Norfund

M E M O

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Matter: Norfund's strategy 2016–2020

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Norfund – Norway's principal instrument for developing business and creating jobs in developing countries

The key importance of the business sector for creating economic growth and combating poverty is highlighted in the sustainable development goals adopted by the UN in September 2015. A profitable business sector with capacity for growth, which generates revenue and creates good workplaces, is essential for attaining the goal of ending extreme poverty by 2030.

Norfund – the Norwegian Government Investment Fund for Developing Countries – was established in 1997, and is Norway's principal instrument for developing businesses and creating jobs. Norfund's task is to contribute equity and other risk capital, extend loans and provide guarantees for the development of sustainable commercial activities in developing countries. Its objective is to establish viable, profitable activities that would not otherwise be initiated by providing risk capital and competence. Norfund's role is to function as a catalyst, i.e. prompt others, too, to invest, and to be additional, i.e. to contribute capital where capital is particularly scarce. Norfund contributes to job creation, poverty alleviation and economic development through investment in profitable enterprises and the transfer of knowledge and technology. Priority is given to investing in least developed countries (LDCs) and Sub-Saharan Africa. Norfund always co-invests with commercial partners, Norwegian or foreign, and only as a minority shareholder.

Norfund's strategy – concentration on country, sector and instrument

In 2007, Norfund established a strategy, the main elements of which were growth based on expertise, geographic concentration, prioritisation of investment in renewable energy and financial institutions, and prioritisation of equity as the principal instrument. This strategy has remained in place since 2007, albeit with some revisions. Agriculture and related industry became the third prioritised sector in 2011, and a 2012 revision of the strategy placed greater emphasis on a stronger regional presence and on building up expertise and additionality.

Sound investments are contingent on the right choice of partners. Norfund has a high level of ambition with regard to environmental and social standards, and good corporate governance.

Growth in a changing landscape

Since the previous strategy review in 2012, the Fund's capital base has almost doubled, from NOK 7.9 billion to over NOK 14 billion today. The growth is primarily attributable to substantially increased supplies of fresh capital from the owner, and to the profitability of the portfolio. Growth is expected to continue at the same rate for the next few years, and in 2020 the Fund's capital is expected to be close to NOK 25 billion. The net asset value at 31 December 2014 was NOK 15.5 billion.

At the same time, major changes are taking place in the markets in which we invest. A number of Norfund's prioritised countries are developing rapidly. The group consisting of LDCs and low-income countries is shrinking, and countries such as Kenya, Bangladesh and Myanmar are moving up into the group "lower-middle-income countries" in the World Bank's classification. A positive development does not mean less need for investment, but is rather an indication of an improvement in the market basis for making sound, sustainable investments that create growth, revenue and jobs. An uncertain global economic situation gives rise to extensive capital flow volatility and potential imbalances. This past year has been characterised by falling commodity prices and global investors have withdrawn a large amount of capital from emerging economies. This has increased the challenges, which include falling exchange rates, faced by many of the countries in which Norfund invests.

At the same time, some commercial capital and financial actors do find their way to markets where grants and microfinance were previously the only sources of funding. In the poorest countries, there is a dearth of actors willing to engage in the more demanding projects. Development Finance Institutions (DFIs) such as Norfund, play an important part in these markets, and there is a growing need for DFI capital. In consequence, countries such as the UK, Finland and the Netherlands are increasing supplies of capital to their DFIs, to make them an even more important development cooperation instrument. A pioneer in this respect, Norway has been systematically boosting Norfund's capital base for many years.

A growing Norfund implies intensified requirements in all areas: investment, asset management, collaboration with partners, administration, personnel and internal systems, risk management and compliance, ownership engagement, reporting and follow-up of external stakeholders. Higher expectations and requirements present a challenge to the Fund's geographical priorities, and our catalytic role as co-investor. It is important, not least, to understand our role as DFI, and to make it clear to the general public what Norfund is, and what is beyond the scope of what we can do or should be doing.

Strategy 2016-2020

Clear and concentrated

Norfund will continue and refine its strategy based on concentration and expertise. The geographic and sectoral concentration has been successful, and made building of expertise and sound, locally based investment possible. The prioritisation of equity as an instrument has been important for meeting needs when capital is in short supply and for paving the way for active ownership. Norfund's ability to make swift evaluations of investment projects, keep decision-making processes short and structure investments with a minimum of bureaucracy, while verifying the quality of the work, will be continued and enhanced.

Use of platform companies and collaboration with co-investors

Norfund has for many years sought close collaboration with other investors in selected areas in which their partners possess specialised expertise and can contribute to better goal achievement. One such example is SN Power, a company jointly owned with Statkraft, which invests in hydropower in developing countries, and increasingly in Africa. Another example is Norwegian Microfinance Initiative, through which Norfund co-invests with other Norwegian financial investors in microfinance, and Globeleq, which is owned jointly with Norfund's English sister fund CDC, and which invests in gas, solar and wind power in West and East Africa. There is also close collaboration with Scatec Solar on investment in solar energy, although a corporate superstructure has not been established in this case. Norfund has positive experience of this type of cooperation, which contributes both capital and expertise, and will seek to extend the use of platform companies, also to sectors other than energy.

"Active, strategic minority investor"

The Fund's role is to be an "active, strategic minority investor". This entails playing an active part as owner in portfolio companies in order to contribute expertise, establish sound corporate governance and set high standards. This role demands skills, culture and an operational ability to handle the challenges facing the Fund. Personal responsibility, the ability to be proactive in meeting challenges and opportunities, and the ability to work with and through partners are crucial. We shall build expertise continuously by learning from experience, developing deep sectoral knowledge and developing the ability to understand risks.

Norfund's organisation is to have well-defined decision-making and responsibility lines, and to perform effectively as an active owner in its investments. One important task is to secure competent boards of directors for the portfolio companies. Norfund will intensify efforts to recruit and train external board members for its portfolio companies, and consider establishing sectoral advisory fora on corporate governance composed of experienced business sector actors.

Norfund will define a more explicit strategy with respect to how long the Fund should remain in the individual investment. The life of the investment is to be decided at the time of making the investment, and a strategy defined for how the Fund should exit. The life of an investment is determined primarily by how long Norfund is additional. The investment period for loans and fund investments is clearly defined in the investment agreement. For equity investments, decision gates should be established at which an explicit position should be adopted on continued ownership or exit. Norfund is to be a serious, predictable, long-term investor, but at the same time not to remain as owner for longer than is necessary to ensure that the capital is performing continuously. As a guide, the planned life of the individual instruments should be: equity: 5–10 years; loans: an average life of 5–7 years; funds: 10–12 years. The ownership period for platforms will be a part of the evaluation of the individual platform.

We will further develop Norfund's framework for assessing financial risk, in order to ensure consistency across investments and investment areas, and to provide a better basis for assessing risk at portfolio level. Norfund has zero tolerance for corruption, and places great emphasis on high quality in its work in connection with compliance with rules and regulations, anti-corruption measures and integrity. We will review and improve our work to identify and limit risk related to failure to comply with rules and procedures, integrity and corruption.

Geography

Norfund will continue to prioritise investment in countries classified as LDCs and countries in Sub-Saharan Africa. Geographical concentration is a key aspect of our strategy[1]. Norfund's priority regions are East Africa, Southern Africa, Central America and selected countries in South-East Asia. However, the size of the Fund, increased cooperation with commercial partners and input from various stakeholders indicate a need for some adjustments to the geographical area covered. We will begin by including Ethiopia and Somaliland in the regional initiative in East Africa. Norfund will also start investing in West Africa, initially in English-speaking countries, using a regional office that is being established in Ghana as a springboard. In a 10-year perspective, we will consider to include the whole of Sub-Saharan Africa in Norfund's geographical area.

Investing through platform companies demands greater flexibility to monitor Norfund's commercial partners. For them, Sub-Saharan Africa is the target area, with the occasional option of investing elsewhere in Africa.

Role as catalyst

Norfund has the important responsibility of mobilising private capital. Establishing mechanisms for mobilising capital has been a central part of the Fund's activity for many years. Capital manager Aureos, SN Power, NorFinance, KLP Norfund Invest etc. are examples of such successful establishments.

Nonetheless, Norfund's task is not to manage capital for commercial actors. In areas in which Norfund has been in the forefront and succeeded in attracting private capital, it is natural to consider assigning the management to independent managers or subsidiaries to take the investments further.

Target figures

Norfund has established a set of target figures as a tool for ensuring that the Fund's mandate is fulfilled. The target figures have primarily been important for guiding the allocation of the Fund's capital over time. Targets have been set for the share of the portfolio that should be invested in LDCs, Sub-Saharan Africa, equity instruments and new business start-ups. In recent years the owner has additionally introduced a target that at least half of the annual allocations of capital must be invested in renewable energy. Thus the target figures are designed to lead to high investment activity in the most difficult markets and the most demanding instruments, thereby ensuring a high degree of additionality.

As well as the traditional targets, the Fund will establish target figures for financial results. At the outset we will establish a target for the portfolio's return over time, and an indicator for an acceptable loss level over time. At the same time, the Fund will define a special asset class of impact investments – investments with higher risk than what is normally accepted by the Fund, but which are made because the anticipated

[1] Norfund's priority countries are: East Africa: Kenya, Uganda, Tanzania, Burundi, Rwanda, South Sudan, Ethiopia and Somaliland. Southern Africa: Angola, Namibia, South Africa, Lesotho, Swaziland, Mozambique, Zimbabwe, Zambia, Madagascar, Malawi. West Africa: Ghana (as a starting point for building a portfolio in the region). Central America: Guatemala, El Salvador, Nicaragua, Honduras, Panama, Costa Rica. Southeast and South Asia: Bangladesh, Vietnam, Laos, Cambodia, Myanmar. Investments via platforms and funds may have a broader geographical coverage.

development impacts of the projects are especially high. This class will encompass investments for a total committed amount of up to NOK 1 billion. This asset class will not be included in the return calculations associated with the new financial targets.

Strategic priorities 2016–2020 by investment area

Norfund's investment activities will be organised in four areas: Clean energy, Agriculture and food industry (Agribusiness), Financial Institutions and SME funds. The strategic priorities in these investment areas are:

Clean energy

A substantial increase in global power production is necessary if the UN sustainable development goals of energy for all are to be attained. Access to electricity is the single factor that is most crucial for business development in poor countries. The current investment strategy, use of platforms and instruments and focus on technology will be continued in the main. The owner's requirement that 50 per cent of the annual capital supplied be invested in renewable energy forms the basis. It will still be important to ensure flexibility and options in order to be prepared for a continued increase in investment in clean energy. Solar energy has become more competitive, and accounts for an increasing portion of the portfolio. Investment in gas power through Globeleq will make an important contribution to meeting Africa's escalating energy needs, curbing the need for more polluting energy sources such as coal and oil, and helping to maintain a power supply with the necessary balance and stability which in turn makes it possible to develop renewable energy sources.

Norfund will maintain an open dialogue and good relations with central partners, including Statkraft, BKK, CDC and Scatec Solar, who are our partners in the most important investment platforms.

Through the platforms SN Power, Globeleq and the Scatec collaboration, we will gradually expand to West Africa. Globeleq and Scatec will have a broader, pan-African focus We will also invest in South-East Asia. We will continue to develop small-scale hydropower plants and consider the options for investing in off-grid micro-solar power. Investments through Statkraft International Hydro Invest (SKIHI) will be gradually phased out, and in due course the capital will be moved to Africa.

The collaboration through KLP Norfund Invest will be continued within agreed limits, but not expanded further. We will consider the possibility of collaborating with other Nordic DFIs on the establishment of a joint loan mechanism, with opportunities for private investors such as pension managers to participate.

Financial institutions

Facilitating the access of small and medium-sized enterprises to financial services is one of the subsidiary goals under the UN sustainable development goals on infrastructure, innovation and industrialisation. By investing in banks, microfinance and other financial institutions, Norfund supplies important capital to SMEs. Norfund will continue to give priority to equity investments and offer long-term financing to financial institutions that target SMEs and the retail market.

The Norwegian Microfinance Initiative (NMI) will remain the most important channel for microfinance capital. The goal is to build NMI up into the leading Nordic microfinance platform. Direct investment in microfinance other than through NMI is a possibility in Myanmar and Central America.

Bank investment will target medium-sized and large institutions that focus on SMEs and the retail market, including clients who have not previously had access to financial services. The aim is to create efficient, scalable banks that can provide less expensive services by reducing sector costs, which are far too high in many countries.

We will also invest in non-bank financial institutions that are dedicated to serving SMEs, such as leasing, factoring and lending institutions. We will also consider investing in insurance.

Equity investment receives priority ahead of lending. Lending is used primarily as a means of establishing long-term strategic relations. Loans will also be used strategically for institutions when equity is regarded as being too risky.

Some investments will be small, but have special strategic purposes or offer unique additionality. This type of investment is particularly relevant for Myanmar.

Norfund will continue to build up a portfolio of investments in financial institutions in Africa, and consider whether it is advisable to set up a platform for this purpose.

Agriculture and food industry (Agribusiness)

Agribusiness is Norfund's third strategic sector, and aligned with the UN sustainable development goals of food security and sustainable agriculture. Norfund's goal is to accumulate a substantial portfolio within this sector, so it is important to build expertise and networks.

We will only engage in agribusiness in Africa. In order to ensure that we take advantage of our comparative edge, we will invest in other parts of the value chain, for example logistics and distribution, and not just primary agriculture. Aquaculture is also included in this strategy. We will invest relatively less in start-up projects and more in expansion. The emphasis will be on working with strong partners who have the same interests as Norfund, and we will build further on the most successful of our existing investments. We will step up our project development work, particularly at the regional offices, and increase our flexibility with respect to the size of agreements and choice of instrument, including providing more loans. We will continue to invest in agricultural funds and work more actively to co-finance with grants where relevant.

Norfund will no longer engage in direct investment with new partners outside the prioritised sectors, but will continue existing partnerships in tourism, property and petroleum-related services.

SME funds

UN sustainable development goal number 8 points out the importance of small and medium-sized enterprises for growth and job creation. Investing through SME funds is an important means of reaching a larger number of enterprises than Norfund can reach alone.

Investment in funds has been an important instrument since Norfund's own start-up phase. The strategy has changed over time, and these investments are now made only in markets and funds in which Norfund can play a special role as an additionality agent. We will continue the strategy with the focus on filling holes in the market and a high additionality factor. We will also consider alternative SME investment models for vulnerable states.

Organisation

Norfund will continue to place emphasis on building the organisation's own expertise and capacity. We will give priority to further development of regional offices, and engage in active recruitment, both of experienced personnel to fill key positions, and of trainees through the trainee scheme that was recently established at our three offices in Africa.

Norfund intends to establish a special internal function of compliance officer for monitoring compliance with rules and regulations.

Norfund will retain its short lines of command and a non-bureaucratic organisation, so the organisation should not grow too much. In order to be able to maintain a small organisation, non-core functions will continue to be outsourced. These include several support functions such as accounting, legal advisory services and IT systems.

Development effects and ESG

Ensuring development effects and contributing to high standards of environmental, social and governance responsibility (ESG) form an integral part of investment processes, and we will continue to place emphasis on explaining how Norfund's strategy (concentration with a focus on countries, sectors, instruments) contributes to development. However, there are growing expectations with respect to reporting and documentation of results in these areas, on the part of both owner and other stakeholders. We will strengthen our reporting on development effects and on the impact of our ESG efforts, for example through in-depth studies and more extensive reporting.