

Fact Sheet

FMO (Netherlands) and private finance for development

What is FMO?

The Dutch development bank FMO was founded in 1970 as a public-private partnership. Actual shareholding is 51% held by the Dutch state and 49% by commercial banks, trade unions and other private sector representatives.¹ The Dutch state intends to retain its majority shareholding as it considers FMO an important instrument of its development policy.²

FMO aims to contribute “to the development of the business sector in developing countries in the interest of the economic and social advancement of these countries”.³ FMO lends both for its own account (FMO A) as well as through Dutch government funds.⁴ 87% of FMO’s investments belong to the first category.⁵

FMO strives to be additional to commercial investors by enabling other financial institutions to step in.⁷ Additionality is an important pre-condition for all FMO’s financial transactions. A transaction is additional when it is not available from private financiers under the same terms and conditions. Nevertheless, a 2012-2013 evaluation concluded that 33% of additionality claims are “insufficiently substantiated”. In response, FMO asserts that it is extremely difficult to calculate exact measures of additionality and that the level of additionality is heavily influenced by financial market conditions. In 2013, FMO claims to have improved its additionality, indicating that 95% of a sample considered by external evaluators shows clear additionality.

Objectives and practices

Sectors

FMO has chosen to service sectors that it believes can have a high long-term impact: financial institutions, energy and agribusiness, food and water.⁸ The last sector was introduced in 2011, in line with the increased focus of Dutch development cooperation on food security and water management. Housing was discontinued at the end of 2011 due to unfavourable market conditions.

Over the last few years, the financial sector was by far the most important sector for FMO, followed by energy and then agribusiness, food and water. As well as these target sectors, FMO remains active

FMO key figures (€ million)⁶

	2012	2011	2010	2009	2008
Capital base (total assets)	5,56	5,06	4,31	3,77	3,65
Committed investment volumes	6,28	5,87	5,29	4,6	4,18
Net interest income	154	147	133	109	106
Return on assets	2,6	1,8	2,9	1,6	1,3
Return on capital (return on average stakeholders’ equity (- net profit))	8,4	5,9	8,9	4,7	4,0
Taxes (direct and indirect) paid	-27	-25	-25	-1	11

Sector focus FMO (€ million)⁹

	Financial institutions	Energy	Agribusiness, food & water	Housing	Other
2012	3,49	1,20	413	—	1,18
2011	3,29	1,02	330	—	1,23
2010	2,80	694	—	407	1,39
2009	2,44	635	—	311	1,21
2008	2,24	518	—	281	1,14

in other sectors too such as infrastructure, telecoms, ports, aviation and tourism. In 2012, it committed the considerable sum of €1.2 billion to these sectors.¹⁰

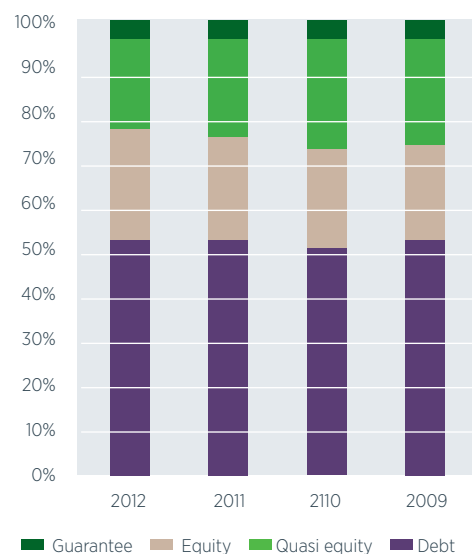
Instruments

Loans and equity are the dominant instruments used by FMO. In 2012, 52% of FMO’s commitments were loans, 44% were equity (including quasi-equity) and only 4% were guarantees.¹¹ This use of instruments has not changed dramatically in recent years.

Use of different instruments¹²

Loans are most frequently used in the following sectors: energy; agribusiness; food and water. In the financial sector, equity and quasi-equity are used more frequently than loans. FMO offers both direct and syndicated loans to financial sector institutions that lend on to different domestic banks. In order to ensure additionality, FMO’s direct loans never exceed 25% of a company’s balance sheet or of the project’s total costs.

Use of different instruments¹²



Use of instruments per region¹³

In terms of regional spread, loans are the dominant instrument used in the Latin American region. The picture is more balanced in other regions.

Use of instrument per sector¹⁴

For FMO, offering risk capital (equity and quasi-equity) in 'higher-risk environments' brings added value beyond bringing finance to the table. It allows for FMO to stay close to the beneficiary companies and to support the implementation of principles on environmental, social and corporate governance (ESG) in their operations. Private equity and mezzanine finance also offer attractive returns, which contribute to FMO's long-term financial strength.¹⁵ FMO's private equity model is based on partnerships with fund managers. FMO invests in funds and co-invests directly in projects alongside these funds. Investments are selected primarily based on impact and potential returns. FMO also actively seeks investments where it can play a supporting role, for example, when working with (often first-time) fund managers in its focus sectors, in low-income countries and in frontier markets.¹⁶

FMO works mainly through financial intermediaries, although it currently does not report separately on intermediary lending.¹⁷ Apart from investing in the financial sector, which lends onwards to other local bank-like institutions or private companies and can be considered an intermediary, FMO also invests in specific funds.¹⁸ Investment funds represent 19% of FMO's portfolio, mainly equity funds or quasi-equity (mezzanine finance). Investment funds mostly target financial sectors in Africa, Asia and Eastern Europe/Central Asia.

FMO aims to be a leading investor in its focus sectors. 2012 was a successful year for FMO in terms of private equity deal flow.

It participated in a high number of direct private equity investments, which were all co-investments with fund managers. In 2012, direct investments outnumbered investments in funds. Most of these equity deals were in FMO's focus sectors, in line with its strategy.

Regions

FMO invests in the following regions: Africa, Asia, Europe & Central Asia, Latin America and the Caribbean and globally. In 2011, FMO invested 28.5% of its total portfolio in Africa, 27% in Asia, 18% in Europe and Central Asia, 21% in Latin America and the Caribbean and 5.5% in global projects.¹⁹ FMO's multi-annual strategy for 2013-2016 aims to invest at least 70% in low and lower middle-income countries, and at least 35% in the 55 poorest countries through its own financing.

In line with this commitment, FMO committed 38% of its total portfolio in 2012 to the 55 poorest countries and 43% of its portfolio in low-income countries, 39% in lower middle-income countries and 18% in upper middle-income countries.²⁰

In every region, emerging countries were top receivers of FMO investments in 2011. Investments in BRIC countries (1. India; 2. China; 3. Russia; and 4. Brazil) represented 18.5% of FMO's global portfolio. India (a lower middle-income country) alone received almost 8% of FMO's investments worldwide (€379 million on a total portfolio of €4.9 billion). China came second (€205 million). In Africa, South Africa (€180 million) and Nigeria (€131 million) were the top receivers of FMO investments, together representing 22% of FMO's investments in Africa. Russia, actually a high-income country (€155 million) and Turkey (€151 million) were the largest receivers in Europe and Central Asia. Argentina (€147 million) was by far the largest receiver in Latin America.

FMO is bound to country lists provided by the Dutch government. FMO invests in

companies not in countries, and therefore there are no specific country strategies. It looks at the impact a client can have, including through employment and taxes paid that are invested in public services. Through its sector focus, FMO believes it has an impact on sustainable development and people's lives. Moreover, through sector-wide initiatives (e.g. improving social and environmental standards in the shipwrecking industry in Bangladesh,²¹ and the introduction of sustainable banking practices in the financial sector in Nigeria²²), FMO tries to initiate changes at the sector level in different countries.

How does FMO determine development impacts?

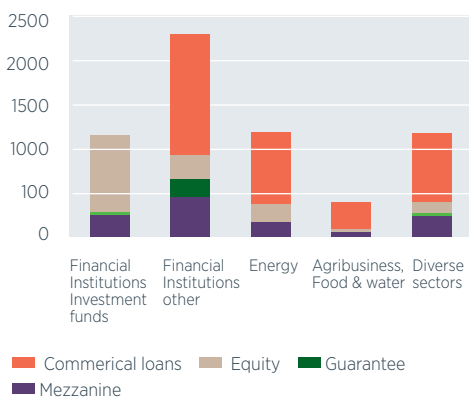
FMO "invests with the goal of having broad economic, social, environmental and governance impact in [its] clients' countries". To measure and track development impact, FMO uses three tools:²³

- An Economic Development Impact Score (EDIS) system – assessing a business's contribution to the local economy.
- The Development Impact Indicator – gauging the relationship between development impact and volume of new investment.²⁴
- Sustrack – FMO's proprietary monitoring system, which tracks FMO's clients' progress in the defined action plan in the area of environmental, social and governance standards.

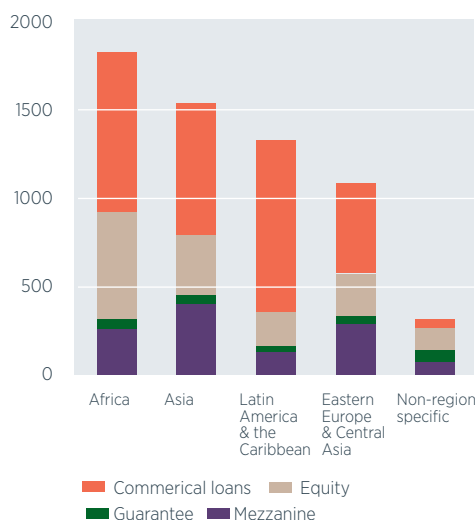
At this moment, however, a new monitoring system is being developed and the EDIS system and Development Impact Indicator are no longer used.

FMO assesses development outcomes across three indicators: a project's business success; its contribution to economic growth; and environmental and social outcomes. Job creation is promoted as an

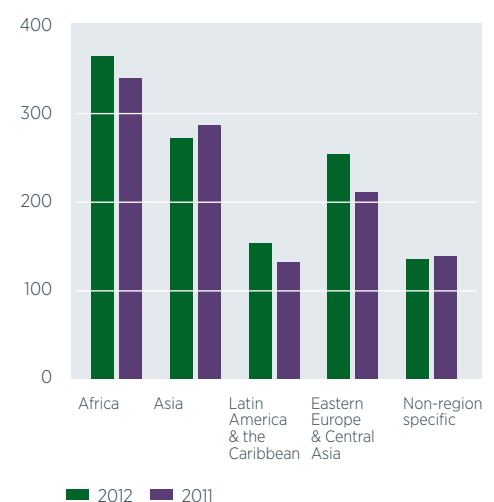
Use of instruments per sector¹³ 2012



Use of instruments per region¹⁴ 2012



Regional chart investment funds



important indicator for FMO's development performance. FMO reports the total number of employees at client level (and underlying investees of private equity funds). In 2012, there were a total of 1.26 million employees.²⁵ This is best practice, according to FMO, as measuring indirect job creation is much more complicated because of attribution problems.

A recent evaluation looked into projects committed in 2007 and found a negative trend in terms of project development outcomes. In 2007, only 54% were evaluated as delivering 'satisfactory' to 'excellent' development outcomes. According to FMO, this is due to external conditions (i.e. the financial crisis in Eastern Europe) and the nature of the sample.

FMO has a biannual independent assessment of all projects that were signed five years earlier. This is in line with the best practice of development banks. Evaluations assess financial and development impact. FMO also performs sector-wide evaluations, and outsources evaluation research in cooperation with European Development Finance Institutions (EDFIs). Government funds are evaluated regularly by external auditors and reports are discussed in parliament.

FMO signed a Memorandum of Understanding with other DFIs on harmonising monitoring and evaluation and the definition of common indicators. These harmonised definitions are currently under development.

Recent policy changes and the way forward

Responsible finance

FMO adopted the Equator principles for responsible project finance in 2005. FMO started to apply World Bank/International Finance Corporation (IFC) policies and guidelines to all its financing in 2000, including investments below the Equator Principles' threshold. FMO is also a signatory to the United Nations Principles for Responsible Investment (UNPRI), as well as being a member of the Global Impact Investing Network (GIIN) and the UN Environment Programme Finance Initiative (UNEP FI).²⁶ FMO engages in harmonisation efforts with other development banks in order to reduce bureaucratic burdens to client companies.²⁷

To ensure sustainable development outcomes, FMO has formulated an ESG policy²⁸ encompassing: (i) corporate governance; (ii) environmental and social issues; and (iii) human rights. This framework is based on the national law that applies to client companies or accepted international standards (IFC Performance Standards and Organisation for Economic Co-operation and Development (OECD) Guidelines for

Multinational Companies) in case these are stricter.

FMO's Human Rights Policy recognises the clients' responsibility to respect human rights, which "means to avoid infringing on the human rights of others and to address adverse impacts business may cause or contribute to". Due diligence is based on the IFC Performance Standards. These are problematic as they do not explicitly refer to human rights and do not require human rights impact assessments. FMO is revising this policy and is providing human rights training to ESG officers. Although it is commendable that FMO has a separate Human Rights Policy giving human rights the attention it deserves, more information is needed to make a full judgement about how effectively this is being implemented.

Transparency

FMO's disclosure policy²⁹ was implemented on 1 January 2013. It applies to government funds projects agreed since 2012, and to all financing and investments agreed since 1 January 2013. FMO discloses institutional information on its website, as well as policies and procedures. At the project level, FMO discloses the client's name and website, origin, sector, date of signature, total FMO finance, total project size, environmental and social category and a project description.³⁰ While FMO is one of the few EDFIs to provide this level of information, it is still below the international IFI benchmark and the American DFI (OPIC), which discloses information well before project approval. For example, IFC also provides information about the development impact of each project and guidance on where information on the project can be obtained in the client's country.³¹ Moreover, for category A and B projects, IFC discloses the Environmental and Social Review Summary, which gives insight into the main environmental and social risks and impacts of the project, as well as mitigation measures identified.

FMO ensures stakeholder engagement in due diligence. However, questions have been raised in terms of the practices in particular cases.³²

Accountability

FMO has recently established an independent complaints mechanism, which became operational at the beginning of 2014.³³ FMO involved several non-governmental organisations (Amnesty International, BankTrack, Both ENDS, CIEL, Oxfam and SOMO) in the development of the mechanism in two consultation rounds in 2013. FMO has gauged interest from other European DFIs, united in EDFI. However, given that this was limited, it decided to set up a complaints mechanism on its own. It was later joined by the German DFI (DEG), although there are differences based on local legislation.

Tax issues

FMO follows the EDFI Guidelines on Offshore Financial Centres (OFCs).³⁴ In the meantime, FMO is developing a framework to create more insights into tax payments by its clients, thus using its influence as investor or financier.

Sectors and development outcomes

FMO sees accessible finance as a cornerstone for viable economies and strong private sectors. As well as providing finance to financial institutions, FMO sees it as its role to assist financial institutions in finding ways to ensure that their own clients adhere to environmental, social and governance performance standards and guidelines³⁵ and to support these institutions to transform their policies in this regard. This means that financial institutions do not necessarily need to have their ESG policies in place when FMO starts funding them, but they should after a number of years of FMO support.

In the energy sector, FMO's policy focuses on the "full chain from exploration and transportation to generation and distribution, with a strong emphasis on renewable energy."³⁶ In low-income countries, FMO focuses on access to energy, preferring sustainable solutions, meaning fossil fuel is not excluded. Recently FMO rewarded an €18 million loan to the natural gas-fired Kribi Power Development Company in Cameroon.³⁷

FMO's recent strategy for 2013-2016 includes financing "sustainable methods of monetizing standing forest, which includes sustainable forestry, forest carbon projects (including REDD) and biodiversity promoting investments".³⁸ Since 2012, FMO has issued sustainability bonds. In 2012, two sustainability bond transactions were effectuated, respectively for an amount of €41.3 million and €40 million. For the first, the airline company KLM placed the lead order and for the second, ethical bank Triodos. The sustainability bonds issued in November 2013 covered a total amount of €500 million. These bonds are marketed with a clear reference to FMO's commitment towards environmental and socially responsible funding.

Subsidised finance (blended finance)

One of the ways in which FMO aims to foster development is by mobilising finance. FMO states that it does not compete with commercial banks, but wants to inspire them. As a 'catalyst' financier, FMO accepts a relatively high share of the risk involved, which in turn gives other financiers the space and confidence to invest.³⁹ FMO has set the strategic goal of catalysing one euro for every euro it invests itself by 2020.⁴⁰ In 2012, FMO took important steps to establish its own fund management activities. FMO's

dedicated Investment Management team will play an important role going forward in making FMO's expertise in investing responsibly in emerging markets available to commercial investors and in catalysing third party money to FMO's markets.⁴¹ In 2012, FMO catalysed €632 million from third parties on a total of €1,390 million new investments.⁴² In 2011, this was €634 million on a total of €1,306 million. Furthermore, in 2012 FMO noted that: "Our results in catalysing commercial investment undershot our target. This was due to the sharply decreased risk appetite among commercial investors amid the global crisis. As a result we were not able to fully realize our ambitions in third-party fund management."⁴³ Moreover, FMO indicates that, for its financial sector activities: "although [it] did catalyse the amount of third-party money into developing countries as [it] had targeted, it did mean that most of the funds we mobilized came from development banks."⁴⁵

Endnotes

- 1 <http://www.fmo.nl/about-us/profile>
- 2 [http://www.fmo.nl/articles-and-internal-regulations, Agreement with the State \('98\).](http://www.fmo.nl/articles-and-internal-regulations, Agreement with the State ('98).)
- 3 Articles of Association, 2009, article 3, p.2.
- 4 MASSIF, Infrastructure Development Fund (IDF), Access to Energy Fund (AEF) and Facility Emerging Markets (FOM). These funds are dedicated to specific sectors in poorer or least-developed countries <http://www.fmo.nl/financials>.
- 5 <http://annualreport2012.fmo.nl/introduction-to-government-funds-and-programs>
- 6 <http://annualreport2012.fmo.nl/page/824>
- 7 <http://www.edfi.eu/publications/all.html>
- 8 <http://annualreport2012.fmo.nl/introduction-to-sector-focus>
- 9 <http://annualreport2012.fmo.nl/at-a-glance-for-figures-relating-to-years-2012-and-2011>; <http://annualreport2010.fmo.nl/media/9860/ar-fmo2010.pdf> for figures relating to years 2010 and 2009; <http://annualreport2009.fmo.nl/report-of-the-management-board/sector-focus/introduction.aspx.html> for figures relating to 2008.
- 10 <http://www.fmo.nl/diverse-sectors>. FMO does not offer a more systematic breakdown of 'diverse sectors'.
- 11 <http://www.edfi.eu/publications/all.html>, 2012 EDFI Annual report, p.36
- 12 Based on FMO Annual Reports, 2009-2012.
- 13 <http://annualreport2012.fmo.nl/committed-portfolio>
- 14 <http://annualreport2012.fmo.nl/highlights>
- 15 <http://annualreport2012.fmo.nl/private-equity/strategic-priorities>
- 16 <http://annualreport2012.fmo.nl/private-equity/highlights>
- 17 The bank will start to do this in its upcoming Annual Report (2013).
- 18 FMO reporting considers investment funds as a sub-category of financial institutions.
- 19 This information is available from Eurodad upon request.
- 20 <http://annualreport2012.fmo.nl/strategy>; <http://annualreport2012.fmo.nl/strategy-2013-2016>
- 21 <https://www.fmo.nl/k/n114/news/view/10978/179/bangladesh-ship-breakers-and-banks-commit-to-improving-environmental-and-social-standards.html>
- 22 <http://www.fmo.nl/k/n114/news/view/1264/538/nigerian-banking-sector-demonstrates-commitment-to-sustainable-banking-practice.html>
- 23 <http://www.fmo.nl/development-impact>
- 24 At this moment, however, a new monitoring system is being developed and the EDIS system and Development Impact Indicator are no longer used.
- 25 FMO Annual report 2012, p.22
- 26 <http://www.fmo.nl/k/n114/news/view/2421/538/fmo-issues-usd-41-3-million-6-year-sustainability-bonds.html>
- 27 <http://www.fmo.nl/partnerships>
- 28 <http://www.fmo.nl/esg-policy>
- 29 <http://www.fmo.nl/disclosure>
- 30 The information FMO discloses on its projects, includes: the client's name, origin and website, the sector, total FMO financing, total project size, the Fund (FMO-A/IDF/MASSIF/FOM EL&I/OS/AEF/CD), the environmental and social category and a project description. FMO also discloses the final evaluations of all its projects.
- 31 <http://www.ifc.org/wps/wcm/connect/98d8ae004997936f9b7bffb2b4b33c15/IFCPolicyDisclosureInformation.pdf?MOD=AJPERES>, p.9.
- 32 For example, in the case of the FMO-supported Barro Blanco dam in Panama. For more information, see <http://www.bothends.org/en/News/Laatste-nieuws/newsitem/301/Anouk-Franck-on-visit-UN-Rapporteur-James-Anayo-to-Panama>
- 33 <http://www.fmo.nl/page/1115>
- 34 www.edfi.be/publications/edfi/publication/45-executive-summary-of-edfi-guidelines-for-ofcs.html
- 35 <http://www.fmo.nl/financial-institutions>
- 36 <http://www.fmo.nl/energy>
- 37 <http://www.fmo.nl/k/n114/news/view/1552/538/fmo-supports-the-energy-sector-in-cameroon.html>
- 38 <http://www.fmo.nl/k/n114/news/view/875/538/fmo-hosts-successful-conference-on-boosting-investments-in-sustainable-forestry-and-forest-carbon.html>
- 39 <http://www.fmo.nl/mobilizing-finance>
- 40 FMO Annual report 2012, p.15.
- 41 <http://annualreport2012.fmo.nl/fmo-investment-management>
- 42 FMO Annual report 2012, p.14.
- 43 <http://annualreport2012.fmo.nl/strategy-2009-2012>
- 44 FMO Annual report 2012, p.32.

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