CDC Group plc (formerly the Commonwealth Development Corporation)

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Section Economic Policy & Statistics section

Since July 2004, CDC Group plc (henceforth "CDC") has been a public limited private equity company owned entirely by the Department for International Development. It is responsible for providing loan finance to private businesses in developing countries, particularly in those areas and sectors which struggle to obtain investment through conventional channels. Directly, through its investments, and indirectly through mobilising other investors, its aim is to contribute to economic growth and poverty reduction in the developing world.

Until recently, CDC invested solely through a 'fund of funds' structure; that is, it did not make its investments directly, but channelled them through intermediary fund managers. Following the agreement between DFID and CDC of a new business plan in May 2011, CDC will begin to make its own investments, though fund-of-funds holdings will continue to form the majority of CDC's portfolio until at least 2015.

One of CDC's fund managers, Actis, is responsible for CDC's 'legacy' of investments it held before restructuring in 2004, which still form a significant and profitable part of its portfolio. DFID has a 40% shareholding in Actis; the remaining 64 fund managers CDC currently works with have no association with the Government.

CDC has performed well financially since its restructuring, but assessing its impact on development is a more contentious business. It has been criticised for investing to maximise returns, at the expense of both the neglected 'high-risk' sectors it was intended to finance, and the business principles it was supposed to uphold. Government oversight, which has targeted financial performance, and CDC's structure, which places it a step's remove from the companies and countries it invests in, have been blamed for this.

On 12 October 2010, the International Development Secretary Andrew Mitchell announced a consultation on the reform of CDC. The consultation closed on 28 February, and on 7 June it was announced that a new business plan had been agreed for CDC. The changes to CDC's operations and approach as a result of this are described in Section 6.

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1 Purpose and history

The CDC was established in 1948 as the Colonial Development Corporation, a statutory body with the purpose of promoting the economic development and resources of Britain's colonies. It was renamed the Commonwealth Development Corporation in 1963, and was given authority to invest outside the Commonwealth in 1969. In 1997 CDC became a Public Private Partnership (PPP) and two years later transformed from a statutory corporation to a public limited company trading under the name CDC Capital Partners. Following further re-structuring in 2004, two separate fund management companies were formed from CDC, Actis and Aureos, leaving CDC Group plc as an emerging markets fund-of-funds investment company owned entirely by the Government (see subsequent section for more details).

CDC's stated purpose is[1]:-

> to invest in the creation and growth of viable private businesses in poorer developing countries to contribute to economic growth for the benefit of the poor; and to mobilise private investment in these markets both directly and by demonstrating profitable investments as part of the mission of the Department for International Development (DFID) to fight world poverty

More succinctly, the CEO of CDC, Richard Laing, says "CDC exists to improve people's lives in developing countries".[2]

CDC is the Government's principal vehicle for directly helping the private sector in developing countries. It is prohibited by statute[3] from supporting public sector projects such as schools and hospitals, although it can invest in public utilities and support privatisation programmes. The countries it is permitted to invest in, and the geographical balance of its investments between them, is restricted by an investment policy agreed with DFID.

For CDC investments to add value, it is seen as important that they meet two criteria; specifically, investment should be:-

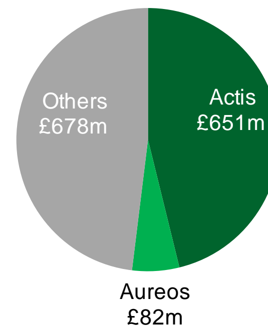
- Additional – that is, it supports business in areas that other investors are reluctant to invest in because of the associated risks, or economies that are underserved by commercial financial institutions
- Catalytic – that is, through demonstrating profitable and responsible investments in difficult and neglected environments, it encourages further investment from elsewhere; in short, mobilising other people's money

[1] BIS Shareholder Executive *CDC*
[2] CDC *Development Review 2009*, p.2
[3] The Commonwealth Development Corporation Act 1978

2 Current structure

Between 2004 and May 2011, CDC was structured as a fund-of-funds; that is, rather than make direct investments itself, it invested through external private equity companies, known as 'fund managers'. Such investments are generally held for about four to eight years. When the fund manager sells the investment, it returns the capital and any net profit to CDC.

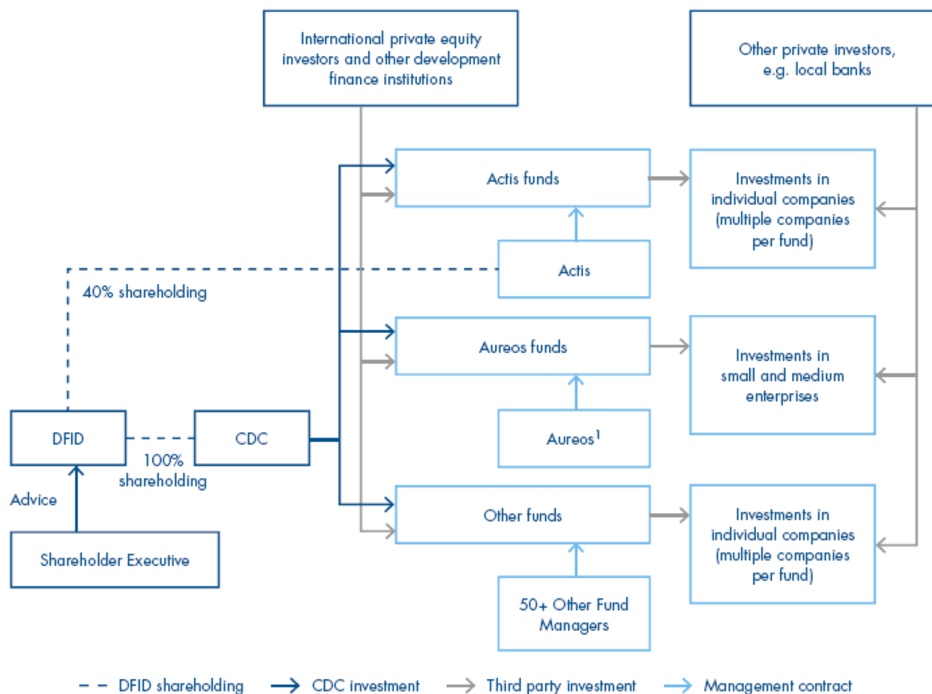
CDC investment value by fund manager, end 2009



Two of these fund management companies, Actis and Aureos, were formed directly ("spun-out") from CDC's restructuring (Actis in 2004 and Aureos in 2001): following these spin-outs the majority of CDC's investment was channelled through these companies. Though most of CDC's resources continue to be managed by Actis and Aureos (see chart), it has made increasing use of other fund managers. In 2009, 38% of CDC's new investments went to Actis, 7% to Aureos, and the remaining 55% to 63 other fund managers. The relationship between Government and these companies is described in more detail in Section 3.

As a result of the new business plan introduced in June 2011 following a review of CDC's work by DFID, CDC will once again start making its own investments, and use a wider range of intermediaries (i.e. in addition to private equity firms). These changes will take some time to be reflected in CDC's portfolio, however: the aim of the business plan is to reduce fund-of-funds holdings to 60% of the total portfolio by 2015.

CDC and its relationship with DFID, its fund managers, portfolio companies and third-party investors pre June 2011 reform



Source: National Audit Office with CDC

3 Government oversight

3.1 CDC Group plc

DFID is the sole shareholder of CDC and dictates its overarching strategy. In practice, this has meant CDC abiding by an Investment Policy, which restricts its investments to a list of eligible countries, known as the 'CDC Universe'; the policy has not, however, constrained investment to specific sectors or in support of particular goals, other than the overarching objective quoted in Section 1.[4] The most recent Investment Policy defines the CDC's universe as countries with a per capita Gross National Income of less than $11,115 in 2006 (low and middle-income countries, by the World Bank's criteria). It also requires at least 75% of new investments to be made in countries with a per capita GNI of less than $905, and at least 50% in sub-Saharan Africa.[5]

A Memorandum of Understanding between DFID and CDC formally recognises that, subject to CDC's adherence to the Investment Policy, there will be no interference or intervention by DFID in CDC's activities.

As a result of the changes agreed in May 2011 following the Government review of CDC's work, CDC will report annually to DFID on its performance against the targets agreed in its new business plan.[6] It is intended that these reports will be published.

3.2 Actis

Actis is a limited liability partnership (LLP), owned 60% by its partners and an employee share trust, and 40% by DFID. The Government has no representation on Actis' Board; it does not take part in its day-to-day operations, nor does it determine its strategic priorities.[7] Actis was created in 2003 as part of CDC's restructuring, and for a short period, DFID had a controlling stake, which it sold in July 2004. Under the terms of sale, DFID was to receive 80% of any residual profits earned by Actis for ten years (i.e. until July 2014), and 40% thereafter. [8] The agreement also granted DFID veto rights over the appointment of the chair of Actis LLP and two non-executives, the three of whom together make up the Business Principles Committee, which is the body responsible for monitoring and controlling the responsible investment principles agreed with DFID when Actis was established. DFID also has the ability to block a sale of Actis, and enforce business objectives.

Actis' single biggest investor remains CDC itself. In the new structure established in July 2004, DFID agreed that Actis should manage CDC's existing investment portfolio, built up over several decades, known as the 'legacy portfolio' for five years, extendable to ten at CDC's option: at the time, this was worth £805m and comprised 95% of CDC's resources[9].

3.3 Aureos and other funds

DFID has no stake in Aureos, and no say in its operations, strategy or appointments. When it was first established in 2001, Aureos was a joint venture between the CDC and Norfund,

[4] The precise relationship between DFID and CDC Group Plc is set out in CDC's articles of association. There is also a legally binding Deed of Covenant that enforces compliance with the provisions of the Investment Policy

[5] The complete Investment Policy can be found on the CDC website, here.

[6] The new business plan is available on the CDC website, here.

[7] BIS Shareholder Executive

[8] Public Accounts Committee (2009) *DFID's oversight of CDC Group plc*, Supplementary memorandum from the National Audit Office

[9] NAO *DFID's oversight of CDC Group plc,* p.14

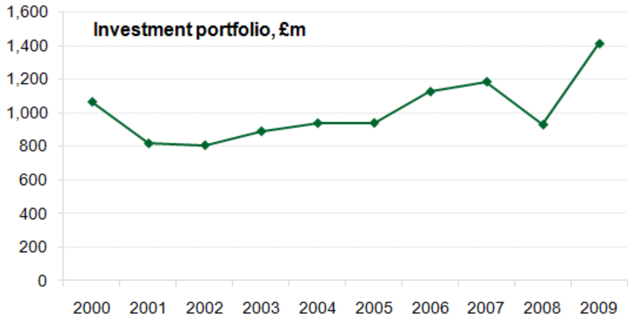
Norway's investment fund for developing countries. However, following a series of buyouts, Aureos has been 100% owned by its staff and management since December 2008.[10] Similarly, the Government has no stake in the 63 other fund management companies used by CDC.

4 Performance – CDC's view

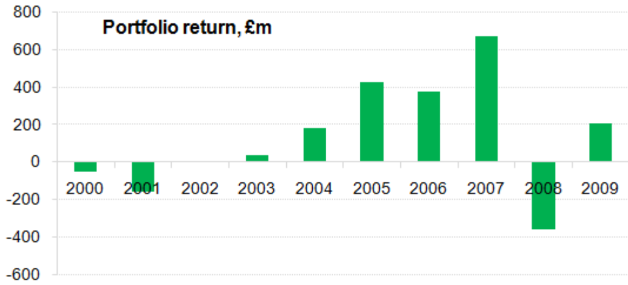
4.1 Financial performance

CDC's financial performance is self-assessed through its Annual Report and Accounts. CDC has received no UK Government capital since it became a PPP in 1997. The value of its investment portfolio stood at £1.411bn at the end of 2009, up 52% on the previous year, and its total assets were £2.535bn[11], up 9%.

CDC measures its performance by comparing the rate of return on its investment portfolio against the Morgan Stanley emerging market index, a measure of the 'average' performance of companies in developing countries. It has outperformed this index in each year since 2005.[12]



DFID does not require a dividend from CDC; instead, all profits are re-invested in funds throughout CDC's target emerging markets. Following the 2004 restructuring, DFID and the Treasury agreed a target annual rate of return of 5% for CDC's portfolio: taking the period from 2004-09 as a whole, CDC has substantially exceeded this.



4.2 Development performance

Measuring CDC's contribution to development is a more contentious business than assessing its financial performance (see Section 5). Since 2008, CDC has published a *Development Review*, in which it assesses the company's impact on development across four criteria. The information for the assessment comes from a combination of information collected from CDC's portfolio companies, and an evaluation of a selection of CDC's funds (20 out of 134[13]). As well as the financial performance of its portfolio, the review assesses:-

The broader economic impact of its investments

In 2009, it found that 733,000 people were employed in the companies in which CDC has a stake, and that of the 75% of companies reporting data, \$2.8bn in tax was paid. The average workforce of its Asia-based companies was 1,825; in sub-Saharan Africa, it was 490. CDC

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[10] Aureos Capital website: *Our history*

[11] The portfolio figure includes only long-term investments, whilst net assets include more 'liquid' funds such as short-term deposits

[12] The NAO describes the index as "not a direct comparator to CDC's portfolio, [but] it appears to be the best single benchmark available"

[13] In 2009, seven of the twenty reviews were conducted by an independent company

concedes that it is not possible to identify the employment and tax revenue directly arising from its investments:-

> because CDC invests through an intermediated model and does not wholly own the underlying portfolio companies, quantitively accurate and reliable estimates of employment maintained or created or tax revenues generated by CDC's investments is not possible.[14]

Adherence to environmental, social and governance (ESG) standards

CDC has an investment code,[15] which specifies its ESG standards, and the principles, objectives, policies and management systems required to attain them. These standards cover environmental impacts, working conditions, corporate governance, and 'other social issues'. CDC devises its own investment code in partnership with DFID; it is described as 'compatible' with the World Bank's International Finance Corporation's Performance Standards and with the 2007 agreement for common environmental and social standards among the European Development Finance Institutions.

Since CDC does not invest directly in companies, implementation of the code requires an agreement with its fund managers. Section 4 of the code describes how this occurs: the agreement is a formal one, 'similar in substance' to the investment code itself. Where Fund Managers have effective control or significant influence over portfolio companies, CDC requires its Fund Managers "to procure that such portfolio companies sign an undertaking confirming that they will operate in line with [the]... Investment Code."

CDC attempts to measure ESG 'risks' by requesting that the funds and companies it invests in produce reports. Of the 65 investment funds, CDC requested information from 20, of which 9 produced 'full' ESG reports; of the 20, four were rated as 'below expectations'. CDC acquired information from 238 of its 794 portfolio companies, of which 71 were identified as 'high risk'.

Private sector development

CDC tries to determine whether its investments are strengthening local capital markets (i.e. mobilising local investment) by identifying which fund managers have raised further 'successor' funds as a result of the fund's initial investment. This occurred in 12 of the 20 funds evaluated, although it is not specified how much investment was raised locally.

5 Performance – the view outside CDC

There is a wealth of material on CDC's performance produced by other organisations. The International Development Committee published a report on the future of CDC in March 2011, and another in 2006 on Private Sector Development, (the role of the CDC is considered in Chapter 5 of this). The National Audit Office, at the end of 2008,[16], and the Public Accounts Committee at the start of 2009[17] published reports on DFID's oversight of the CDC. It has also been the subject of a long-running investigation by the satirical current

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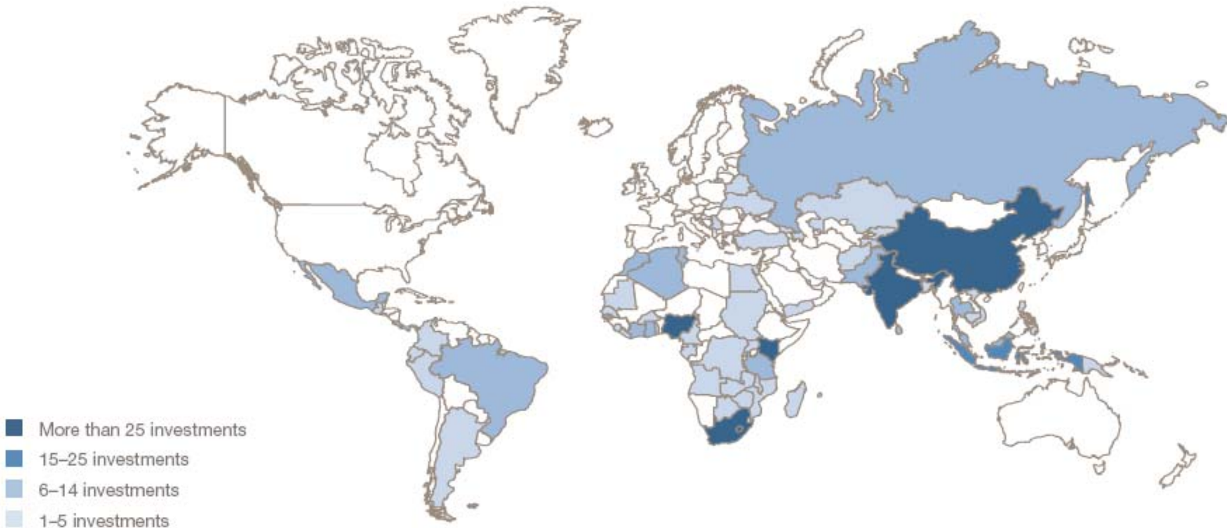
[14] CDC *Development Review 2009*, p.15
[15] The most recent version can be found on its website, here.
[16] NAO *DFID's oversight of CDC Group plc*
[17] Public Accounts Committee *DFID's oversight of CDC Group plc*

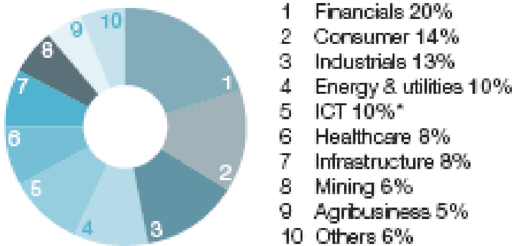
affairs magazine *Private Eye*[18], a report by the TUC[19], a Westminster Hall debate[20] and 97 parliamentary questions to DFID since July 2004.[21]

A full treatment of this material is beyond the scope of this note. At the heart of much of the criticism, however, lies the problem that investment choices that are profit-maximising for CDC are not necessarily poverty-minimising, and in some cases may even conflict with or undermine development objectives. The oversight process, structure, performance targets, and remuneration policy of CDC, so the argument goes, have encouraged it to prioritise investment in countries (Nigeria, South Africa, India and China; see map) and sectors (financial services and consumer goods; see chart) that are profitable, rather than those which might be 'additional', 'catalytic' (see Section 1), or otherwise effective from a development perspective.

CDC Investment portfolio by country



CDC investment portfolio by sector



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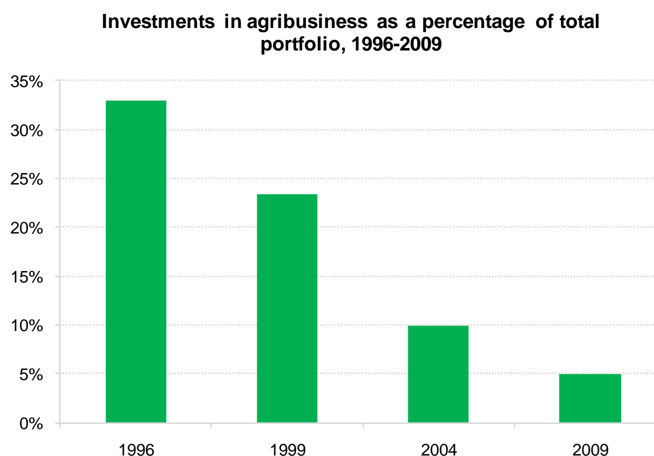
[18] The sale of the 60% share in Actis to CDC managers, and the valuation of this stake at £373,000, has been a particular focus of Private Eye's investigation, in light of Actis' £8m profit during its first full year of operation.

[19] TUC (2010) CDC: time to improve its poor effort

[20] HC Deb 14th May 2008 c413WH

[21] There has also been extensive media coverage of of the remuneration and expenses bills of CDC's top executives (see, for example, The Times 3rd May 2009;)

The dwindling of CDC's agricultural portfolio is often cited as evidence that CDC is prioritising the 'wrong' sectors, from a development perspective. In 1994 and 1996, agriculture accounted for 34% and 33% of CDC's portfolio respectively. Following its restructuring as a public private partnership in 1997, and again as a public limited company in 2004, the relative importance of agriculture has declined; by 2009, agriculture projects accounted for 5% of CDC's portfolio (see chart). Investment in the financial and consumer sectors, meanwhile, has increased. In the International Development Committee's enquiry into Private Sector Development, Richard Laing, CEO of CDC, admitted that the decrease had occurred because 'returns on agribusiness were quite low'.[22] The fact a comparatively small proportion of CDC's portfolio is invested in small and medium-sized enterprises (which tend to offer low returns but high development benefits) has also been criticised: in 2009, the average CDC-supported firm had 1,188 employees.[23]



The monitoring of CDC's performance by the Government has been questioned by the National Audit Office, the Public Accounts Committee, and the International Development Committee in their reports (listed at the start of this section); in particular, all three believed there to be undue focus on financial performance as a measure of development impact, with little evidence of CDC's impact on poverty reduction. The remuneration policy, which links 75% of directorial pay to financial performance, has also been blamed for skewing incentives towards profit maximisation.

More generally, the Public Accounts Committee pointed out that, whilst DFID proscribes the countries that CDC can invest in, it has not set CDC targets to invest in neglected sectors or disadvantaged areas *within* those countries. In any case, the report asserts, CDC's fund-of-funds structure, whereby it contracts the business of identifying investment opportunities to fund managers, prevents it from specifying its investment choices at this level of detail.

The most recent (2011) International Development Committee Report recommended that CDC be split in two, with one part investing through the fund-of-funds structure, which it saw as a preferable structure for achieving the 'catalytic' effect of mobilising other investments. The high returns anticipated from this part of its work, the Committee proposed, should be reinvested in the second part of its operations, *CDC Frontier*, where the 'additional' mandate of CDC's investment would be emphasised; in particular, *CDC Frontier* would have an explicit mandate to make more 'innovative' investments with the specific aim of poverty-reduction.

[22] Select Committee on International Development, Minutes of Evidence to Fourth Report (HC 921-II), Tuesday 21st March, Q.99

[23] Select Committee on International Development, *The Future of CDC* (HC 607), p.18

6 Consultation and reform

On 12 October, the International Development Secretary Andrew Mitchell launched a public consultation and commissioned four independent studies, with a view to reforming CDC[24]. The written statement set out the reasons for this:-

> [CDC] has become less directly engaged in serving the needs of development. Using public capital CDC pursued the narrowly defined private sector goals for which it was incentivised and this meant the greatest return for the least risk. This was not consistent with concentrating its efforts in the regions of greatest development need.
>
> We will create a revitalised CDC with a great deal more clarity and ambition over what it does and where it works.

Among other things, the review examined how CDC might:-

- reduce new commitments to future third-party funds and consider the benefits of liquidating some of its existing investments
- regain its power to make investments directly in target countries
- participate through a wider range of vehicles, including investment in debt instruments and the provision of guarantees
- regain its power to borrow
- more effectively deal with environmental issues, and take a more rigorous approach to corruption

The consultation closed on 28 February 2011[25] and a Written Statement was made by Andrew Mitchell on 7 June 2011 on planned reforms.[26] At the centre of these is the agreement of a new business plan for CDC, covering the period 2011-15.[27] The proposals touch on most of the areas highlighted in the previous section, including:-

- ***Geographical balance of CDC's portfolio*** – all new investments will take place in South Asia and Sub-Saharan Africa, with a concentration on the 8 poorest states in the case of India. CDC's portfolio holdings outside these regions are to be reduced by 15-20% by 2015 (described as an 'aim' in the Statement)
- ***Sectoral balance of CDC's portfolio*** – no new investment in sectors 'already well-served by private investors,' and other sectors to be selected on the basis of development outcomes.
- ***Profit vs development maximisation*** – CDC will be requried to remain 'sufficiently profitable to offset the cost of taxpayers' money invested in it', but performance will be judged according to a new framework focused on development impact.
- ***Fund-of-funds structure*** – CDC to be given the mandate to make its own direct investments, to work with a wider range of intermediaries (i.e. in addition to private equity funds), and to offer loan finance as well as equity investments. Its

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[24] HC Deb 12th October 2010 c14-16WS. Background to the consultation can be found on the DFID website.
[25] A summary responses and the outcome of the four studies is available on the DFID website at this link.
[26] HC Deb 7 June 2011 c18-21WS
[27] Available on the CDC website, here.

investments through the fund-of-funds structure will be reduced to 60% by 2015 (described as an 'aim' in the Statement).

- ***Remuneration*** – salaries and bonuses are no longer to be benchmarked against private equity fund-of-funds firms in the City, and bonuses will be contingent on development results rather than profitability. A new remuneration framework will be devised following the appointment of the new CDC chief executive.

- ***DFID oversight*** – CDC to report on performance against business plan and targets annually to DFID

- ***Tax evasion*** – no new investments through regimes which do not comply with OECD guidelines[28] on international tax transparency and exchange of information, where this is at CDC's discretion (i.e. where it is the original or sole investor). Where CDC does not have discretion, it will be transparent about its judgment with respect to the investment decision. Information to be published, where possible, on taxes paid within CDC's portfolio.

- ***Investment code*** – the investment code will be updated to reflect 'best practice' and 'latest international standards'.

[28] Further details are available on the relevant page of the OECD website.