EDFI

EDFI Conference Report

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1. Introduction

Organised by EDFI and ODI, the EDFI Impact Conference promoted knowledge exchange and learning around the impacts of private investment and how DFIs affect sustainable development in developing countries. Focusing on investments in energy, climate change, jobs, and economic transformation, the conference informed participants on how EDFI members are targeting these outcomes, how these outcomes are currently measured, and offered a glimpse to the development of these metrics. It also offered insightful discussion on which metrics are important for different types of internal and external audiences.

Key Takeaways from Sessions

1. Harmonisation when feasible

Investors have different capacity to collect and disseminate data, but the ability of stakeholders to compare investor operations is currently hindered by different investor report styles.

2. Understand portfolio-level climate impacts

Project-level impact calculations may lead to suboptimal outcomes as there may be a tension between climate change adaptation, climate change mitigation, and poverty reduction.

3. Focus on quality and decency of jobs created as well as quantity

'Jobs created' does not offer the desired nuance of the relative impact on the job market caused by an investment or the distributional impacts of these jobs.

4. Clearer linkages between indirect job calculations and theories of change

Understanding indirect impacts can steer investments *ex-ante*, evaluate investments *ex-post*, and monitor and improve the impact of investments during the project-- different products and models are required for these different areas.

5. Further partnerships and knowledge sharing

Bringing in diverse viewpoints and pursuing partnerships with those outside the immediate community allows for deeper consideration of the short- and long-term investor impact and for potential collaborations that can enhance these outcomes.

2. Opening Remarks by Nanno Kleiterp, EDFI Chairman and Dirk Willem te Velde, ODI

To set the tone for the day, both speakers offered their observations from their years of experience working in and around the development finance space. In mapping the evolution of thinking around development finance, Mr. Kleiterp mentioned that when he began in the industry there was an assumption that money equalled impact and that as funding increased so would the impact. As he moved through his career, there was a change in thinking and much more focus on development finance delivering impact on specific issues. There was a focus by investors on environmental issues, that then shifted to a greater concentration social issues, and, later, an acknowledgement of the importance of governance in countries receiving development finance. The SDGs have now re-oriented development finance again and accurately capturing impact on SDGs is crucial as the role of investors grows.

The combined European DFI portfolio of committed investments was €37.2 billion at the end of 2017 and has more than tripled over the past decade from €10.9 billion at the end of 2005. With this increased influence comes increased scrutiny; DFIs and private investment are part of the development discussion whether they like it or not. To meet this scrutiny, investors must consider better aligning their impact metrics to help comparability among investors and investments as well as to improve overall transparency. Investors also must be mindful to balance the accessibility of their reporting with the increasingly sophisticated tools available to generate impact measurements.

In short, DFIs face an impact measurement challenge, eloquently captured by the EDFI Chairman, when he said *it is simple to make it more complicated but complicated to make it more simple'*

3. Sessions

The sessions focussed on four key themes: energy investments, direct job impacts, indirect job impacts, and economic transformation. This report highlights the main discussion points and concludes with concrete recommendations arising from the event.

Session 1: Energy- Clean energy transformation and energy access

Session Moderator: Kjell Roland (former Norfund)

Panel Members: Sam Attridge (ODI), Mikkel Kallesøe (FMO), Milena Berta (Finance in Motion), and Pierre Forestier (Proparco)

EDFI members invested €2 billion in the power sector during 2017 and the combined EDFI investment portfolio in power totalled €8.2 billion; accounting for 22% of the total EDFI portfolio. Given this importance to the overall portfolio, participants engaged in a lively discussion that focussed on two main questions: i) to what extent must investments in energy access and climate change reduce poverty, and, ii) how much importance should be placed on harmonising reporting across investments.

The catalyst for the discussion on the pro-poor nature of energy investments was a statement recognising that when people in developing countries are less economically vulnerable, they are less vulnerable to impacts of climate change. Moreover, as there are very few jobs directly attributable to investments in energy, are energy investments creating enough of an impact on poverty reduction to favour them over other types of interventions?

The ensuing discussion focussed on the indirect impact that increased energy access can have on economic growth and a recognition that energy investments are rarely made to create direct jobs. Rather, these investments are made to spur economic growth through various streams in an economy, which include but are not limited to, increased firm productivity and household benefits. To this point, it was noted that investments in sectors that facilitate economic growth (i.e. energy, transportation, infrastructure) should be assessed on whether an economy can take advantage of these investments to garner a more holistic view on their impact on poverty reduction.

The topic on which there was more agreement amongst the panellists and audience but more difficulty with the details was on the issue of harmonisation of metrics measuring energy access and climate change. While most agreed that there was value in EDFI members and private investors measuring their investments in the same manner; there were differing viewpoints on what to harmonise and how to do so.

The argument for harmonisation of these metrics are fundamentally linked to communication. If investors are committed to doing their fair share to meet the SDGs and UNFCCC targets, they must remain accountable to their stakeholders. This accountability is inextricably linked to reporting concise, easily-understood data that are comparable across investors. Furthermore, for those interested, documentation of how these data are calculated should also be available, similar to footnotes in audited financial reports. This enhanced comparability may also facilitate investment decisions and offer private investors more streamlined data for their investment considerations and reporting.

Where opinions diverged were on what data to report. Currently, members of the EDFI are using different guidance to account for their GHG emissions. As well, there was little agreement on whether the calculation of emissions should be based on the GHG avoided by an investment, whether an investor should net its GHG avoided calculation against the GHG its investments created, or whether simply calculating the total carbon footprint of a portfolio is the most transparent way forward.

It was also an interesting point of discussion that project-level metrics may lead to perverse incentives. That investors may be drawn to investments that address climate change mitigation because it will report well on GHG metrics, but that may undermine climate change adaptation efforts. Or, in the case of smaller investors, they may be attracted to invest in projects that are well-established and easy to report on to attain these incentivised metrics and keep reporting costs manageable. Portfolio-level metrics allow for greater project-level experimentation that enhance the likelihood of financial or development additionality as an outcome. However, how to attribute this additionality when there are multiple investors remains an unresolved challenge.

The session ended without consensus on how to address these disagreements. There was an acknowledgement that aligning with IFI reporting would provide comparability across investments that may be less costly or onerous than EDFI members creating their own standard and could be a solution to some of the issues mentioned. As well, it was reiterated that the future of reporting on energy and climate change should be thought of as on two parallel paths: one for stakeholders that are interested in “headline” numbers and the other for stakeholders that desire detail and nuance.

Session 2: Jobs- Direct impacts on job creation and decent work

Session Moderator: Christiane Rudolph (DEG)

Panel Members: Alberto Lemma (ODI), Corianne Van Veen (FMO), Paola Simonetti (ITUC), and Paul Hailey (responsAbility)

Job creation is at the core of reporting on investment impacts. This focus is unsurprising given that the significant number of additional jobs that the world needs to create each year to absorb new entrants to the labour market. This challenge is especially acute in low income countries. For example, an *additional* 35,000 jobs need to be created each day in Sub Saharan Africa – that is 13 million each year –

until 2030, simply to keep up with demographic challenges. Data from 2003-2016 indicate that only two-thirds of the required annual additional jobs had been created over that period; this portends a required 50% increase in employment creation to meet the demand. With these numbers in mind, the participants discussed: i) the role that job creation has on investment decisions, ii) the importance that jobs created are decent jobs, and iii) how to better integrate distributional impacts of job creation into reporting metrics.

There was wide-spread agreement that despite the focus of EDFI members and private investors to report on jobs created, job creation is rarely the sole investment criteria. Investments are completed to attain a variety of impacts, with each investment considering job creation with different levels of importance. For private investors who are managing client investment, these varying levels of focus is further complicated by the importance that each of their clients puts on job creation and that there may be tensions between retail and institutional investment mandates. This point was reiterated by comments that each investment has its own investment thesis and that forcing job creation into the narrative supporting an investment can be detrimental to properly assessing an investment's potential impact.

An interesting discussion centred on where along the productivity spectrum investments should be made considering the focus on job creation. Investments in firm and employee productivity have shown to increase employee incomes; however, investments in capital may actually reduce jobs (in the short-run) as employees may be replaced by automated functions. Yet some participants noted that this 'job-replacing' narrative is likely context-specific and that the linkage between automation and unemployment only exists if employees have no other firms to go to after their job has been automated; a phenomenon that has not borne itself out in developed countries.

On the importance of job creation being targeted toward the creation of decent jobs, it was suggested that investors integrate the UN SDGs into their investment models and core frameworks. As an element of this integration, there needs to be a thorough understanding of what is meant by decent work and that investor focus on job creation should ensure that jobs created are accompanied by legal and social rights. This idea was echoed by participants outlining how EDFI members account for decent work and the importance of including investee firms in the process. For example, an investor recently finished asking employees in an investee company for suggestions on how to improve the company, but also asked about ways in which the company could improve the work environment. Employee answers included elements of decency such as increased transparency regarding pay, rewards and promotion, better work-life balance, and better education opportunities for employees. It was agreed that this type of investor involvement in the decency of work being provided by their investee was an impressive initiative as it went beyond the low-hanging fruit of addressing basic health and safety concerns.

An important element of the decent jobs discussion is how a focus on decent jobs may affect the countries in which investors are willing to deploy capital. It was hypothesised that if investors put too much focus on ESG and job decency criteria, investments in the least developed countries, where these standards are less ubiquitous, will decrease. It was noted that investors need to be mindful of this trade-off and that each investor needs to make their own decision regarding the impacts they are willing to accept regarding the decency of the jobs their investment creates. A suggestion that was provided mentioned having different tiers of job decency criteria that are relevant to country-specific data or relevant to income-level groupings.

Regarding the importance of accounting for the distributional impacts of job creation (e.g. disaggregations by sex, skill and income level, minorities, disabilities), it was noted that most investors are not releasing data publicly, if they are gathering it at all. Investors admitted that there remain significant gaps regarding the amount of data they can collect from clients and the data they would prefer to report. This mismatch, in many cases, is the result of the reporting agreements signed at deal inception and would be difficult to alter despite a desire for more nuanced data.

The discussion closed with some agreement that jobs created, perhaps the most important metric for external stakeholders, is a blunt proxy for the impact of an investment. That to truly understand the impact of an investment on jobs, better data on the types of jobs and decency of these jobs would be beneficial. Moreover, an understanding of the relative impact of the jobs created in their respective economies would provide further comparability among investments. Despite this desire, there are costs of gathering this information that must be considered as well as contemplating how increased reporting may impact investees. Even if these data become more readily available in the future, investors will still need to make their own decisions regarding how to integrate this data into their investment criteria and weigh their impact on economies at different points in the development process.

Session 3: Jobs- Modelling of indirect impacts on job creation

Session Moderator: Dirk Willem te Velde (ODI)

Panel Members: René Kim (Steward Redqueen), Wilhelm Löwenstein (Ruhr-Universität Bochum), Joe Shamash (PIDG), and Kaisa Alavuotunki (Finnfund)

Investments do not solely generate impact in the firms or sectors in which they are made; there are indirect and induced impacts that result from these investments. Much of the focus of the literature on these types of impacts remain focused on job creation; indirect employment created in upstream and downstream firms resulting from the investment and induced employment as a result of direct and indirect employees spending more and increasing consumption. Whereas the calculation of direct jobs is usually associated by some form of investee reporting and aggregation by investors at the portfolio level, indirect and induced jobs calculations are based on models. While these models may not allow for precise calculations, it was noted that they do provide a relative benchmark from which investors can compare their portfolios. The discussion among participants centred on: i) the utility of existing models and whether investors need fewer or more models to explain their holistic impact, and ii) how to better explain models to external audiences.

The session noted that there are three possible reasons for understanding indirect impacts: to steer investments ex-ante, to evaluate the impacts of investments ex-post, and to monitor and improve the impact of investments during the life cycle of the project. Different products and models are required for these different areas.

Participants acknowledged that although models can sometimes be complex and difficult to understand, fewer models are not the answer. For example, while there is not consensus regarding the causal relationship between electricity access and GDP growth, it was noted that by decreasing electricity outages, certain sectors of developing economies expand. Although the decrease in outages and increase in supply of power may not lead to lower prices for consumers due to government tariff control, increased resilience of power has shown that firms can increase productivity and consumers can alter their consumption patterns. The point was made that perhaps investors should make investments in places that are on the cusp of a more resilient system. That the greatest impact may not be to build electricity installations where none exist, but to make investments where increased electricity production

will shorten outages and increase the indirect and induced incomes of those relying on electricity.

In another example of a model having the ability to answer investor questions, it was shown that an increase in the capital stock of the formal sector of a developing country will lead to increased employment in the formal sector. While this may seem obvious, this also means that as people leave the informal sector for employment opportunities in the formal sector, wages in the formal sector may not increase immediately. The speed with which employees transition from the informal sector to the formal sector is based on a number of country- and time-specific factors. It was noted that while the model relates to the aggregate and may inform investors as to in which countries their investment may have the greatest impact, it does not specify the sectors in which impacts will be the greatest or does not account for policies and institutions.

With a better grasp of some of the models available to investors, the discussion turned to how to explain the models to internal and external stakeholders. A key point made related to presenting the results of these models with caution. Terms like "jobs supported" can sometimes be used by stakeholders to promote a certain agenda without full disclosure that the model captured a moment in time. Calculations for the model use past data and have a shelf-life. Adding to this difficulty is that the full effect of an investment on GDP growth, incomes, or job creation are difficult to measure in the short-term. Flagging these caveats to users of these impact metrics is crucial to maintain credibility.

While there was no real consensus on how to better sensitise users of the outputs of impact models, there was acceptance that models, if understood and employed cautiously, have an important role in explaining relative impact. Moreover, there is a desire for other models to explain the impact of investment on electricity access by consumers, income inequality, and migration patterns. It was concluded that (i) it is important for DFIs to invest in capabilities to appreciate and understand models; (ii) there is considerable interest in the analytical insights of the models; and (iii) more thought needs to be devoted to understanding in which areas we need more modelling and in which areas modelling can make little progress.

Session 4: Frontier methodologies – Economic transformation

Session Moderator: Paddy Carter (CDC)

Panel Members: Jan Olivier Imhof (IFC), Nina Fenton (EIB), and Alberto Lemma (ODI)

Dovetailing with the previous session, the participants discussed new ways in which investment impact can be measured. These new metrics are especially important if investors seek to change traditional investment outcomes and pursue economic transformation in the geographies in which they invest. Such transformation can sometimes be at odds with the desire of external audiences to see immediate change as a result of investment. Transformation is a longer process and requires patience from all involved. The conversation amongst participants focused on the utility of these methodologies in supporting investments directed toward economic transformation.

The first element of the discussion was on the value of simulations and how new investment models could be used to provide *ex ante* predictions of impact. As there is greater accumulation of firm and household data in developing economies, practitioners can simulate the firm and household effects of an investment in agriculture, manufacturing, or service sectors. Because the data have the requisite

level of nuance, findings amongst countries can vary significantly. Under certain scenarios, simulations have predicted that investments in certain sectors will lead to increased GNI/capita, lower levels of poverty, but higher levels of inequality. This counterintuitive finding is especially informative for those who automatically subscribe to the theory of change that investment leads to jobs and good outcomes; the simulation provides a more comprehensive picture.

As another point of departure, the participants discussed the role of investment to shrink productivity gaps and how new models can direct investment to sectors where productivity gains may have the most impact. Under this type of model, investors can determine whether they want to strengthen sectors in which the productivity gap is small or whether they want their impact to be focussed on larger productivity gains in low productivity sectors.

While there was general acceptance of the models discussed, there were two points that forced further consideration. The first was related to the current structure of many EDFI member portfolios and how to pursue transformative change when 31% of EDFI's total portfolio is in the financial sector. While the financial sector can facilitate economic transformation, it is unlikely that investments in the financial sector will in and of themselves lead this change. Moreover, fund-of-fund structures may further hamper any efforts for economic change as the investor is one-step removed for the investee.

The second consideration was the need for greater partnership between investors going forward. Participants acknowledged that the capacity to create and use complex models varies among investors and that smaller investors may lack this capacity entirely. While these frontier methodologies provide new insights, it will be important that these insights are shared among investors to ensure investments are targeted correctly.

Session 5: Concluding reflections

Session Moderator: Søren Peter Andreasen (ODI)

Panel Members: Eva Terberger (KfW), Paul Horrocks (OECD), Irene Basile (OECD), Sony Kapoor (Re-Define), and Sam Attridge (ODI)

The final session allowed participants to reflect on the day's events and discuss what they thought were the most important insights from the day. Two recurrent themes from these comments were the need for honesty and transparency, and the importance of partnerships going forward.

To the need for honesty and transparency, it was noted that investors must be upfront with their stakeholders regarding their need to experiment. Abiding by a singular focus on the reported metrics may actually divert investor attention away from investments that have greater, but less-accountable impact. If stakeholders desire transformative change, they must embrace uncertainty and longer-term thinking. Transformative change is likely to be the result of experimenting, not attaining the desired result, and implementing these learnings in successive attempts. Experts in the field must be transparent about this process and guide stakeholders to this different thinking, even though it may not seem to align with stakeholder agendas.

Moreover, it was agreed that their needs to be honesty in the investment process. With a concentrated focus on the *ex post* results of an investment, it is easy to lose sight that those results should come from rigorous consideration at each juncture of the investment process. That even if the impact metrics do not meet expectations,

there was thesis embedded in the decision to undertake an investment and that this decision was supportable regardless of impact measurements.

On partnerships, the point was made that not only do investors need to learn from each other, but that they need to share knowledge with those outside their immediate community. Development finance is evolving and there are those outside of the investment community that are sceptical of the impact it can have on the least developed countries. Working with the IFIs and sharing knowledge with development agencies may dampen this scepticism and enable greater impact as result of new collaborations.

Annex 1: Agenda and List of Participants