions across the rest of our portfolio. When we are investing in affordable housing, for example, does the housing have the right environmental standards? Does manufacturing have the right standards? Within our geography, and it is important to stress that, we are doing as much as we possibly could be doing in our specific investments in renewables at this point.

Q26 **Chair:** Do you have any plans to scale up any investments in agriculture?

Graham Wrigley: CDC has lots of plans to do that.

Chair: I suppose this goes to the poverty reduction target.

Nick O'Donohoe: Agriculture is about 9% of our portfolio today. It is clearly a critical area to poverty alleviation. If I am honest—I hope I am, at least—I would like it to be a bigger part of the portfolio. It is a difficult area, particularly when you invest in the sort of scale that we do. Catalyst has been very beneficial to us in that respect. As I mentioned before, it has allowed us to make four or five investments in Malawi that we would

not have been able to do. A year ago, we did not have a dedicated food and agriculture team within CDC. We now have a dedicated team as one of our six sector teams. There is clearly more we can do, both at the processing level, as well as with primary agriculture. When you are investing at the sizes that CDC invests in, it is difficult to find appropriate investees.

Q27 **Chair:** ICAI finds that your financial returns were 10.6% in the six years up to December 2017. That is significantly above breakeven. Are you getting the balance right between development impact and financial return?

Graham Wrigley: This is a great question. Development impact is our purpose. You are talking about agriculture. What motivates us is Zambeef, where we have 30,000 smallholder farmers, or SeKaf, a small company in north Ghana of 6,000 women selling shea butter. That is what we want to do. Sometimes people think CDC has a profit-maximisation culture. That is not us. Having said that, financial returns are an important metric. As Nick said earlier, they are an indicator of sustainability, which creates jobs and taxes: $3.5 billion in national taxes. They help us with mobilisation, which may be something we will talk about in a minute. In an investing organisation, is important to have that sense of discipline.

As Nick Dyer said earlier in this conversation, we have deliberately moved CDC to high-risk areas, first through the grid. That was the first strategy period. Now the new strategy period with catalyst is taking it to another level of risk. We have repeatedly said to anybody who would listen or read our annual reports for the last four years that returns will come down. We believe that the key metric to look at, and we have now started reporting like this, is dollars. If you look at figure 15 on page 41 of this report, you see those returns and they show the picture that we have been predicting to the PAC and NAO. In the first three years of that period, the average returns were 11%. In the most recent year, they were 4%. When we announce our results next month, you will see again that this year has had a lower level of return.

There is a series of structural reasons I am happy to explain, but the reality is that returns are coming down in the way we said. That is not a point of alarm for us, but we believe that the mistake many people make when they look at CDC is that there is a lot of headroom and we are not taking on a lot of risk. In 10 years when people look at this period of CDC's growth and investment, I will be very surprised if they criticise us for not taking on enough risk.

Nick Dyer: Lower returns do not mean higher development impact. You need sustainable companies that invest in supply chains, deliver services and pay their tax. We did a deep dive on returns in one of our quarterly shareholder meetings, and we see the story Graham tells about how returns are coming down. We still think there is headroom to take more risk, hence the catalyst portfolio, but we do not want to start

undermining shareholder value. We do not want to get into that position either, but we need to recognise that we need sustainability. The key here is sustainability.

Richard Gledhill: It is right for CDC to continue to pay close attention to financial returns, in both individual investments and the resilience of the portfolio as a whole. We think there is headroom for more ambition within the catalyst portfolio and individual sectors, and I am encouraged by the support that DfID is giving for that.

Q28 **Richard Burden:** ICAI notes the approach CDC takes to safeguarding, but it is only at the planning stage at the moment. When can we expect that planning to turn into concrete proposals?

Graham Wrigley: A huge amount has happened. We regard safeguarding as deeply important. Nick and I have personally been involved in this from the beginning. We were fully involved in the safeguarding summit and we have given all the assurances to the Secretary of State, alongside the other contractors. We are implementing all four of the strategic shifts that were asked for. First, on survivor and whistleblowing policies, we reviewed all our policies internally and externally, which were there through the code of responsible investing, and have made some changes to them. On leadership and culture, we appointed Dolika Banda at board level, who is a Zambian, because we are thinking not just about the CDC team but our portfolio companies, as champion for safeguarding across the board.

On standards, performance standard 2, which is an IFC performance standard, is and has always been built into our code for responsible investing. We have been doing more work looking at particular high-risk areas, such as education where there are power imbalances, to see how that can be improved. We are about to start a human rights review of all our processes under UN principles. On the fourth strategic shift, which is system-wide, we started work several months ago with EBRD and IFC, to look at how those performance standards can be turned into companies in Africa and south Asia to implement the safeguarding policies. All our learnings will be important to that. We are training our people, so a lot of work is happening. I cannot say it has finished. It is an ongoing job. We have our board meeting next month and this is now part of our internal audit processes. We will be giving a level of assurance to the shareholder about the work we are doing.

Q29 **Richard Burden:** Are you getting reports of any issues?

Graham Wrigley: Yes, we are. We have had three in the last year. Is that enough? No, I think it will rise as we communicate more but, on each of those three, we have responded, reported to DfID and worked with the companies providing support to solve them.

Q30 **Richard Burden:** Does DfID have any views about the priority that CDC is giving to safeguarding issues?

Nick Dyer: CDC has done a good job in responding to the safeguarding agenda. I chaired part of the safeguarding summit, where the commitment was made with IFC and EBRD, so it is good that this been taken further beyond CDC. The core priority for me is that, when safeguarding issues arise, they are reported to the relevant authorities, so there is action to follow up, as well as telling DfID and having action on the ground. What CDC has done with its code of conduct, whistleblowing policy and appointing somebody at board level has put in place many of the elements that will stand it in good stead on improving its response to safeguarding.

Richard Burden: Does ICAI have any views on that?

Richard Gledhill: This is clearly a difficult area for any investor. You are dependent on the processes of investee companies and the integrity of management. I think the right steps are being taken. An increase of independent monitoring and evaluation by CDC will help this, as there will be another lens on what is going on in companies.

Q31 **Richard Burden:** We recently had an evidence session of the full Committee with DfID's private sector contractors, on the issue of safeguarding. It is fair to say we were a bit concerned by the lack of specifics about what was being done. Do you think CDC could get involved in that area, such as there are private sector contractors working there?

Graham Wrigley: We are delighted to work with anyone. I attended, spoke and made that commitment at the summit. We are happy to share knowledge. We do not want to say that we are the best; we are happy to share knowledge and try to learn. That is what we are trying to do with the toolkit: it is to help private companies work in this area. In some countries, it is not as important as it is here. That is the reality. How do you explain that and change these cultural barriers?

Q32 **Stephen Twigg:** Earlier, you referred to expanding country presence and talked us through the history of things starting here, but then moving to other countries, which is very welcome. Nevertheless, the review draws attention to a failure between CDC and DfID to collaborate effectively and share knowledge at a country level. I will invite both CDC and DfID to comment on that but, more importantly, to tell us about plans to strengthen collaboration and knowledge sharing going forwards.

Nick Dyer: Maybe I should start. We are keen to see this expanded country presence. We are in the process of making sure that each country has an identified contact point within CDC. We have a portal now, which everybody in CDC and DfID can access. It has all the projects, information and policy documents on it. We are encouraging greater engagement with CDC on the ground in the work DfID is doing on its country diagnostics and, in return, DfID has been engaged in CDC work on the sector plans. It is starting but, if we are honest, it is patchy. This is work in progress.

I saw a great example in Kenya, when I was talking to Globeleq, one of CDC's companies, which invests in Malindi in solar power. There was a real problem with the Government, and it is fair to say the British high commission and DfID were helping to resolve that. There are some good practical examples. There is no comparison with 10 years ago, but is it where we want it to be? We are getting there, but it is still work in progress.

Nick O'Donohoe: From a CDC perspective, there is no substitute to having people on the ground in terms of relationships. That is why it is so important to continue to build that out. We have seen transformation of the level of communication in India and Kenya, when we have put people on the ground. There are a number of specific things we have done. Karandaaz is an NGO in Pakistan that was supported by DfID. It is a microfinance organisation. As CDC has significant experience in that area, we took the whole Karandaaz management team and did a two-day training session with them. That is an example of how we can work together. We mentioned Virunga earlier, which many of you have seen. That was introduced to us by DfID. Nick touched on the enormous value to us of having the Government connections that DfID has in country. A lot of what we do has a Government connection, in infrastructure particularly. They have been enormously supportive in helping us interact with Government locally.

Stephen Twigg: Richard or Jonathan, do you want to comment on that? It was a strong point.

Richard Gledhill: That is consistent with what we saw. Engagement with DfID at the centre has improved dramatically over the period of the review, and we commend that. I think "patchy" sums up the level of engagement at country level. All the people we spoke to could give examples of some engagement, but were much more optimistic about the plans for the future. Engagement on sector strategies, country plans and country diagnostics will help. Generally across the piece in UK aid, we are seeing much better cross-Government working, not just DfID, but the Foreign Office and others. That is absolutely the right way to be doing it.

Q33 **Chair:** Finally, Graham, we have talked a lot about the reality on the ground, as a result of the things that are in train anyway, but are you making any new changes or time-bound commitments directly as a result of the report?

Graham Wrigley: Nick can talk about some of the specifics. We accept their recommendation on learning. Nick said that earlier and he can talk about something specific we have done to resolve that in a minute. I think it will bring sharpness. A lot of the work we have talked about on the development impact—and Nick may talk about the impact framework—will help us execute well, on the ground, in our offices, because it confirms the approach we want to take. Nobody likes getting an amber/red, frankly. Nick, why do you not take some of the more specific things we are doing?

Nick O'Donohoe: I completely endorse what Graham said. There is an enormous amount of learning we can take and have taken from the very good work ICAI has done. There are two areas where we are, not surprisingly, most focused. The first is the question of development impact and having an understandable framework for it that clearly identifies who is benefiting from the investments we make, how and how much. Although those are all questions asked every time we make an investment, which you will find in our development impact cases, they are not articulated as clearly as they need to be in a proper framework. We will shortly launch a framework based on what is known as the impact management project, which will help to bring discipline to that process.

The second area of development impact is better baselining and clearer, more consistent metrics. Again, we have a set of metrics we use, but we do not present them in as clear a way as we can. The third area, as ICAI highlighted, is on learning. We have to do two things. We have to do more studies of more companies and of more investments to demonstrate where impact is happening, but we also have to disseminate it better. ICAI highlighted this in its report. We have done some good work, but I worry it does not always reach everybody it should and, therefore, does not have the benefit it should. We are looking closely at not just the content we are creating in the studies we are doing, but how we are getting them out to people.

Chair: Gentlemen, thank you very much for a really interesting discussion. Richard, can I thank you particularly, as I suspect this is your last meeting after this iteration of ICAI?

Richard Gledhill: I finish at the end of June, but I will be back for the climate change review.

Chair: Yes, of course. Until then, thank you.

Graham Wrigley: I just want to say one other thing. I hope you think we are a learning organisation. I hope you think we are delivering. One of the commitments we made in our strategy period—it was actually Lord Collins's suggestion—was to have an annual report of everything we have done. It will be on 1 July. You will be getting an invitation, and Stephen is coming. It is of everything that has happened in the last year, and we would welcome IDC membership to join.

Chair: Thank you very much.