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The case of the UK: BII and FCDO

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By Samantha Attridge (ODI)

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This study is part of a series of analyses covering 8 European case studies (France, Germany, Italy, the Netherlands, Spain, United Kingdom, the European Bank for Reconstruction and Development - EBRD and the European Investment Bank - EIB) as well as a synthesis report.

BRIEF OVERVIEW OF COLLABORATION

British International Investment (BII) is the United Kingdom's development finance institution (DFI). It is entirely owned by the UK government and its single shareholder is the Foreign, Commonwealth and Development Office (FCDO), represented by the Secretary of State for FCDO. The relationship between FCDO and BII has evolved over time and continues to evolve. Over the last few years, there has been a growing appreciation within the UK government of the value of BII as an important channel to achieve not only UK development objectives but also to contribute to geopolitical objectives such as promoting Global Britain. The result has been a rising profile of BII towards achieving broader UK government policy objectives.

Strategic policy coordination and collaboration

At the highest level, integration and coordination are governed by five-year BII strategies, which reflect the policy preferences of the government of the day and lock in alignment with these. The latest BII strategy and investment policy, for 2022-2026, were developed and negotiated by BII and FCDO in 2020 and 2021 (BII 2021a, 2021b). These reflect high-level UK government policy objectives and priorities in relation to geography, sector and cross-cutting issues, such as tacking climate change and gender inequality. The strategy sets the broad parameters within which BII operates on an arm's length basis. Quarterly shareholder meetings allow for general shareholder oversight to ensure that BII is on track to deliver the priorities of the UK government as set out in the strategy and investment policy. The FCDO BII shareholding team meets on a weekly basis with BII; it manages the UK government relationship with BII and plays a coordinating role across FCDO and the UK government more broadly.

Multifaceted programmatic and transactional coordination and collaboration

Coordination beyond this is multifaceted, occurring at many levels (e.g., country, regional, thematic) and for different purposes (e.g., knowledge sharing, policy development, market shaping, transaction support). Some collaboration is more formal and structured, with BII staff providing regular technical input into ongoing FCDO programmes. An example of such formal collaboration is the in-country prosperity boards (e.g., in Kenya and Ghana) which on a quarterly basis bring together different FCDO teams in the country with BII and other UK government departments, such as Trade and UK Export Finance, to share information and support Global Britain objectives. This type of collaboration seeks to harness synergies between UK development finance and wider UK economic diplomacy. To further promote these objectives, the prosperity board in Ghana organises a semi-annual UK-Ghana Business Council which brings together the UK development finance and economic proposition and involves discussion with the Ghanaian government, as well as the private sector. Other examples of more structured collaboration beyond the prosperity boards include the sitting of a BII senior director on the FCDO Financial Sector Deepening Africa platform investment committee; a BII seat on the FCDO-funded Prospero special purpose vehicle in Zambia which aims to promote investments in small and medium-sized enterprises (SMEs); and the joint FCDO and BII oversight of the steering group for the joint evaluation and learning programme of FCDO and BII.

Other collaboration efforts are opportunistic and develop organically, as they are demand driven. This tends to be the most common form of collaboration (Van Rhyn et al. 2022). Examples include technical working groups, investment-specific coordination and collaboration, and to a lesser extent, collaborative market-shaping activities. Investment-specific collaboration can take two forms. The first is direct and immediate collaboration consisting of FCDO and BII providing complementary support to each other's investments. As an example, BII's investment in the Blue Orchard COVID-19 response fund was also supported via an FCDO programme wherein FCDO provided the first loss guarantee. Similarly, FCDO invested in road linkages in Somaliland to improve the flow of goods to and from Berbera Port, in which BII is invested. The second type of investment-specific collaboration is demand driven and follows the logic of 'escalator' engagements, whereby FCDO activities and investment pave the way for BII to invest later, when a near-commercial investment becomes viable. An example is FCDO's pioneering investment in M-PESA and the technology underpinning M-KOPA through the FCDO Research and Evidence Division; this paved the way for subsequent investment by BII.

The FCDO BII shareholding team in London keeps tabs on all collaboration efforts, disseminating information and coordinating with other teams in FCDO, as well as in country offices and throughout the UK government. More broadly, this helps ensure that the necessary professional connections are made and that networks are established for joint programmes to succeed. These connections are especially important at the country level and tend to work well where BII and FCDO both have a country presence (e.g., India and Kenya). Where BII does not have country offices, the central shareholding team plays an even more important role in connecting BII with FCDO High Commissions and vice

> "Coordination and collaboration between FCDO and BII is multifaceted and occurs at many levels. Some is formal and structured, other efforts are more opportunistic and develop organically, as they tend to be demand driven. This tends to be the most common form of collaboration."

versa. In this regard, it is important to note that BII has been expanding its country presence and is set to continue this effort in the new strategy period.

Both FCDO and BII recognise the value of collaboration and hope to extend and enhance their methods of cooperation to further their development impact, especially with respect to market shaping and sector transformation.

INVEST FOR IMPACT NEPAL: AN EXAMPLE OF COUNTRY-LEVEL COLLABORATION TO SHAPE MARKETS

A good example of BII and FCDO collaboration to shape markets in-country is Invest for Impact Nepal (IIN). Part of this collaboration has been funded by BII Plus, a technical assistance facility managed by BII which until the end of 2021 was funded by an FCDO grant. Section 2.1 below provides a brief introduction of BII Plus. Section 2.2 then provides an overview of IIN.

BII Plus overview

BII Plus is the dedicated technical assistance and support facility of BII. As part of BII's value addition activities, BII Plus works to identify and create opportunities that are beyond BII's current portfolio and returnable capital. The facility supports the development of BII's investable pipeline and investee companies, as well as broader market-shaping activities, although the latter is still under establishment. The BII Plus portfolio consists of two types of activity:

- Impact and value creation within BII portfolio companies (64% of portfolio). Available to the whole BII investee portfolio, BII Plus provides both technical expertise and, in some cases, co-funding for targeted value-addition activities to deepen development impact.

- Impact and value creation beyond BII portfolio companies (36% of portfolio). Outside investee portfolio operations allow BII to test solutions that address systemic issues affecting multiple BII investees in the markets in which BII operates, as well as ecosystem-level challenges that investors within these markets face. BII Plus also works with industry stakeholders to uncover opportunities in priority sectors and geographies.

Since its launch in 2018, BII Plus has worked closely with FCDO, and the two have continued to explore how BII Plus' technical assistance offerings can be expanded within BII's wider advisory services, including by opening up the investment advisory role to serve FCDO's network of country programmes (CDC 2018).

BII Plus (formerly CDC Plus) was developed and negotiated in 2012 as part of the impact investment programme of the Department for International Development (DFID).[1] DFID selected BII to create and manage the facility with the explicit aim of fostering the market for impact investing in sub-Saharan Africa and South Asia. The memorandum creating BII Plus sets out high-level governance arrangements and the broad policy parameters of the facility, to ensure that it docks into FCDO's wider economic development policy objectives. A member of the FCDO central shareholding team sits as an observer[2] on the BII Plus committee, which supports wider FCDO coordination and linkages; but BII leads and manages the facility's day-to-day deployment.

Despite the scheduled end date of 2025, in 2022 BII and FCDO began to rethink the facility's strategic objectives. To date, BII Plus projects have focused mainly on post-investment technical assistance. However, BII's 'deal teams' and its 2022-2026 strategy highlight a great need for pre-investment support and investment readiness. Considering this strategic shift and the UK government's downscaling of official development assistance (ODA) spending commitments, in 2021 FCDO moved to consolidate BII Plus funding under the overarching BII business case.[3] This consolidation will see new arrangements developed under a new BII business case, rather than a separately funded impact investment programme (as was previously the case for CDC Plus).[4]

With FCDO's support and continued cooperation, BII Plus has maintained an active portfolio. As of mid-2022, it had completed 258 projects and made a total funding commitment of US $40 million (BII, 2022).

1. DFID was merged with the Foreign and Commonwealth Office in September 2020, creating FCDO.
2. Previously, this was not a member of the FCDO central shareholding team. The new arrangement is more effective in coordinating across FCDO.
3. The business case sets out the justification for any new government funding of BII.
4. For 2022 and 2023 BII will fund BII Plus from its retained earnings and own account resources. BII is in discussion with FCDO about its future after 2023.

About Invest for Impact Nepal

Invest for Impact Nepal (IIN) (formally known as 'Nepal Invests') was established in February 2021 by BII, the Dutch Entrepreneurial Development Bank (FMO) and the Swiss Agency for Development and Cooperation (SDC). The initiative is a technical assistance and market-shaping platform which seeks to tackle investor-specific barriers constraining the scale-up of DFI operations and similar impact-orientated investment in Nepal. The platform initially operated in a 'discovery phase' for 18 months, from February 2021 to June 2022. A larger scaled-up phase has been approved to run from July 2022 to June 2025.

The platform is linked to the DFI Fragility Forum, a wider initiative to improve inter-DFI and donor collaboration from upstream to downstream, to strengthen investment environments so as to unlock investment in fragile states (Collier et al. 2021).

During the discovery phase, the platform focused on developing the private equity and venture capital industries and on developing environmental, social and governance (ESG) standards within these industries to create a level playing field which can attract DFI and impact-orientated investment to Nepal. Activities have been focused in five areas: (1) making foreign direct investment (FDI) regulation more conducive to DFI investment; (2) exploring new SME financing options; (3) increasing the capability of private equity and venture capital investors; (4) increasing demand for DFI capital; and (5) improving ESG standards among companies and ensuring a unified approach across institutions and DFIs.

> The Invest for Impact Nepal platform has the objective to shape and build markets. It is widely regarded as one of the most successful and advanced country platforms bringing DFIs and donors together in fragile states.

Nature of collaboration

IIN is a DFI-donor partnership which pools DFI technical assistance and leverages the investment expertise of DFIs with the policy reform and advocacy capabilities of donor partners. The platform was seed funded by a small grant of £260,000 , with 40% funded from BII Plus, and FMO and SDC contributing 30% each. The FMO contribution was funded by the MASSIF financial inclusion fund that FMO manages on behalf of the Dutch state.

The impetus for creation of the IIN platform was a conversation between the resident FCDO private sector development (PSD) advisor in Nepal and a BII Plus manager about what could be done to unlock more investments for BII and other DFIs. Given that Nepal is a country of interest to BII in the South Asia region, due to its existing investments there, it made sense to explore this further. The idea was then pushed forward during a trip organised jointly by the Embassy of Switzerland in Nepal and SIFEM, the Swiss DFI. That trip occurred in January 2020, as part of a country platform initiative of the DFI Fragility Forum and Oxford University. The BII Plus manager, a colleague from FMO (on secondment) and representatives from the Swiss embassy and other DFIs designed the platform, seeking input from the resident FCDO PSD advisor. BII took the design lead, and FCDO provided technical expertise, drawing on its wider economic development knowledge and broader experience in Nepal.

The platform is supported by a steering committee, which consists of DFIs and donor partners[5] and provides informal oversight and strategic guidance on the direction of IIN. Meanwhile, BII, SDC and FMO (IIN funders) sit on the management committee overseeing the daily business of the platform, for instance approving, co-designing and supporting the delivery of projects. Project delivery is contracted to a service provider (Nathan Associates), which works hand in hand with the management committee. Donor partners, including SDC and FCDO, engage in technical working groups around specific projects reflecting their strategic interests and expertise. SDC is the technical partner in the 1st pillar, on the legal and regulatory framework for foreign investment in Nepal, and FCDO is the technical partner in the 2nd on 3rd pillars, on SME financing and increasing professional investment capabilities, respectively. Examples of key collaborations between BII and FCDO in the 2nd and 3rd pillars are the following:

5. Including the International Finance Corporation (IFC), FMO, BII, Proparco, SIFEM, SDC, Swedfund, Norfund, FCDO and the US Agency for International Development (USAID).

- Provision of additional grant funding by FCDO to support the establishment and development of the Nepalese Private Equity Association, a key actor in the ecosystem, in preparation for IIN's Nepal launch and subsequent further support to the Nepal Private Equity Association (NPEA) during the 'discovery phase'.

- The sharing of technical expertise on SME financing through FCDO participation in the finance working group of the platform which seeks to unlock DFI capital for SMEs. FCDO has also shared its prior work on SME financing and a market mapping to support the objectives, while the Invest for Impact SME finance working group has assisted FCDO's approach to support for the SME sector.

Further, in the 1st pillar FCDO has leveraged its networks to help the platform engage as one voice and interact with key stakeholders in discussing regulatory barriers to DFI investment, such as withholding tax and tax on interest caps.

Results

As the initiative just recently completed its discovery phase, results to date have been more at the inception activity level, as opposed to market-shaping outcomes. These latter are expected to follow over time as a result of the scale-up. In terms of results, several stand out:

- The platform has identified more than 35 investment-specific challenges and opportunities related to the legal and regulatory framework for foreign investment in Nepal which need to be addressed to help increase the flow of DFI and impact-orientated capital.

- It has assessed the investment capability of more than 50 Nepali investment professionals and piloted training to address skills gaps.

- It has undertaken analysis with 22 leading private sector companies, identifying knowledge gaps and barriers to the absorption of DFI investment (IIN 2022).

Given these achievements, the platform is widely regarded as one of the most successful and advanced country platforms bringing DFIs and donors together in fragile states (Collier et al. 2021). To this end, the momentum surrounding the initiative has created opportunities and new avenues to deepen engagement and collaboration with donors in the country. On top of this, IIN recently secured a new £3 million budget (an eleven-fold increase in funding) for the next 'market-shaping phase'. BII, FMO[6] and SDC will each provide £1 million over the current three-year phase. During this period, the platform will focus on mobilising more investment into and by financial intermediaries and funds. It also hopes to leverage new donor resources, which will enable IIN to amplify its impact in various sectors and themes, while preserving capital. For example, it has received numerous advisory and fund management proposals from donors in the country. It hopes to take these forward during this second phase.

In terms of donor and DFI collaboration, the main achievements are the following:

- The platform has established itself as the 'go-to' place for donors and DFIs interested in working together to increase private investment in pursuit of economic development goals in Nepal. The platform has opened an office, and it is now common for DFIs and donors to drop in when they are in Nepal to exchange market insights.

- It has helped build consensus around key challenges to scaling up DFI investment and similar impact-orientated capital and is leveraging the different strengths of actors in a coordinated and collaborative manner. For example, an FDI workstream report identifies priority issues for joint DFI and donor advocacy with the government on regulatory barriers. It will be important to leverage the capacity, policy reform expertise and networks of donor partners such as FCDO to address the identified barriers.

- The platform has quickly built networks and trusted relationships that can be leveraged by both donors and DFIs. For example, the platform has established a good relationship with the Central Bank, which is keen to engage in the platform and work on new options for SME financing (Collier et al. 2021).

- The platform has attracted the interest of other donors and DFIs, who see it as a proof of concept. For example, the inter-DFI collaboration has facilitated the engagement of the International Finance Corporation (IFC), and in doing so has established a link to the upstream economic development and policy reform work of the World Bank in Nepal (Collier et al. 2021).

6. FMO's contribution has been financed by the MASSIF financial inclusion fund that FMO manages on behalf of the Dutch State.

CHALLENGES, LESSONS LEARNT AND IMPLICATIONS FOR DONORS AND DFIS

DFIs and donors need to find common ground

A small number of DFIs and donors have come together to collaborate in the IIN platform, but each has their own strategic priorities, technical approaches, expertise and interests. These invariably present challenges for alignment. Further, incentives differ between donors and DFIs, and are not generally aligned. DFIs are near-commercial investors, with profit targets alongside impact targets. Donors focus first on development impact, without the constraint of having to see financial returns on investment. Market shaping is a long-term endeavour at odds with the time horizons of both DFIs and donors. These differing incentives, priorities and interests can mean that DFIs and donors do not always pull towards a shared agenda. To make the IIN platform a success, these actors have had to make compromises and find common ground where there is mutual interest, but also leverage the respective expertise and capabilities of each. Further, the IIN case suggests that it is important for market-shaping initiatives to involve DFI investment colleagues right from the start, so the platform is investment focused, which can help break down barriers in terms of unhelpful preconceptions. Moreover, donors and DFIs must be able and willing to prioritise the common vision and goal over their own individual interests and bureaucracies. One area that helped in the IIN case was cross-over knowledge and capacity between FCDO and BII, as the FCDO PSD advisor in Nepal became the BII country manager. This helped broker understanding of the respective value added by the DFI and the donor. Further, a staff member seconded from FMO to BII helped broker mutual trust and understanding between these DFIs. A lesson here is the potential value of secondment programmes between donors and their DFIs, to facilitate mutual learning and appreciation of the institutions' respective expertise and capacity.

> "DFIs and donors each have their own strategic priorities, technical approaches, expertise and interests, which present challenges for alignment. DFIs and donors will need to find common ground to work towards a shared agenda."

Scalability requires vision, long-term commitment and adequate resourcing

The platform has been driven by individual staff within BII and the FCDO in-country PSD advisor, and has remained reliant on the strong relationships between them and other partners, including FMO (enabled by an FMO secondment to BII). It has not been driven by the pursuit of a strategic and coordinated programmatic vision to create markets shared by BII and FCDO. While opportunistic behaviour, driven by the will and motivation of individuals, can be inspirational and insightful, joint institutional ownership will be necessary for these initiatives to lead to a scaled and more systematised approach. For this, FCDO and BII need to be structured in their intent and prioritise transformational approaches over transactional approaches. This should include the joint articulation of a long-term vision that sets out a mutually agreed strategic intention to shape markets and transform sectors over the long term; as well as a common understanding as to what this means and involves. This would help ensure that this is an organisational priority and driven by the organisations rather than individuals. It would also help ensure that adequate long-term human and financial resources are dedicated to this purpose, thereby

> "DFIs and donors need articulate a joint long-term vision that sets out a mutually agreed strategic intention to shape markets and transform sectors over the long term; and make long-term commitments to support these initiatives and resource them adequately over the long-term."

securing programmatic certainty and investment planning. This is key, because market-shaping collaborations are labour-intensive; they need to bring together a diverse set of actors, are dependent on securing buy-in and need to build trusted relationships and leverage networks. Pooling and coordinating DFI and donor technical assistance resources (as in the IIN platform) enables a larger pool of resources to be leveraged and deployed in a coordinated way, which can lead to greater synergies and impact.

Prioritise countries and learn by doing

Collaboration to shape markets is a long-term endeavour, involving many different local and international actors. The network and relationship building that is required is resource intensive. Accordingly, it may be unworkable or even undesirable to do this in every country. In the first instance, FCDO and BII should identify and prioritise several key countries where they could focus their collaboration on sector transformation. This would ensure a targeted approach and enable both BII and FCDO to 'double down' on market shaping and ensure that resources are not spread too thinly, adversely impacting the long-term success of such endeavours.

Given that market shaping is country- and sector-specific, collaboration platforms will vary in terms of mandates, objectives and processes. It is desirable to allow these collaborations to evolve and progress according to country circumstances and the interests and expertise of different DFIs and donors, rather than to specify a model that may become a straitjacket. Indeed, a small number of like-minded and interested DFIs and donors may be preferable initially to get the ball rolling and for a collaboration to progress quickly and not become too bureaucratic. As momentum builds, it will become important for other large DFIs and donors to come on board and engage either as funders or as technical partners (or both), depending on their interest. This is important for legitimacy, efficiency and effectiveness.

DFIs and donors need boots on the ground

Market shaping and transformation is country- and sector-specific. Both the donor and the DFI need an in-country presence, as market shaping requires deep knowledge and expertise on the local context. To be successful the market-shaping process must ultimately be locally led.

> “Collaboration to shape markets is a long-term endeavour, involving many different local and international actors and is resource intensive and country specific. DFIs and donors should prioritise their focus countries and allow these initiatives to evolve and develop, with boots on the ground to ensure initiatives are locally led.”

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