# Norfund

Norwegian Investment Fund for Developing Countries

## Creates value
## Combats poverty

# Report on operations **2008**

# Norfund

The Norwegian Investment Fund for Developing Countries – Norfund – was created by the Storting (parliament) in 1997. Its job is to contribute, through investment capital, loans and guarantees, to the development of profitable and sustainable business activities in countries which have limited access to commercial financing because they present a high level of risk.

Norfund is a hybrid state-owned company established by law with limited liability, owned on behalf of the state by the Ministry of Foreign Affairs with Erik Solheim as the minister with constitutional responsibility. Its activities are conducted in accordance with the fundamental principles for Norwegian development cooperation. The board of directors is appointed by the government.

- NORFUND'S INVESTMENTS SUPPORTED 248 000 JOBS, HALF OF THEM HELD BY WOMEN
- NOK 3.2 BILLION WAS PAID IN TAX IN DEVELOPING COUNTRIES
- 43 PER CENT OF INVESTMENT IN 2008 WENT TO THE LEAST-DEVELOPED COUNTRIES (LDCS)
- NORFUND'S EQUITY TOTALLED NOK 5.3 BILLION.

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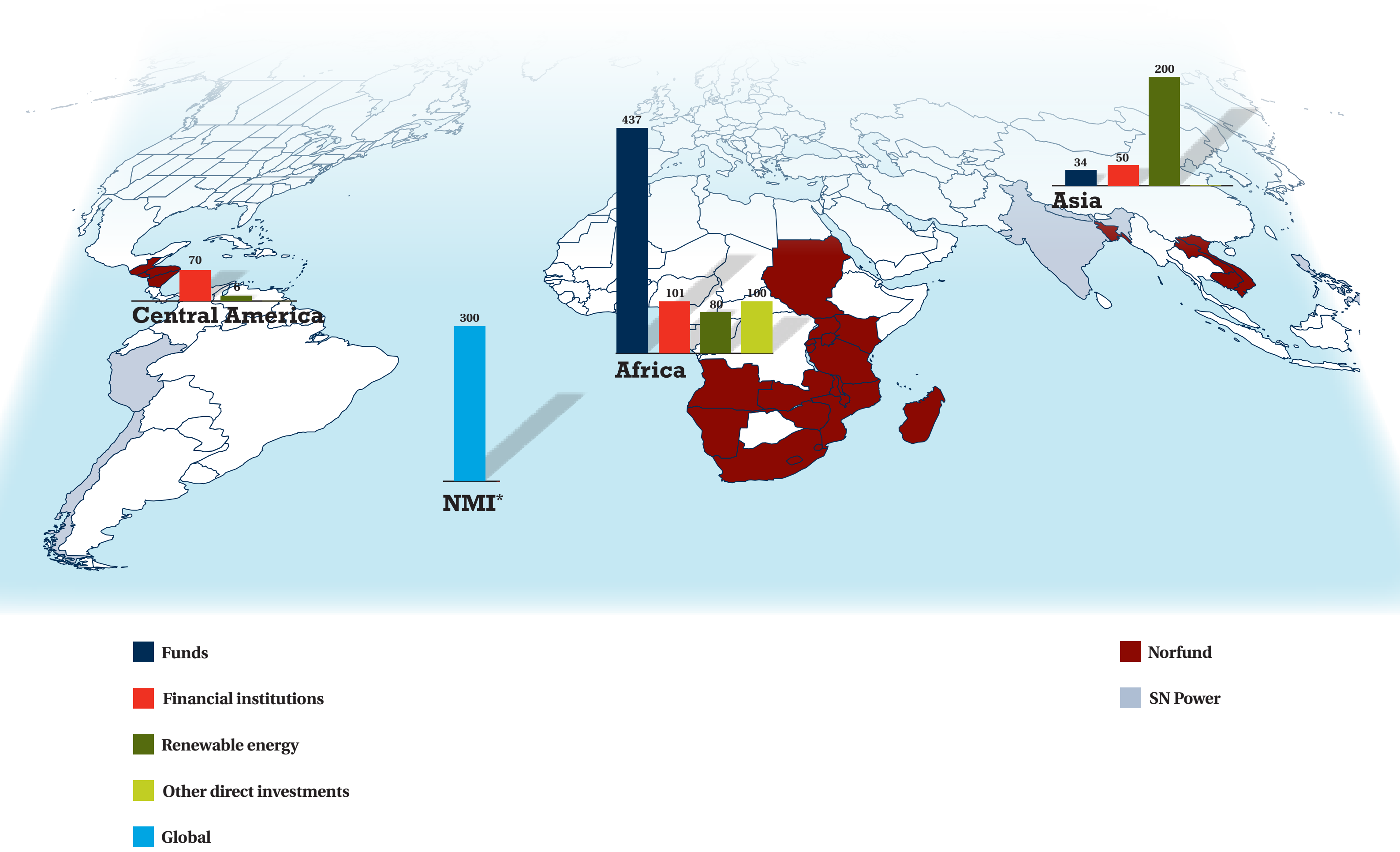
# New investment agreements in 2008

## Total: NOK 1.4 billion




*The Norwegian Microfinance Initiative (NMI) was established in 2008 and has yet to invest its capital. However, its investments will be concentrated in poor countries.

# Strong 2008 – demanding future

**We achieved a surprisingly good result in 2008, with substantial development effects in a difficult market. One reason is that the financial crisis did not initially have a particularly strong effect on the countries in which we invest. On the other hand, the decline in the real economy during 2009 will be far more demanding – increasing risk and reducing short-term profitability in our investment markets.**

We had another year of good progress in 2008. New strategic investments were made in our core markets, particularly sub-Saharan Africa. A new subsidiary for clean energy was founded to increase supplies of energy in Africa and Central America, and the Norwegian Microfinance Initiative (NMI) was established with private investors in Norway.

Profitability is essential for ensuring that our invested capital creates viable companies as well as lasting value and development effects. It is also important for convincing more Norwegian and international players to invest in poor developing countries.

The highest possible profitability is not a goal in itself for Norfund, so we have not quantified a required rate of return. The return on the different parts of our portfolio varies considerably. At the same time, risk in the portfolio is growing – partly because our investment is gradually being concentrated on fewer and poorer countries, particularly in Africa.

Developing countries avoided the first shock from the financial meltdown in the USA during the autumn of 2008 because poor nations are not integrated with the global financial market. They are part of the world economy, however, and get hit all the harder when foreign investment dries up, money transfers from family members abroad decline and revenues from exports and tourism fall. History also shows that development assistance often drops during economic downturns. Nor have the developing countries any financial reserves to spend on crisis packages – a lost job is a tragedy for whole families which have no social security or other safety net.

We must therefore be prepared for the likelihood that 2009 will be demanding for the most important countries in which we work. Precisely for that reason, and precisely at this time, it is crucial that liquid investors such as ourselves do our job, invest counter-cyclically and are willing to accept higher risk. That represents our role and our mandate, as presented in section 1.1 of this report.

The government's Policy Coherence Commission unanimously recommended in September that a fund of NOK 10 billion would be created to invest in low-income countries with a special focus on Africa and the LDCs, channelled through us. Our subsequent report to the Ministry of Finance proposed how such a fund can be established in practice. At the same time, the report you now hold in your hands demonstrates that such investments can be made both profitable and sustainable. I look forward to continued work on this proposal in 2009.

Combating poverty through profitable business development is an overarching goal for our investments. We are proud to report a record number of jobs derived from this spending, a gender-balanced workforce, and large tax payments to national and local government. In addition, we add value by improving business management, including follow-up of environmental and social standards and prevention of corruption. On the other hand, 2008 was a disappointing year in HSE terms for two of our energy investments, with an unacceptable level of fatalities. Section 1.2 of this report identifies both the opportunities and the limitations of our work on social responsibility.

We have made a bigger commitment to Africa than ever since 2007, and the share of this continent in our investments increased sharply during 2008. Our focus on poverty is also illustrated by a rise in the LDC share of our new investment (including SN Power) from 34 per cent in 2007 to 43 per cent in 2008.

Combating poverty through investment in the world's most difficult markets is no easy business. Major risks and many dilemmas are involved, and achieving results requires patience. Over 13 years, we have built up a unique professional expertise with such investment in Norway. We have regional offices in South Africa, Kenya and Costa Rica as well as substantial regional and international networks. We will be strengthening and exploiting these in the years to come.

Enjoy this publication.

**Kjell Roland**
**Managing director**

# Events of 2008

**January**

**HRH Crown Prince Haakon Magnus** lays the foundation stone for SN Power's La Confluencia hydropower station in the Chilean Andes.

**Kabul Serena Hotel**, part-owned by Norfund, suffers a terrorist attack which affects the delegation accompanying foreign minister Jonas Gahr Støre.

**February**

**March**

Norfund celebrates its **10th anniversary** and can report its best financial results since its creation as well as major development effects.

The first payment is made by Norfund to the **Bugoye** hydropower station in Uganda. This project will increase the countries electricity supplies with seven per cent.

**April**

**May**

Unacceptable working conditions are exposed in Bangladesh among sub-contractors to Norfund borrower **Grameen Phone**. Norfund investigates HSE supervision by the company and its owners.

Norfund invests in the **Blue Waters Growth Fund** in Vietnam, which offers financing to SMEs.

**June**

Norfund invests in northern Mozambique's **Matanuska** plantation, the first major initiative for banana exports from south-eastern Africa.

The **Norwegian Microfinance Initiative (NMI)** is established as a groundbreaking public-private collaboration between Norfund (with 50 per cent), DnB NOR, Ferd, KLP and Storebrand.

The Ministry of Foreign Affairs appoints a **government commission on capital flight** to investigate the role of secrecy jurisdictions (tax havens) in illegal transfers of capital from and tax evasion in developing countries.

**Uganda Microfinance Ltd (UML)** is sold to Equity Bank Ltd in Kenya and is being further developed as a professional microbank with both lending and deposit-taking.

## July

Norfund steps up its commitment to **microfinance in Cambodia** by investing in AMRET and Cambodian Entrepreneur Building as well as by converting a loan to equity in Hattha Kaksekar.

## August

Norfund makes a strong commitment to SMEs in Africa through the **Aureos Africa Fund** which focuses on regional companies, and the loan finance company **GroFin Africa Fund.**

## September

The **Lehman Bros** investment bank goes into liquidation and accelerates the financial crisis which began in the late summer of 2007. This crisis hits developed economies, but spreads gradually to the developing world.

Mozambique's President Guebuza opens **Banco Terra**'s head office in Maputo. Norfund has invested more than NOK 12 million in this bank, which specialised in agriculture-related industry.

The government-appointed **Policy Coherence Commission** recommends in its report (NOK 2008:14) that NOK 10 billion from the Government Pension Fund – Global should be invested in developing countries through Norfund.

Norfund publishes its report on **contribution to development**, which quantifies the jobs, female employment and tax revenues generated by the fund's investments.

The **Development Investor** computer game is launched by Norfund for all Norwegian colleges of further education. Erik Solheim, Minister for the environment and international development, opens the competition.

## October

Norfund invests in the production of cassava starch by **Casquip Swaziland.** This enterprise focuses on sales to South Africa's paper and food industries.

An investment agreement is concluded by Norfund with **BRAC Africa**, a large microfinance institution from Bangladesh which is expanding to Africa.

## November

Norfund agrees to reduce its holding in **SN Power** to 40 per cent and enters into a **new subsidiary** which will concentrate on developing renewable energy in Africa and Central America.

## December

A loan is given to **Exim Bank Ltd** in Tanzania and additional liquidity provided for **CIFI** in Latin America. Capital from the institution helps both banks to continue lending despite the financial crisis.

Norfund exits from its lender participation in the **Latin America Challenge Investment Fund**, the first loan fund specially directed at microfinance in this continent.

CHAPTER 1

# Norfund explained

## 1.1 MANDATE AND STRATEGY

**The Norfund Act of 1997 specifies that the fund will "establish viable, profitable business activities which would not otherwise be initiated because of high risk". To achieve this while simultaneously mobilising funds from other investors, Norfund has adopted a strategy of concentrating geographically on selected extremely poor regions and on sectors with a high development effect. This is paralleled by building an organisation with substantial operational experience and good local networks.**

### MANDATE

Norfund has a development policy mandate from the Norwegian Storting (parliament) and government. Poor countries need investment in profitable companies which can create jobs, generate tax revenues, bring in expertise and technology, and thereby contribute to economic and social development. High risk and ignorance mean that many private investors hesitate to invest in the poorest countries. That creates a need for a competent and commercially oriented intermediate, which can reduce barriers for private investment in profitable business enterprises through its own expertise and risk capital.

This is why Norfund was established by the Storting in 1997 as a hybrid state-owned company established by law with limited liability. Its duty to establish viable, profitable business activities which would not otherwise be initiated because of high risk is enshrined by law. Norfund is owned by the Ministry of Foreign Affairs on behalf of the government, and is required to work in accordance with the basic principles of Norwegian development policy and with high standards of business ethics and social responsibility. It will also combat corruption throughout its operations.

The Storting appropriates an annual capital contribution for Norfund over the development assistance budget. NOK 485 million was provided in 2008. Developing countries in which Norfund could invest in 2008 were defined as those with a maximum GDP per capita of USD 6 055. Norfund's investment must never comprise more than 50 per cent of the total capital invested in a company, and will normally be substantially less.

### STRATEGY

As a financial investor in a demanding market with high risk, Norfund has financial and country expertise which equips it to select the investments with the greatest prospects of success in both commercial and development terms. The fund has detailed knowledge of the countries, and sometimes the markets, in which it invests. Its success depends furthermore on deep and broad experience-based knowledge of how projects should be structured and followed up by an active investor and owner.

Norfund also contributes with expertise on social responsibility and in order to combat corruption, and makes grants when necessary to boost the development effect. In addition, it devotes funds to developing projects, a use of resources regarded as risky by commercial players but crucial for launching new companies and developing new products in countries which desperately need additional jobs.

An important requirement for success is the choice of good Norwegian and foreign partners who can complement Norfund's own expertise and who also share its attitudes and values. A number of companies collaborate with the fund today. (See the box opposite.) In addition, Norfund participates in the European Association of Development Finance Institutes (EDFI) and collaborates closely with the International Finance Corporation (IFC), the World Bank's arm for the private sector. First and foremost, however, it maintains close collaboration with a large number of private investors and partners, particularly in developing countries.

Fundamentally, therefore, Norfund's strategy is about building the expertise essential for making sustainable investments in profitable companies in difficult markets. This expertise falls into the following categories:

- *Investment expertise embraces* the analysis of companies, partners, fund structures and managers, investment strategies, valuations, structuring of appropriate capital instruments, establishment of good local partners, negotiating techniques and, not least, exercising ownership in a constructive manner for the enterprise.

- *Country expertise* comprises an understanding of frame conditions and cultures in the countries in which Norfund works. As a small organisation, it has chosen to concentrate its activities on four regions – southern and eastern Africa, Central America and four nations in south-east Asia. These have been chosen because they embrace a high proportion of LDCs and are partner countries for Norwegian development assistance, and because Norfund has networks and existing investments on which it can build. Where direct investments outside the energy and financial sectors are concerned, moreover, the fund has opted to concentrate on Africa. Its ambition there is to develop expertise which makes it the obvious partner for Norwegian and other players who want to build new companies in the continent.

- *Sector expertise*. Norfund selects sectors where it already has experience or where it can build further on in-depth expertise possessed by partners in the Norwegian business community. Renewable energy, with the emphasis on hydropower, and the financial sector have accordingly been selected as the areas in which Norfund will be particularly good, and in which it will invest a significant proportion of its capital.

- *Social responsibility*. Norfund works actively to promote social and environmental sustainability. Emphasis is given in all its investments to labour and human rights. Another condition is naturally that the environment suffers no irremediable harm. All Norfund's projects have zero tolerance for corruption.

- *Project development*. When Norfund increases its investment in the poorest countries, it must often accept a role which goes beyond what most commercial investors would find appropriate. Where no projects exist from before, and no other players are devoting resources to develop them, Norfund itself must create development opportunities from the ground up.

## Box 1: Some of Norfund's Norwegian partners

| Partner | Sector |
|---|---|
| Statkraft | Renewable energy |
| Trønder Energi | Renewable energy |
| Telenor | Telecommunications |
| DnB Nor/Vital | Microfinance |
| Storebrand | Microfinance |
| Ferd | Microfinance |
| KLP | Microfinance |
| Strømme Foundation | Microfinance |
| Yara | Fertiliser distribution |

- *Reinforcing development effects*. Norfund finances programmes in its companies to combat HIV/Aids, improve the working environment, enhance educational opportunities for the children of employees and to strengthen health services. Resources are devoted to training managers, increasing respect for union rights and improving the position of women. Such programmes often involve costs which Norfund's commercial partners cannot be expected to meet over the company's budget, and which the institution accordingly covers from its own grant funds.

### INDUSTRIAL AND LONG-TERM INVESTOR

Unlike the Norwegian Government Pension Fund – Global, Norfund seldom invests in listed companies because these are found in liquid markets with plentiful access to capital from private sources. Norfund's ambition is to secure industrial partners which can join forces with it to build and develop companies. The fund takes a long-term approach, and will typically have an investment time frame of five to 10 years for creating value and a substantial business. Norfund invests equity in individual companies (directly or through fund management companies) or gives them loans.

# 1.2 SOCIAL AND ENVIRONMENTAL RESPONSIBILITY

**Norfund works actively to promote social and environmental sustainability. Weight is given in all its investments to respect for labour and human rights, while ensuring that the environment does not suffer irremediable harm. The fund acts as both a lender and a part-owner, and takes responsibility by setting requirements, exerting influence and providing help.**

Detailed analysis of environmental and social conditions and impacts are conducted before Norfund makes an investment decision. In the case of particularly demanding investments, a full impact assessment by external consultants is required, with findings benchmarked against international standards. Norfund works to ensure satisfactory standards along five dimensions.

**1. REQUIREMENTS**
Companies in which Norfund invests must comply with national legislation and regulations concerning the environment and labour rights. These companies also undertake to respect international HSE standards and labour rights, and to take action to align with these over time. In addition, Norfund considers it important to respect the rights of indigenous peoples and the fight to preserve biodiversity, and to ensure that its companies work actively to take account of the local community of which they form part. Employees will be given necessary training, and Norfund must receive reports. The most important standards are set by the IFC and also accommodate the core conventions of the International Labour Organisation (ILO).

Norfund requires that companies in which it has a direct equity interest must immediately notify of serious incidents such as fires, strikes, serious accidents or fatalities. That also applies to some of the loan agreements. In such cases, Norfund is responsible for ensuring that compensation is paid and preventive measures are instituted. Ownership is exercised in funds by the managers, who are responsible for follow-up and reporting to Norfund.

**2. EXERTING INFLUENCE**
Norfund's opportunities to influence the management of companies in which it invests depends on the size of the investment and whether this is made directly or indirectly. The institution is normally represented on the board of companies in which it has a direct equity interest, and this provides it with information and the opportunity to raise conditions with the management and the other shareholders. Where fund investments are concerned, Norfund sits on governing bodies which provide guidelines for the investment strategies to be followed, but the actual ownership function and follow-up of the companies are exercised by the fund managers.

**3. SUPPORT**
Norfund can provide support for the preparation of position analyses and action plans to improve conditions. In its direct investments, the institution seeks to play the role of an active owner by contributing to continuous improvement of environmental standards and social conditions throughout the duration of its involvement.

Exiting from a loan agreement or selling a shareholding are usually inappropriate as means of pressure – more can be achieved by staying. Moreover, Norfund invests in unlisted companies, where exiting from an early involvement is very difficult. This motivates Norfund and the company to collaborate over necessary improvements.

**4. INTERNATIONAL HARMONISATION**
Norfund collaborates with other development finance institutions (DFIs) to secure a common approach to work on environmental and social standards and to contribute effectively to improvements both at the companies invested in and with fund managers.

**5. TRANSPARENCY**
Norfund participated actively through the press and its own website in the Norwegian debate on HSE related to investments in developing countries, and openly shared its experience and challenges.

**ACTIVITY IN 2008**
Norfund devoted particular attention during the year to handling fatalities in its portfolio. Problems

related to SN Power's Allain Duhangan development project in the Indian Himalayas, where six deaths unfortunately occurred, were followed up both in the boardroom and through contact between Norfund and SN Power employees whose responsibilities include HSE. In India, SN Power was an active prime mover in efforts to improve HSE standards in Allain Duhangan through personnel training, owner audits, secondment of HSE and safety experts and work to unite owners and lenders behind a common focus on improving HSE standards.

Continuous information on incidents is provided to Norfund, which focuses constant attention on HSE standards at SN Power in general and Allain Duhangan in particular.

*Good lighting and hearing protection are in place at this textile mill in Madagascar.
Norfund sets requirements for its fund managers on following up HSE standards and other aspects.*

CHAPTER 2

# Analysis of the portfolio

## 2.1 GEOGRAPHY – AFRICA AND LDCS TAKE PRIORITY

**Norfund combats poverty by investing in some of the world's most difficult markets and LDCs. To succeed in this, the fund must know as much as possible about the countries in which it operates. As explained in section 1.1, its strategy gives priority to regions in which it has experience and networks. Southern and eastern Africa and certain poor countries in Central America and Asia are the main priorities. Norfund is investing more than ever in sub-Saharan Africa, and the share of LDCs in these investments accordingly increased significantly in 2008.**

The OECD's development assistance committee (DAC) groups developing countries into low-income, lower middle-income and upper middle-income in accordance with data and income limits from the World Bank. In addition, the UN has defined a separate category for the LDCs. One of the UN's criteria for LDC status is that the country is a low-income country in accordance with the World Bank's categorisation. The corresponding limit values measured by GNI per capita are presented in figures 2 and 3.

LDCs have a high priority in Norwegian development policy, and accordingly also occupy a key place in Norfund's strategy. It worked intensively in 2008 to study, prepare and implement investments in these difficult markets.

LDCs accounted for 43 per cent of Norfund's new investment in 2008, and no less than 59 per cent in the renewable energy area. See table 1 below. This is attributable in part to an investment of NOK 100 million in Nepal through SN Power, as well as the creation of a new energy company dedicated to Africa and Central America. See box 2 in section 3.2. Investment in the Bugoye hydropower station in Uganda together with Trønder Energi also helped to raise the LDC share.

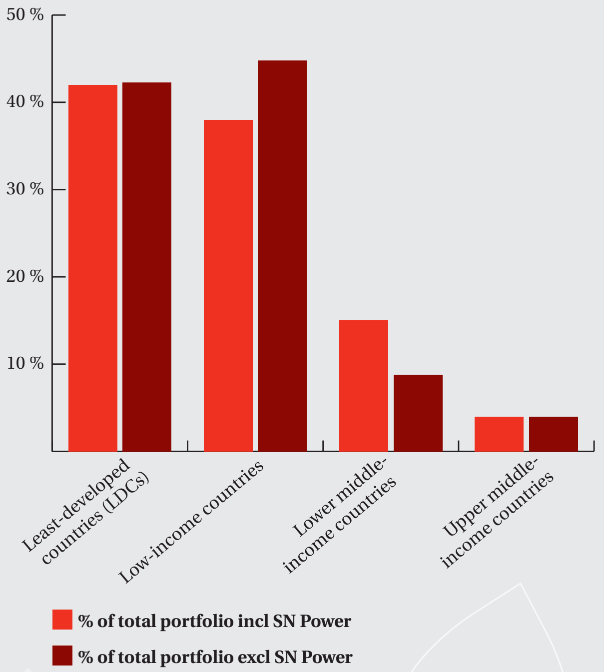
Within the financial institutions area, which gives weight to banks lending to SMEs (SME banks) and to microfinance, a number of investment commitments were made in Cambodia and African countries with an LDC element of 50 per cent. Where funds were concerned, 28 per cent of investment agreements were in LDCs, while the LDC share of other direct investments (with the main emphasis on agricultural projects in Africa) was 41 per cent.

Figure 2 shows all investments committed in 2008 by the OECD/DAC classification, with and without SN Power. Including the latter, a total of 81 per cent of the investments were made in LDCs and low-income countries. When SN Power is excluded, this proportion rises to 87 per cent. Figure 3 shows the size and OECD/DAC country classification for all new investments

**Table 1: LDC share of Norfund's portfolio**

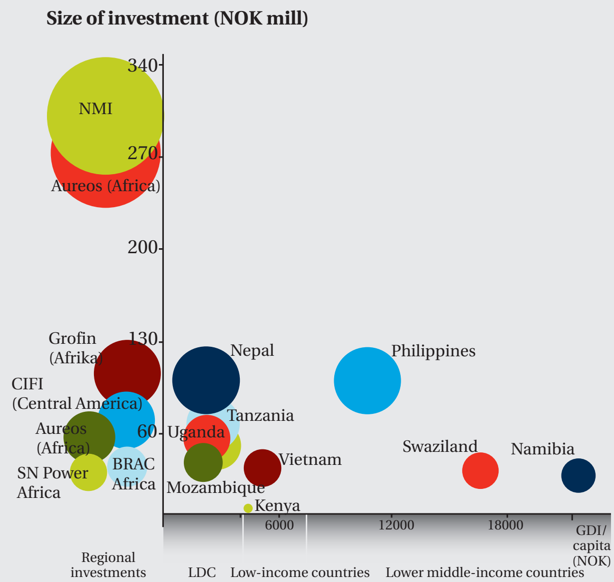
| | | Total portfolio | | By investment area | | | |
|---|---|---|---|---|---|---|---|
| | | Total | Excl SN Power | Funds | Financial institutions | Renewable energy | Other direct investments |
| New investment agreements in LDCs in 2008 | NOK mill | 598 | 485 | 130 | 260 | 168 | 41 |
| | **LDC share** | **43 %** | **42 %** | **28 %** | **50 %** | **59 %** | **41 %** |
| Investments in LDCs in the total committed portfolio at 31 Dec 08 | NOK mill | 1 096 | 893 | 232 | 441 | 259 | 164 |
| | **LDC share** | **23 %** | **36 %** | **19 %** | **53 %** | **11 %** | **43 %** |

**Figure 2 • New investment by recipient country's GNI per capita in relation to the OECD/DAC classification**




*Explanation: Norfund's investments agreed in 2008 by DAC classification, based in part on GNI per capita (converted at an exchange rate of USD/NOK 6.5): least-developed countries/LDCs – (less than NOK 4 875), low-income countries (NOK 4 875-6 077), lower middle-income countries (NOK 6 077-24 082) and upper middle-income countries (NOK 24 082-74 457).*

**Figure 3 • New investment in 2008 by size, country and DAC classification.**




*Explanation: Norfund makes both regional investments (where the funds are spread over a number of countries) and investments in individual countries. The latter are shown on the right-hand side of the figure, with the poorest to the left. SN Power's investments in the Philippines and Nepal were the largest here. Regional investments are shown on the left, with the Norwegian Microfinance Initiative (NMI) and Aureos Africa Fund as the largest.*

agreed in 2008. The left-hand Y axis also shows the size of investments in regional funds. These funds invest in LDCs and low-income countries in Africa and Central America, but also have investments in lower middle-income countries. With the exception of those in Swaziland, the Philippines (through SN Power) and Namibia, most of the investment agreements concluded in 2008 were in LDC and low-income countries in Asia and southern and eastern Africa.

## 2.2 DEVELOPMENT EFFECTS AND CLIMATE

**The fundamental idea behind Norfund's operations is that profitable companies create broad economic progress and development effects which persist after the fund has exited.**
**The 2000 *Voices of the Poor* study by the World Bank found that the majority of poor people surveyed saw paid work (either for others or self-employed) as the most important way of escaping from poverty.**

Norfund invests in a number of different companies in poor countries. It identifies the overall development effects of its work in order to assess how far its projects contribute to jobs, equal opportunities, tax revenues, energy development or the reduction of carbon emissions.

### EXTENSIVE DATA GATHERING FOR 2008

Norfund presented employment figures for all its investments in 2007, along with female jobs for about half the portfolio and tax paid by companies in which it had invested directly. To provide a complete overview of the effects of all its investments, the fund decided to work with the fund managers through whom it invests in order to improve their reporting. Norfund is pleased to say that the 2008 figures cover all the companies in which it has invested.

### JOBS

At 31 December 2008, 248 182 people worked in companies in which Norfund had invested. These were either permanent employees, temporary personnel in full-time posts or part-time employees measured in full-time equivalent. Where companies had invested both in developing countries and in OECD members, the latter were excluded. Of the 248 182, 106 413 worked in companies which had received Norfund investment through fund managers.

The change from 2007 to 2008 in employee numbers for our companies is substantial, representing an increase of about 100 000 jobs. This is attributable partly to more complete reporting and to an expansion in Norfund's total capital and consequently in the overall scope of its activities. But the principal reason is that the fund has invested heavily in microfinance institutions which have big workforces. Such enterprises depend on a large number of office workers to reach their clients. Growth was particularly substantial at the BRAC microfinance institution, which employed 117 000 people in Bangladesh in 2008 and is now expanding to Africa.

### WORK FOR WOMEN

A total of 121 350 women worked in Norfund enterprises, representing a female proportion of no less than 49 per cent. This high share can largely be attributed to the investments in microfinance institutions, which have a lot of female workers. Excluding the finance sector, the proportion of female employees was no less than 38 per cent in companies covered by the private equity funds in which Norfund invests and in Norfund's own direct investments. The proportion in Norfund's own direct investments in non-finance companies was 18 per cent.

### TAX PAID

Companies in which Norfund has invested made various forms of tax contributions totalling more than NOK 3.2 billion in fiscal 2008. This calculation includes corporation tax, various licences and fees, value-added tax and payroll taxes to local and central government in the investment country. Income tax paid by employees comes in addition, and is not included here.

Tax contributions from companies in which Norfund has invested are very large. This can primarily be attributed to two factors. One is that the tax calculation, like the employment figures, has not been

## DEVELOPMENT EFFECTS – TOTAL PORTFOLIO

**Jobs:** 248 000 people
**Female share:** 49 per cent
**Tax paid:** NOK 3.2 billion

proportionately weighted in relation to the size of Norfund's investment. Second, tax paid by Grameen Phone in 2008 totalled more than NOK 2.2 billion. Of the remaining NOK 1 billion, SMEs in which Norfund has invested through private equity funds paid about NOK 600 million in direct and indirect taxes to local and central governments in three continents.

**ENERGY AND CLIMATE**

A well-functioning electricity supply system is essential for economic growth and business progress, while the development of clean renewable energy sources plays a key role in achieving important environmental and climate policy goals. SN Power's hydropower stations had a capacity of about 1 000 MW in 2008, corresponding to the electricity consumption of some 11.5 million people in the relevant countries. Of these, SN Power's share equals roughly 7.1 million people.

SN Power continued to develop its clean development mechanism (CDM) projects, and currently has three large-scale CDM-registered hydropower stations. These have a potential to deliver certified emission reductions (CERs) corresponding to 1.35 million tonnes of carbon dioxide per year. SN Power's share of this will be 850 000 tonnes.

Applications for CDM registration have been submitted by SN Power for four further projects. These seven developments are expected to yield an annual reduction of carbon emissions by the equivalent of more than two million tonnes in CERs. SN Power will account for just over 1.2 million tonnes.

**FUNDS AND MICROFINANCE**

Norfund invests in a number of funds and financial institutions where an important component of the development effect is the number of customers and companies who secure access to financing. More than 200 SMEs, employing a total of 100 000 people, were built up or further developed in the fund's portfolio during 2008. Financial institutions (including microfinance) had transmitted Norfund's capital to 6.9 million people at 31 December.

Further details of development effects in the various sectors are provided in chapter 3 of this report.


*Bangladesh received no less than NOK 2.2 billion in tax from Grameen Phone during 2008. Here from Dhaka, the capital.*

## 2.3 KEY FINANCIAL FIGURES

**Norfund achieved a profit in investment currencies of NOK 233 million for 2008. This positive result was primarily attributable to good profitability, the reduction in the SN Power holding, and increased revenues from the rest of the investment portfolio. This means that Norfund achieved a good result in a demanding market, even after making larger write-downs in 2008 than the year before as a consequence of the financial crisis and the changed outlook. A good return on investments gives opportunities for a continued commitment to poverty reduction by financing new projects from profits.**

**A GOOD RESULT IN 2008**

Norfund's result is affected by fluctuations in the exchange rate of the Norwegian krone against relevant investment currencies. Because the fund's goal is to create profitable companies in the countries in which it invests, and profits and gains are to be reinvested in the same group of countries, its performance is measured by the return on investment currencies rather than on Norwegian kroner. For that reason, and in accordance with Norfund's mandate, the results of the business are measured in the investment currencies (excluding the effect of exchange rate changes).

Norfund's profit in investment currencies was NOK 233 million in 2008, compared with NOK 264 million the year before. Because the markets in which Norfund has invested also developed more weakly, investments in the investment currencies were written down by NOK 84 million in 2008 – mostly in investment funds. By comparison, the value was written up (reversal of write-down) by NOK 63 million in 2007. The negative effect of these write-downs on Norfund's profit in investment currencies for 2008 compared with the year before was thereby NOK 147 million.

Profit in Norwegian kroner for Norfund totalled NOK 422 million in 2008. Because the Norwegian krone weakened against the US dollar and euro during the year, the value of investments in this currency rose correspondingly. In total, this had a positive effect of NOK 189 million on results for 2008. The position was reversed in 2007, when Norfund had a negative currency effect of NOK 64 million. Including currency effects, Norfund's profit for 2008 was NOK 422 million compared with NOK 202 million in 2007. In addition come currency effects of NOK 477 million on SN Power's equity, which have been charged directly to equity in Norfund. That is because SN Power's accounts are in US dollars. (This illustrates the appropriateness of focusing on the profit in investment currencies, thereby isolating the currency effects.)

*Total operating income* came to NOK 197 million, compared with NOK 85 million in 2007. Norfund increased its lending at fairly high interest rates on high-risk loans. Realised gains of NOK 32 million derive from the sale of shares in such companies as Uganda Microfinance Ltd, which has been a profitable investment. Dividends received were somewhat lower than in 2007, but Norfund again secured substantial gains in 2008 from repayments through the investment funds which are recorded as dividend. Other project income includes the recognition of NOK 80 million received earlier following a settlement over non-cash contributions to SN Power. This sum was recorded as a special item in 2008. In addition comes NOK 18 million in repayments on the loan portfolio transferred from the Norwegian Agency for Development Cooperation (Norad) to Norfund in 2001.

*Operating expenses* for Norfund came to NOK 74 million in 2008, an increase of 14 per cent from the year before. This primarily reflects special items related to the restructuring of the ownership posi-

**Table 2 • Profit in 2008 (NOK million)[1]**

| | 2008 | 2007 |
|---|---|---|
| Interest income, invested portfolio | 39 | 14 |
| Realised gains | 32 | 9 |
| Dividends received | 26 | 37 |
| Other | 99 | 25 |
| **Total operating income** | **197** | **85** |
| Payroll expenses | -34 | -33 |
| Other operating expenses | -40 | -32 |
| **Total operating expenses** | **-74** | **-65** |
| Write-downs in investment currencies | -84 | 63 |
| **Operating profit in investment currencies** | **39** | **83** |
| Share of profit SN Power | 120 | 110 |
| Interest income | 69 | 72 |
| Other financial items | 5 | -2 |
| Net financial items | 194 | 180 |
| **Net profit in investment currencies** | **233** | **264** |
| | | |
| Currency effect portfolio | 189 | -62 |
| **Net profit (NOK)** | **422** | **202** |

[1] *The currency effect of Norfund's liquid assets has been moved from currency effect portfolio to other financial items in 2008. Figures for 2007 have been restated in accordance with this reclassification.*

tion in SN Power, as well as increased activity with new investments, project follow-up and sales.

### GOOD RETURN ON CAPITAL INVESTED

As table 3 shows, all the investment areas showed a positive internal rate of return (IRR) in 2008. This means the IRR on cash flow including the estimated value of the investments at 31 December. However, profitability will vary between the investment areas depending on their character. The factor which determines the location of Norfund's investments is where it can make the best use of its capital. Its IRR contrasts with the substantial fall in world stock markets during 2008. That reflects good progress by SN Power as well as the fact that the countries and types of companies in which Norfund invests are only to a small degree integrated in the global financial market and are accordingly less directly affected by the crisis. However, the global economic downturn could have substantial consequences for developing countries in 2009 and the IRR will be affected by that in the future.

### RETURN MUST BE MEASURED OVER TIME

As a result of the substantial level of risk in Norfund's portfolio, the return on funds invested will vary strongly over time, between countries and between investment areas. Norfund has had an average annual IRR of 12 per cent since its foundation in 1998, for instance. However, this conceals a range from minus four per cent to plus 24 per cent, and it is reasonable to expect a similar variation in the future. Measuring IRR over a long period is accordingly necessary to achieve a good appreciation of the trend.

In the longer perspective, investments in financial institutions and renewable energy in particular have yielded good returns. The IRR for fund investments was substantially weakened in 2008 as a result of the economic downturn, particularly in Asia. Other direct investments earlier showed weak returns, but are now clearly improving.

The ultimate profitability of Norfund's investments will first become clear when they are realised. Annual estimates of value development depend on valuations made before the final realisation. Such valuations are based on guidelines prepared by the European Venture Capital Association. That Norfund's valuations are and should be rather conservative is borne out by the fact that realised values have generally turned out to confirm or exceed prior estimates.

### EQUITY INVESTMENTS SOLD

Norfund realised NOK 48 million in 2008 by exiting from investments in Finarca, Pan Fish Shanghai, TC Trading, Pan Marine Qingdao, Aureos Capital Ltd, Uganda Microfinance Limited and the Indian Ocean II fund. The institution received NOK 31 million more from these sales than was indicated by its valuation of 31 December 2007. Substantial efforts were also devoted in 2008 to cleaning up the portfolio and exiting from problem commitments.

**Table 3 • IRR in investment currencies**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | Since foundation |
|---|---|---|---|---|---|---|---|---|
| Funds | -5 % | -15 % | -4 % | 17 % | 1 % | 32 % | 4 % | 7 % |
| Financial institutions | 19 % | 4 % | 18 % | 10 % | 9 % | 27 % | 16 % | 14 % |
| Renewable energy | 0 % | 17 % | 1 % | -3 % | 44 % | 14 % | 25 % | 18 % |
| Other direct investments | -9 % | -22 % | -28 % | 2 % | -19 % | 16 % | 4 % | -8 % |
| **Total** | **-4 %** | **7 %** | **-1 %** | **4 %** | **24 %** | **17 %** | **21 %** | **12 %** |

*The table shows Norfund's IRR.*

CHAPTER 3

# Investment areas

## 3.1 OVERVIEW

**Sections 3.2 to 3.5 of this report present each investment area (sector) separately, with the main emphasis on investment activity and development effects in 2008. This section provides a quick overview of all the investments made in 2008.**

The overall portfolio grew by 31 per cent during 2008, and 27 new agreements with a value of NOK 1.38 million were entered into. At 31 December, the investment portfolio totalled NOK 4.8 billion.

Thirty-four per cent of committed investments agreed in 2008 were in funds, 38 per cent in financial institutions, 21 per cent in renewable energy and seven per cent in other direct investments.

Renewable energy is the largest area, accounting for no less than 49 per cent of Norfund's total portfolio – primarily through its holding in SN Power. Funds, financial institutions and other direct investments account for 26, 17 and eight per cent respectively.

**Figure 5 • The overall portfolio at 31 Dec 08 by investment area (NOK million and percentage change)**

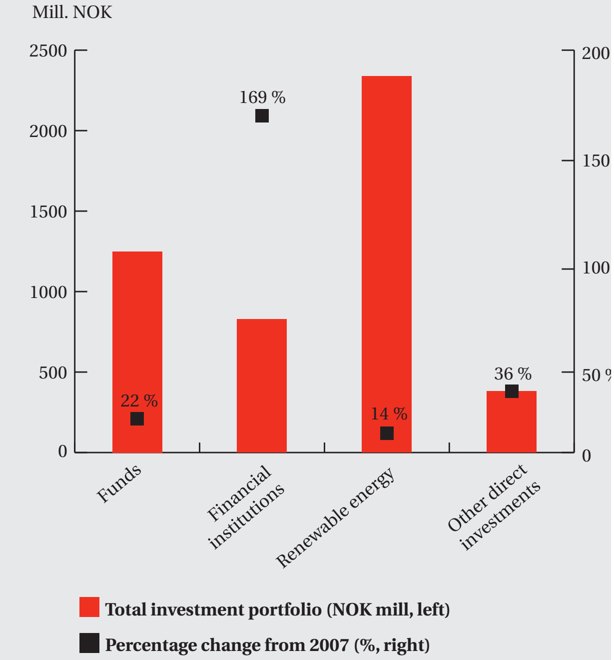



**Figure 4 • Norfund's four investment areas: development grounds and instruments**

| Banking and microfinance | Funds | Renewable energy | Other direct investments |
|---|---|---|---|
| **Build financial infrastructure** | **Strengthen SMEs** | **Build a better energy infrastructure** | **Risk capital where development effect is particularly large** |
| **Why:**<br>• Create financial services for the smallest entrepreneurs | **Why:**<br>• Shortage of risk capital<br>• Important for building a formal economy<br>• Strengthen local capital market | **Why:**<br>• Electricity supplies are essential for economic growth | **Why:**<br>• Supplement where no investment funds exist. Start-ups and high-risk projects with big development effect<br>• Draw expertise and technology to LDCs |
| **How:**<br>• Investment in SME banks and financial institution<br>• Microfinance investment<br>• Increase competition and range locally<br>• Partnerships – NMI | **How:**<br>• Invest through existing PE managers<br>• Establish new managers in countries/segments where it is needed | **How:**<br>• Invest in renewable energy projects<br>• Mobilise Norwegian capital and expertise in renewable energy | **How:**<br>• Mobilise Norwegian business<br>• Take long-term approach and follow up closely |

**Table 4 • Investment agreements in 2008**

| Name | NOK mill | Sector | Country/area |
|---|---|---|---|
| Norwegian Microfinance Initiative | 300 | Microfinance | Global |
| Aureos Africa Fund | 274 | Fund | Regional Africa |
| GroFin Africa Fund | 105 | Fund | Regional Africa |
| SN Power | 100 | Renewable energy | Nepal |
| SN Power | 100 | Renewable energy | Philippines |
| ClFI | 70 | Bank | Central America |
| Aureos Africa Interim Facility | 57 | Fond | Regional Africa |
| Bugoye HPP | 55 | Renewable energy | Uganda |
| Matanuska | 38 | Agriculture | Mozambique |
| Brac Africa Microfinance Ltd | 35 | Microfinance | East Africa |
| EXIM Bank Ltd. | 35 | Bank | Tanzania |
| SEAF Blue Waters Growth Fund | 34 | Fund | Vietnam |
| Casquip Starch | 31 | Agriculture/industry | Swaziland |
| Equity Bank Ltd | 31 | Microfinance | Tanzania |
| SN Power AfriCA | 31 | Renewable energy | Regional Africa and Central America |
| TMP | 28 | Telekom | Namibia |
| AMRET | 22 | Microfinance | Cambodia |
| Sathapana | 21 | Microfinance | Cambodia |
| Hattha Kaksekar Ltd (HKL) | 4 | Microfinance | Cambodia |
| CHC Limited (MFI) | 3,5 | Microfinance | Cambodia |
| Euro TechBridge | 2,5 | Information technology | Kenya |

**Table 5 • Investment agreements in 2008 and total portfolio at 31 Dec 08**

| | | Total portfolio | | Investment areas | | | |
|---|---|---|---|---|---|---|---|
| | | Total | Excl SN- Power | Funds | Financial institutions | Renewable energy | Other direct investments |
| **New investment agreements** | | | | | | | |
| Committed* | NOK mill | 1378 | 1 147 | 470 | 522 | 286 | 100 |
| | % of total activity in 2008 | 100 % | 83 % | 34 % | 38 % | 21 % | 7 % |
| | | | | | | | |
| **Total portfolio at 31 Dec 08** | | | | | | | |
| Committed* | NOK mill | 4 798 | 2 514 | 1 249 | 829 | 2 339 | 381 |
| | % of total portfolio | 100 % | 52 % | 26 % | 17 % | 49 % | 8 % |
| Exposure* | NOK mill | 3 580 | 1327 | 528 | 487 | 2 308 | 256 |
| | | | | | | | |
| **Total portfolio at 31 Dec 08 by instrument** | | | | | | | |
| Committed* | Equity** NOK mill | 2 731 | 447 | 0 | 176 | 2 292 | 263 |
| | Funds NOK mill | 1 662 | 1162 | 1 249 | 363 | 0 | 50 |
| | Loans NOK mill | 405 | 405 | 0 | 290 | 47 | 6 |

** Exposure refers to what Norfund has disbursed overall to investment, less the cost price of sales of and repayments from investment, while committed means Norfund's exposure plus undisbursed committed sums.*

*** Equity is direct equity investments and equity-like instruments.*

Financial institutions showed the biggest increase from 2007. The involvement in the newly-created NMI substantially expanded Norfund's portfolio in this area during 2008.

Equity is the most common instrument used by Norfund. Its portfolio comprises both equity investments and loans. At 31 December 2008, 57 per cent of the portfolio represented equity and equity-like instruments. This means that Norfund exercises active ownership in more than half its portfolio, although it is not a majority owner in any of these investments.

NOK 3.6 billion or 75 per cent of the total committed investment had been paid out in 2008. The corresponding figures for 2007 were just over NOK 2.9 billion and 80 per cent.

## 3.2 RENEWABLE ENERGY – POWERING DEVELOPMENT

**Without adequate electricity supplies, achieving high levels of economic growth is impossible. Hydropower is so far the most suitable for large-scale electricity generation, but wind and other technologies are also relevant. Despite high investment barriers and levels of risk, Norfund's energy commitments have produced large and lasting development effects in developing countries.**

Hydropower projects face many barriers in developing nations. They are capital intensive and particularly risky because of design, geological and hydrological factors. However, investing in renewable energy makes large and lasting contributions to economic growth. It also displaces carbon emissions from alternative fossil fuels.

SN Power had hydro and wind power projects in six Asian and South American countries at year-end 2008. Norfund has invested in Africa together with Trønder Energi. A new subsidiary was established in late 2008 for commitments in Africa and Central America. See box 2.

### ACTIVITIES IN 2008

- *In Nepal*, SN Power increased its holding in Himal Power Ltd to 56.3 per cent because two of the minority shareholders wanted to exit. A licence was granted to SN Power in November 2008 to begin preliminary studies for a possible 50 MW expansion of the Khimti power station. Moreover, project development and preliminary investigations continued for Tamakoshi 2 and 3 with a combined capacity of 500 MW. Norfund was also a lender to Interkraft Nepal until 31 December.

- *In the Philippines*, the Binga and Ambuklao power stations of 100 and 75 MW respectively were transferred to SN Power's project company. A full-scale rehabilitation of Ambuklao began in September. Binga, which is partly in operation, is due to be rehabilitated in 2010-15. These two projects will help to boost electricity capacity in the north Luzon region of the country by 125 MW.

- *In Chile*, Norvind SA – owned 80 per cent by SN Power – began constructing the Totoral Wind Farm of 46 MW. Representing SN Power's first wind power investment, this is expected to become operational in the fourth quarter of 2009. Building of the La Higuera and La Confluencia hydropower stations continued in cooperation with Pacific Hydro. SN Power now has three renewable energy projects under construction in Chile, where restrictions on gas imports from Argentina have led to scarcity and increased power prices.

- *In India*, SN Power devoted substantial resources to following up the Allain Duhangan project. HSE conditions at this facility have been unacceptable since 2007 and unsatisfactorily dealt with at local level. SN Power has therefore initiated extensive measures at its own expense. Project management at the construction site has been reinforced with international experts, detailed reviews of health and safety have been conducted, local employees have received training in Norway, and SN Power has initiated measures to achieve better control over and follow-up of the project management.

- *In Uganda*, Norfund invested NOK 55 million in the Bugoye hydropower station in western Uganda through a joint venture with Trønder Energi. This project represents the first energy commitment in Africa for both partners. When completed in 2009, the power station will have a capacity of 13 MW or seven per cent of Uganda's current electricity sales. Norfund seconded one of its staff to the country in 2008 to follow up the project, including social standards and HSE.

- *Small-scale commitment*. Norfund and the E+CO energy fund signed a letter of intent in December 2008. E+CO is a leading investor in SMEs which provide energy services in developing countries, including the distribution of solar panels, solar-powered drying facilities for harvests, distribution of bottled gas and provision of energy-efficient cooking facilities. The agreement covers a loan to be invested in SMEs providing energy services in Africa and Central America.

### DEVELOPMENT EFFECTS

New and renovated power stations increase electricity supplies for both private and public sectors. New machinery and technology are installed, and expertise in hydropower management and sales is transferred to developing countries. Training and other measures are also provided to strengthen HSE.

According to the International Monetary Fund (IMF), in *Regional Economic Outlook for Africa*, April 2008, upgrading the energy infrastructure in Africa to the same level as the most advanced countries in the region – such as Mauritius – could boost the long-term per-capita growth rate by two percentage points. That could considerably improve food production and distribution. Such an increase would have substantial positive consequences for the poorest in the region.

Norfund's energy investments contributed in 2008 to jobs for 1 860 people directly and 4 105 indirectly. NOK 278 million was paid in tax. Power capacity (operational and under construction) of roughly 1 000 MW corresponded to the consumption of 11.5 million people in the region at 31 December 2008. SN Power's share represented 7.1 million.

Where carbon emission reductions are concerned, SN Power continued to develop its CDM projects and currently has three registered large-scale hydropower plants. These have the potential to deliver CERs corresponding to 1.35 million tonnes of carbon dioxide per year. SN Power's share is 850 000 tonnes.

## RENEWABLE ENERGY

**Number of investments:** Four in all, three in 2008
**Committed investments:** NOK 2.34 bn
**Share of total portfolio:** 49 per cent

**Development effects:**
**Employment:** 1 860 directly
4 105 among sub-contractors
**Tax paid:** NOK 278 mill
**Generating capacity:** About 1 000 MW (partly under construction), corresponding to 7.1 mill consumers (11.5 million with partners)
Carbon reduction (capacity): Two mill tonnes (partly under construction)

**Figure 6 • Investments agreed in 2008 (committed) by geographical area**

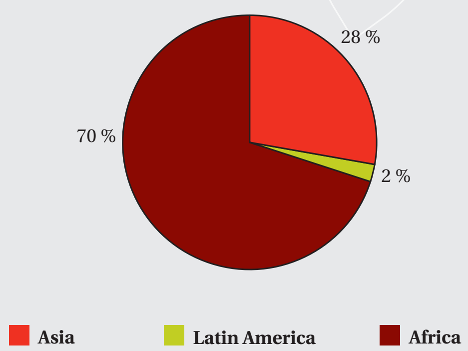
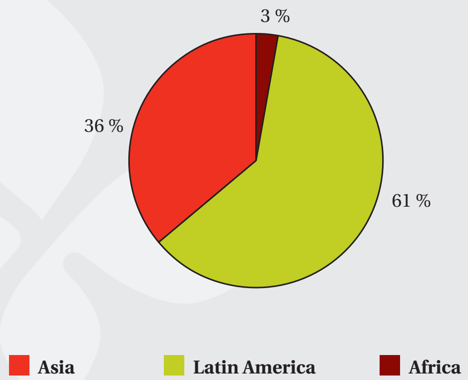



**Figure 7 • Total investment in renewable energy (committed) by geographical area**



## Box 2. Restructuring of SN Power and creation of a new energy company dedicated to Africa and Central America

Agreement was reached by Statkraft and Norfund in December 2008 on a new ownership structure for SN Power. Statkraft increased its holding from 50 to 60 per cent when the agreement was concluded, with an option to increase its stake to 67 per cent by 2015 at the latest. Norfund has been guaranteed an opportunity to exit wholly or partly during the same period. The SN Power owners agreed on a new financing plan for the company up to 2015, under which Statkraft will inject NOK 2 billion in 2009 with subsequent annual equity injections from the owners of up to NOK 1.6 billion (USD 235 million). At the same time, SN Power established a separate company with Norfund to invest in renewable energy in Africa and Central America. This will be owned 51 per cent by SN Power and 49 per cent by Norfund. Norfund aims to invite other Norwegian energy companies to invest in and be actively involved in the new company.

Restructuring SN Power gives Norfund the opportunity to re-allocate capital from SN Power's global portfolio to countries which lie closer to Norfund's mandate and strategy, while utilising SN Power's expertise with hydropower projects in developing countries so that new investments can be made in Africa and Central America. The change also gives SN Power a solid capital base which permits a continued commitment to investment in renewable energy in the future.

Taken together, the projects initiated by SN Power are expected to reduce annual carbon emissions by the equivalent of more than two million tonnes in CERs. SN Power accounts for just over 1.2 million tonnes of this.

**PROSPECTS FOR 2009**

The financial crisis and the consequent weakening in economic growth are likely to mean lower energy prices in 2009. Combined with a shortage of capital, this could reduce investment in the sector and lead in the longer term to new supply shortages in the energy market. That illustrates the importance of counter-cyclical investment in the future by Norfund and other institutions with capital and a willingness to accept risk.

*Africa and Central America*: Norfund will continue to develop SN Power, but with a growing emphasise on the new power company for Africa and the Middle East. See box 2.

*Uganda and Bugoye*: The Bugoye hydropower station is expected to be operational during the autumn of 2009. Norfund will investigate opportunities for more energy investments in the area after this project has been completed.

*Small-scale commitment*: Norfund will collaborate with E+CO to realise solar power and other small-scale projects in developing countries.

# 3.3 FUNDS – BUILD UP SMALL COMPANIES

**Norfund invests in more than 200 SMEs in Africa, Latin America, and south and south-east Asia. SMEs form the backbone of a modern economy and contribute to employment, diversification and economic growth. However, they lack growth capital in poor countries. Norfund develops and follows up fund managers who possess local networks, cultural understanding and presence. These transmit and manage the institution's capital through close follow-up of the individual company. Funds represented Norfund's second-largest investment area after renewable energy in 2008.**

Encouraging the growth of SMEs is a demanding business because of the great breadth of sectors and levels of maturity, many small transactions, and the need for detailed local knowledge and presence. Norfund has built up expertise in selecting suitable managers and establishing appropriate contractual structures. It follows up managers to ensure that they provide the desired added value for customers and invest in the right type of SME.

A four per cent return was achieved by the fund portfolio in 2008, which is a good result given the negative trend of global markets. The broad-based MSCI Emerging Markets index lost more than 50 per cent of its value during the year. Norfund's fund portfolio accordingly out-performed the broad market by more than 50 per cent.

### ACTIVITY IN 2008

Norfund observed lower liquidity in the market during the autumn of 2008 as a result of the financial crisis. Funds in a late phase and those which sought to exit from some of their investments were particularly hard-hit. The financial crisis also began to affect the bottom line and prospects for future growth at a number of companies.

Investment commitments totalling NOK 413 million were accepted by Norfund in 2008, with payments up to 2013. Africa had the highest priority in these new commitments.

## FUNDS

**Number of investments:** 30 in all, five in 2008
**Committed investments:** NOK 1.25 bn in all
NOK 470 mill in 2008
**Share of total portfolio:** 26 per cent

**Development effect:**
**Employment:** 95 000 people
**Female proportion:** 42 per cent
**Tax paid:** NOK 591 million
**Number of companies:** More than 200

**Figure 8 • Investments agreed in 2008 (committed) by geographical area**

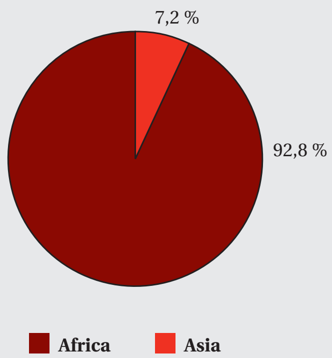



**Figure 9 • Total investment in renewable energy (committed) by geographical area**

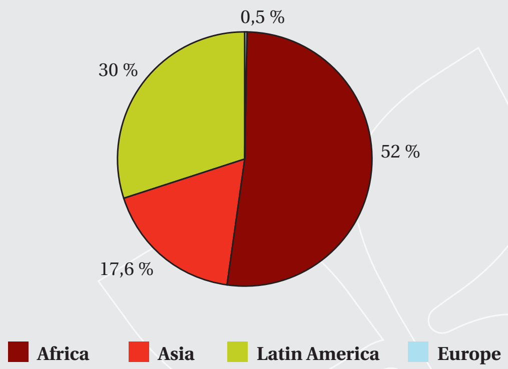
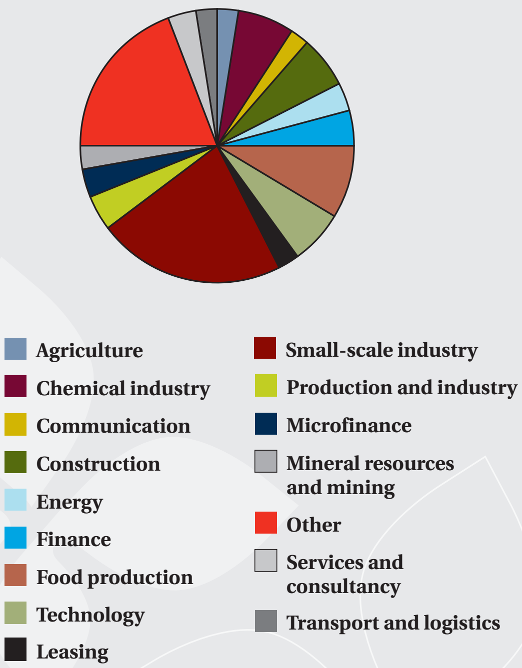


**Figure 10 • Fund portfolio by sector**




*Diversity in SME investment by the funds contributes to diversification of the economy.*

- *Aureos Africa Fund* received Norfund's biggest fund investment to date, totalling USD 40 million. Aureos offers tailored solutions for medium-sized companies and ranked once again as Norfund's most important fund manager in 2008. For further details, see box 3 on Aureos.

- *GroFin Africa Fund* received a Norfund investment of USD 15 million. It offers loan products in local currencies to stimulate growth for small companies.

- Norfund took the initiative on creating two *new investment funds*. FIPA will be Angola's first private equity fund after substantial efforts to reform relevant legislation. Fansi is a venture capital fund for east Africa, and Norfund hopes to be able to develop this offer and launch the fund during 2009.

- The smallest new investment fund was *SEAF Blue Waters Growth Fund* in Vietnam, with USD 5 million. This fund again offers growth capital to small companies, and is the first of its kind in Vietnam.

*One of Norfund's fund managers (right) talks with the managing director of an SME in Madagascar's textile industry.*

**DEVELOPMENT EFFECTS**

In addition to a substantial employment effect and tax payments, fund investments contribute to creating or developing the SME segment. At 31 December 2008, Norfund had invested risk capital in more than 200 SMEs which paid NOK 591 million in tax during 2008. Building up the SME sector in developing countries is regarded by Norfund as very important for building local capital markets and generating growth.

**PROSPECTS FOR 2009**

Norfund will continue to concentrate attention on SME funds. In addition to those focused on specific geographical areas, it wants to assess sector-specific funds for health, agriculture and clean energy.

Norfund was among those members of the EDFI who took the initiative on appointing a working group which will discuss such matters as standards and minimum requirements for investment through offshore financial centres and opportunities for synergies with other international initiatives. This EDFI group began work in 2009. Norfund is also collaborating with the government commission on capital flight appointed by the Norwegian Ministry of Foreign Affairs in 2008, which is due to present its conclusions in June 2009.

## Box 3. Norfund's sale of the Aureos Capital management company

Norfund depends on good distribution channels to the SME market in poor countries. By building up professional teams of managers, the fund can invest more on its own account while serving as a catalyst for other investors. Viewed overall, investment in the SME sector helps to strengthen local capital markets.

Aureos Capital was established in 2001 as a joint venture between Norfund and its UK opposite number, CDC. Since then, Aureos has grown into the world's biggest SME manager in emerging markets, with about USD 1 billion under management through 29 different funds in Africa, Latin America, south and central Asia, China and south-east Asia. Aureos employees became shareholders in 2006, and took over the whole company in 2008.

Norfund is very satisfied to be able to exit from the company, having succeeded in establishing a sustainable manager which can stand firmly on its own two feet. The fund's role in the future will be as an active investor in Aureos Capital.

USD 143 million has been invested by Norfund in some of Aureos Capital's funds, and this company will remain the fund's most important fund partner. It is particularly important for Norfund that Aureos Capital makes a strong commitment to sub-Saharan Africa, since this is the fund's most important priority area.

# 3.4 FINANCIAL INSTITUTIONS – BANKS AND MICROFINANCE

**Norfund is Norway's largest investor in microfinance through the NMI and other investments in this sector. It is also active in SME banks and other financial services, such as leasing and currency hedging. Investments are made directly in the banks and institutions.**

Norfund's strategy for this investment area is to make a commitment to banks and other financial institutions which serve SMEs. Microfinance is also a priority area, particularly through the creation of the NMI. In addition, Norfund has invested in providers of other financial services, particularly The Currency Exchange (TCX), a facility for hedging currencies in developing countries.

Investments by Norfund in financial institutions are made either directly through loans and equity, or indirectly through investment funds.

# FINANCIAL INSTITUTIONS

**Number of investments:** 21 in all, 11 in 2008
**Committed investments:** NOK 829 mill in total
NOK 522 mill in 2008
**Share of total portfolio:** 17 per cent

**Development effects:**
**Employment:** 128 000 people
**Female proportion:** 61 per cent
**Customers:** 6.9 mill
**Tax paid:** NOK 71.5 million

**Figure 11 • Investments agreed in 2008 (committed) by geographical area**

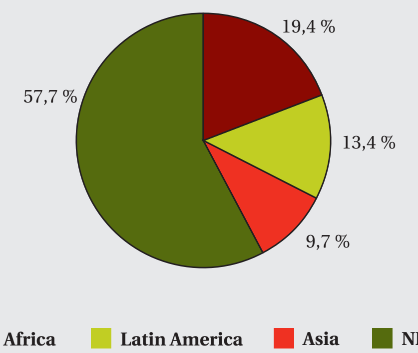
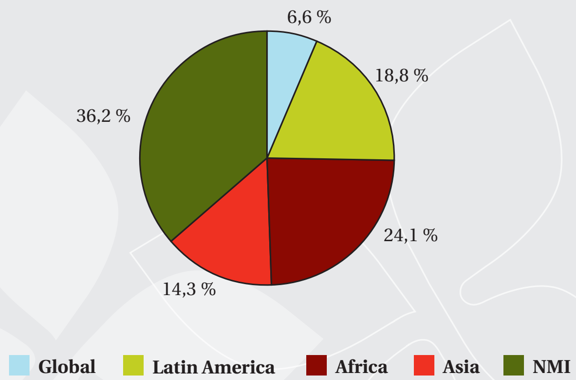



**Figure 12 • Total investment in renewable energy (committed) by geographical area**




*The NMI was established in 2008 and made no investments in that year.*

**ACTIVITIES IN 2008**

New contracts worth NOK 522 million were entered into. Financial institutions accounted for the biggest investment activity in Norfund during 2008:

- *NMI*: Norfund undertook to invest NOK 300 million in the NMI, signalling thereby that this represents a substantial commitment to microfinance over the next five years. See box 4.

- *Sale of Uganda Microfinance Limited (UML)*: Since Norfund invested in UML in 2005, the latter has enjoyed outstanding growth. Norfund sold its holding in the company in 2008 to Equity Bank of Kenya in exchange for shares in the bank, one of the most successful microfinance institutions in Africa. The investment in UML together with Aureos East Africa Fund has contributed to a professionalisation of the microfinance segment in Uganda as well as an expansion in UML's business in the country. This was one of Norfund's most profitable sales ever, with a quadrupling of the invested capital.

- *Microfinance in Cambodia*: Norfund invested NOK 50.4 million through the Hattha Kaksekar, Sathapana, Cambodia Health Committee (CHC) and Amret institutions. Between them, they have more than 300 000 borrowers and an average female proportion of 80 per cent.

- *Commitment to banks*: Banco Terra opened its head office in Maputo in Mozambique as well as two branches in the provinces. Norfund increased its investment from USD 1.4 million to USD 2.1 million. Investments were also made in BRAC Africa Microfinance and Exim Bank in Tanzania.

- *Sale in Nicaragua*: Norfund could exit completely from Finarca, a leasing institution for SMEs. After years of good growth, part of this company was taken over by Costa Rica's Corporation Interfin bank, and then by the major international Scotia Bank. Finarca is continuing to offer companies a flexible way to finance their operating assets. This represents a lasting development of the capital market in Nicaragua, one of the world's poorest countries.

## Box 4. The Norwegian Microfinance Initiative (NMI)

The NMI was launched in 2008 as a unique collaboration between state-owned and private players with a shared vision of strengthening the economic position of poor people and creating jobs and social progress in developing countries.

Norfund has contributed half the capital of NOK 600 million, while the rest is invested by Ferd, KLP, Storebrand and DnB NOR/Vital. Norad will also contribute with professional support. The investors are represented on the company's board.

The NMI will invest directly and indirectly in microfinance institutions through equity, loans or the issue of guarantees. Professional support will be devoted to institution-building in the microfinance enterprises, primarily through the development of human resources. The funds will operate on a commercial basis and provide both development effects in poor countries as well as a financial return.

- Norfund exited from its lender participation in the Latin America Challenge Investment Fund. This was the first loan fund specifically directed at microfinance in this part of the world.

### DEVELOPMENT EFFECTS

When small companies and individuals in poor countries are able to borrow from banks, microfinance institutions and leasing companies, they can contribute to economic development and reducing poverty.

No less than 128 000 people were employed in enterprises in which Norfund had invested in 2008. Of these, 117 000 worked for BRAC in Bangladesh and included 61 per cent women. However, the most important employment effect of banks and microfinance is provided by increased capital provision for 6.9 million customers – mainly in the microfinance sector, with most of them women.

### PROSPECTS FOR 2009

Norfund will continue its commitment to financial institutions in 2009. In the microfinance sector, follow-up of the NMI and development of the portfolio in Cambodia will be the most important activities. Norfund is also working on a number of possible investments in SME banks in southern Africa, Central America and south-east Asia.

## 3.5 OTHER DIRECT INVESTMENTS

**The strategy for other direct investments was changed in early 2008, and Norfund made new commitments within this area in eastern and southern Africa alone. Agriculture and related industries have been identified as an interesting sector with a big development effect, but requiring active ownership and a local presence. Norwegian companies have a potential to contribute to growth in Africa, and Norfund wants more partnerships with them.**

This investment area embraces Norfund's loan and equity involvements in individual companies outside the energy and finance sectors. A purposeful commitment is made to the sectors and geographical areas where it can provide the best contribution to lasting development effects, and where other financing is hard to find.

### ACTIVITY IN 2008

During 2008, Norfund accepted investment commitments worth NOK 100 million in three new companies and one in which it had already invested. All the new investments were in eastern or southern Africa and in the form of equity or loans.

# OTHER DIRECT INVESTMENTS

**Number of investments:** 14 in all, three in 2008
**Committed investments:** NOK 381 mill
NOK 100 mill in 2008
**Share of total portfolio:** Eight per cent

**Development effects:**
**Employment:** 10 000 people
**Female proportion:** 18 per cent
**Tax paid:** NOK 2.3 bn

**Figure 13 • Investments agreed in 2008 (committed) by geographical area**

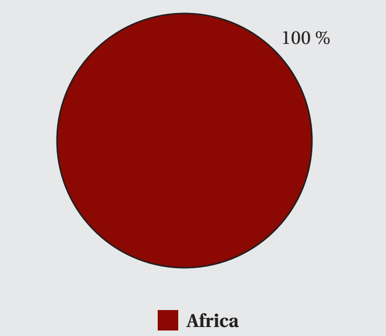
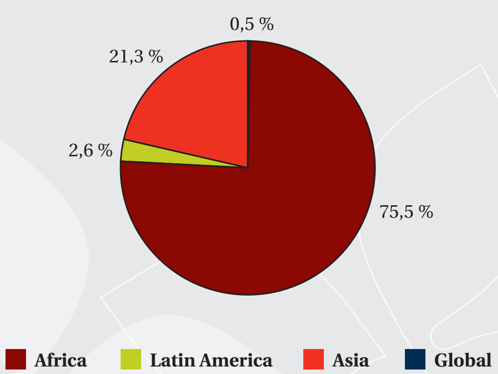



**Figure 14 • Total investment in renewable energy (committed) by geographical area**




- *Agriculture in Africa*: Norfund invested during 2008 in a plantation growing bananas for export in northern Mozambique and in a company cultivating cassava to produce starch in Swaziland. Both projects are start-ups with a big development effect. See box 5.

- *Sale of telecoms company in Namibia*: Telecom Management Partners (TMP) sold its holding in Namibia's second largest mobile phone company, PowerCom, to a major regional player. PowerCom has had major development effects in the form of greater competition in the market, lower prices and a doubling in mobile phone coverage. The Namibian part of the investment was profitable for Norfund, but is unlikely to cover losses on TMP's other African investments.

- *Exit from China*: The department has exited from projects outside Norfund's geographical priority areas. The shares in Pan Fish Shanghai were sold to a co-investor. This company processes and sells fish in the Chinese market. It has developed positively in recent years and had 245 employees at the date of the sale. Norfund's loan to TTS Marine in Shanghai and Dalian was repaid. The company has achieved substantial job creation and expertise build-up.

- *Grameen Phone*: The company is one of the largest taxpayers and employers in Bangladesh. As a lender, Norfund has assured itself that the company and its owners have adopted measures to correct the HSE problems identified among sub-contractors.

- *Kabul Serena*: This hotel, owned 17 per cent by Norfund, employs 366 people in Kabul. Both construction and operation of the facility has given great weight to a high local employment effect and work for local suppliers. Security has also been further strengthened.

- *LDC loan scheme*: Norfund has established a scheme to provide small loans to Norwegian companies investing in the LDCs. One loan was made under this scheme in 2008.

**DEVELOPMENT EFFECTS**

At 31 December 2008, 10 000 people were employed in companies with a direct Norfund investment. The female proportion was 18 per cent. This investment area gives weight to a high employment effect, active ownership and close collaboration with partners, preferably Norwegian.

Grameen Phone in Bangladesh employed 4 682 people, while the Green Resources tree planting company in east Africa had more than 3 000 employees at 31 December. Among the smallest employers was the Nicafish fish processing plant in Nicaragua, with 171 jobs.

Tax payments were higher in this sector than in other parts of the portfolio. Grameen Phone accounted for 98 per cent of the NOK 2.3 billion paid.

Contributing to jobs in areas with particularly high unemployment was a key justification for Norfund's decision to make its two largest new direct investments in 2008 within African agriculture. These projects also have a substantial export potential. Agricultural start-ups are very high-risk and usually difficult to finance. See box 5.

**PROSPECTS FOR 2009**

The department will further expand its investment activity in Africa during 2009, in sectors with a high development effect and in projects where Norfund can make a difference. It will also continue to be an active owner in order to help ensure that investments are sustainable and profitable.

## Box 5. Agriculture in Africa

Norfund invested during 2008 in two major start-up companies within southern Africa's agricultural sector.

*Casquip in Swaziland* is a combined agricultural and industrial project for cultivating cassava and producing starch from its roots. This product will largely be exported to the paper and food industry in South Africa. Casquip could provide jobs or a basis of existence for 1 500 people. A modern starch factory is being moved from South Africa to Swaziland and will become an important reference project for the country.

The *Matanuska banana plantation* in northern Mozambique will sell its fruit to Chiquita for export to Europe and the Middle East. Matanuska could provide jobs for as many as 3 000 people in full operation, and create opportunities for local suppliers. Key staff from Chiquita will ensure expertise transfer to the project for a number of years.

## 3.6 OTHER ACTIVITIES

**LOAN PORTFOLIO**

Norfund took over a portfolio of 48 loans from Norad in 2001. Fourteen of these were in Africa, 11 in south-east Asia and China, 18 in south Asia, four in Latin America and one in eastern Europe. In 44 per cent of these, the sum involved was less than NOK 5 million. Interest terms on all the loans were soft (below normal market rates).

At 31 December 2008, 14 of the loans with a total face value of NOK 49.7 million remained to be repaid or terminated. Some are valued below their face value, so that the estimated value of the outstanding loans was NOK 28.6 million. The final repayment falls due in February 2011. Norfund had received a total of NOK 306 million in repayments and NOK 49.4 million in interest by 31 December 2008.

## PROFESSIONAL SUPPORT

Norfund receives a small amount each year to fund professional support for strengthening the development effects of its investments for local communities or for early-phase studies of particularly demanding investments. NOK 15 million was received and spent in 2008, primarily in the energy area. Recipients included project development in Africa, a health project related to the Bugoye power station in Uganda and studies for small-scale climate projects. Support was also given to extending the HIV/Aids programme for portfolio companies in the Aureos East Africa Fund, constructing a primary school linked to the Matanuska banana plantation in Mozambique, and energy-saving measures at the Kabul Serena Hotel.

## BALKAN TRUST FUND

Business development occupies a key place in the reconstruction of the countries in the western Balkans. This is also an important instrument in the peace and reconciliation processes in which Norway and other countries are participating.

Norfund received a further NOK 15 million in 2008 to continue its work in western Balkans, which has been under way since 2000. One full-time position at the institution is dedicated to this work, including advice and other assignments related to Norwegian-financed projects in the region.

SME funds have been established by Norfund in both Macedonia and Kosovo in cooperation with USAID (United States Agency of International Development) and Crimson Capital. The Macedonian fund has been active for some time and experience with it is good, while the Kosovo one became operational in the second half of 2008. Norfund has invested USD 1 million in each of the funds, which offer financing to SMEs without access to ordinary credit because no collateral can be provided.

Norfund is working to establish more SME funds in the region during 2009-10, including in Bosnia.

## INFORMATION OFFICE FOR PRIVATE SECTOR DEVELOPMENT IN DEVELOPING COUNTRIES

This office has provided Norwegian companies since 2007 with easier access to advice and guidance on financial support and financing of business activities in poor countries. Administered by Norfund, the office is physically located at Norad. It received 283 enquiries in 2008 compared with 256 the year before, an increase of 10 per cent. The proportion of enquiries from Norwegian companies or institutions rose from 70 per cent in 2007 to 73 per cent, with the remainder coming from foreign companies.

## TENDER GUARANTEE SCHEME

This scheme is administered by the Norwegian Guarantee Institute for Export Credits (GIEK) on behalf of Norfund, and is intended to encourage Norwegian companies to become involved in poor countries. The LDCs and Norway's development partner countries have the highest priority. Priority is also given to participation by SMEs. Eleven applications were considered in 2008, and NOK 0.9 million were paid out. NOK 1.7 million was expensed in Norfund's accounts for the scheme in 2008.

CHAPTER 4

# NORFUND'S BODIES AND EXTERNAL RELATIONS

## 4.1 BOARD OF DIRECTORS IN 2008

**KRISTIN CLEMET, CHAIR, OSLO**
Born 1957, MSc business economics. Head of Civita. Ms Clemet has long political experience, including service as minister of education and research in 2001-05, deputy head of the Confederation of Norwegian Enterprise (NHO) in 1998-2001, minister of labour and local government in 1989-90 and member of the Storting in 1989-93. She also holds several other directorships.

**KARL-CHRISTIAN AGERUP, DEPUTY CHAIR, OSLO**
Born in 1962, MSc in management. Founder of and partner in Northzone Ventures. Long experience from the financial sector, including with Hugin AS, McKinsey & Co and Milipore Corp. Has boardroom experience from LNU and Schibsted ASA.

**STEIN TØNNESSON, DIRECTOR, OSLO**
Born in 1953, PhD in history. Head of the International Peace Research Institute (Prio). Dr Tønnesson has long research experience, with a particular focus on Asia. Previously headed a programme on paths to development in the global south at the Research Council of Norway. Boardroom experience from such bodies as Care Norway.

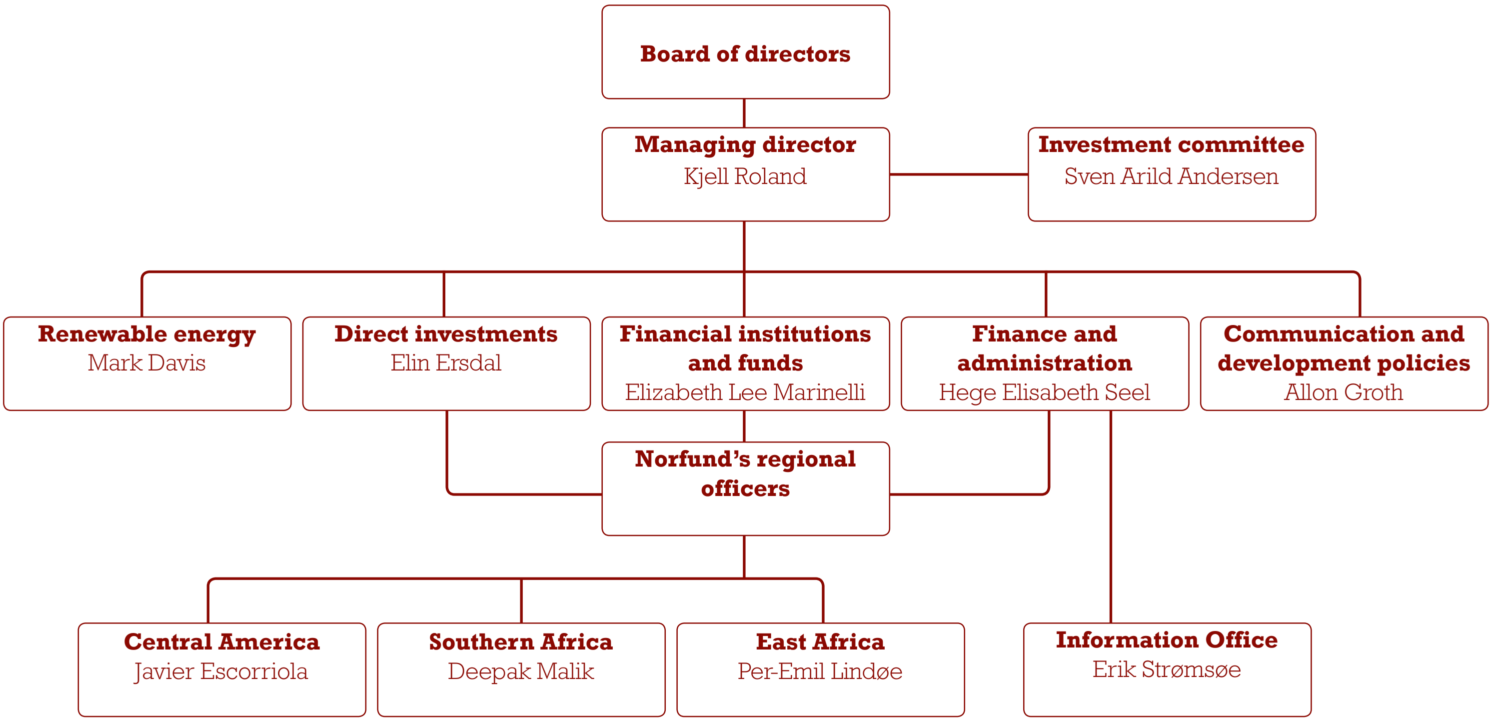
**MARI SKJÆRSTAD, DIRECTOR, HAMAR**
Born in 1969, law degree. Ms Skjærstad is a partner in the Johnsrud, Sanderud & Skjærstad AS law firm, and has worked since 1995 as a commercial lawyer. Holds a number of other directorships, including Mesta, Flytoget, Scana Industrier and Forsvarsbygg.

**BORGHILD HOLEN, DIRECTOR, OSLO**
Born in 1955, MSc business economics. Vice president of DnB Nor, heading the international section of the bank's international corporates and institutions division. Background from Eksportfinans, member of the North-South Development Assistance Commission in 1993-1995, and former director of Giek.

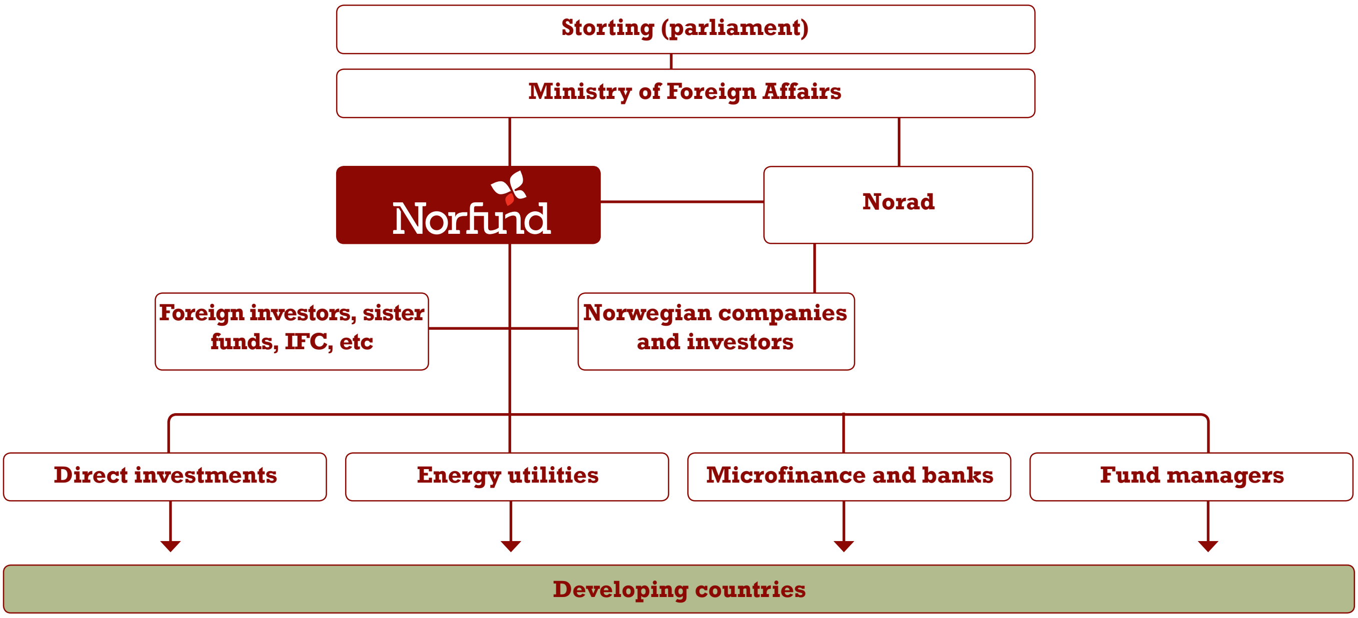
**ANETT HOLLUM VALSVIK, ALTERNATE DIRECTOR, OSLO**
Born in 1966, MSc business economics. Ms Valsvik works for Det Norske Veritas and has previously been with the Asian Development Bank and Norad. More than 10 years of experience from development cooperation projects and international financial institutions. Director of Norplan from 2003-05, and a former director of Scan-Water AS.

**SVEIN TVEITDAL, ALTERNATE DIRECTOR, FROLAND**
Born in 1947, MSc in engineering. Director of Climate 2020 and environmental ambassador, Arendal local authority. Previously a vice president of Grid-Arendal and head of division at the UN Environment Programme (UNEP) head office in Nairobi, Kenya. Current appointments include chair, Asplan Foundation, South Norway Europe Office, Frameworks AS and Purity AS, and director, University of Agder, Earthprint Ltd and the Zero environmental foundation.

# 4.2 NORFUND'S ORGANISATION



## 4.3 EXTERNAL RELATIONS



## 4.4 COMMUNICATION

Norfund invests in public funds and serves as a tool of Norwegian development policy. That calls for a high degree of transparency concerning its activities. At the same time, the fund must observe commercial principles in its relations with partners, co-investors and clients, which requires discretion in certain contexts.

The fund is Norway's leading professional milieu for private equity investment in developing countries. It has a broad network of contacts with investors and companies at home and abroad. Norfund is a member of the European Association of Development Finance Institutions (EDFI), where both guidelines and commercial opportunities are discussed.

Norfund will continue to contribute to the public debate on reducing poverty and the need to build up profitable jobs, infrastructure, technology and expertise in poor nations. It is open about ethics and social responsibility in its activities, including the challenges faced by investors in developing countries.

A web-based computer game for Norway's colleges of further education was launched by Norfund in 2008. This simulates investment in developing countries and presents players with commercial, management and ethical choices. Some 2 600 students at 67 colleges in 16 counties participated in a nationwide competition which was won by St Hallvard's College of Further Education in Lier.

Norfund's website at www.norfund.no presents information on such subjects as investments, guidelines, new developments and technical matters.

Please feel free to contact the institution at post@norfund.no.

## Definitions and abbreviations

| | |
|---|---|
| **Additionality** | Value over and above what the market or private commercial players can provide. |
| **GDP** | Gross domestic product. Indicates the size of a country's economy, measured both in total and per capita (by head of population) |
| **CDM** | Clean development mechanism – a system for international trade in emission allowances/CERs. |
| **CER** | Certified emission reduction – a certified cut in carbon emissions. |
| **DAC** | Development assistance committee, a coordinating body within the OECD (see below). |
| **DFI** | Development finance institution. A collective term for bodies which invest in developing countries with the aim of combating poverty by contributing to economic growth. Norfund is a DFI. |
| **EDFI** | European Association of Development Finance Institutions. Norfund is a member. |
| **GIEK** | Norwegian Guarantee Institute for Export Credits. |
| **GNI** | Gross National Income comprises the total value produced within a country (gross domestic product) together with income received from other countries less similar payments made to other countries |
| **HSE** | Health, safety and the environment. |
| **IFC** | International Finance Corporation. Part of the World Bank group, investing in the private sector in developing countries. |
| **ILO** | International Labour Organisation. Part of the UN. |
| **IMF** | International Monetary Fund. |
| **LDC** | Least-developed country. Usually defined as a nation with a GDP per capita of less than USD 750. |
| **Nibor** | Norwegian interbank offered rate – a reference interest rate in the currency swap market. |
| **OECD** | Organisation for Economic Cooperation and Development. An international organisation of economically developed countries (industrial nations). |
| **OFC** | Offshore financial centre, also known as a secrecy jurisdiction or tax haven. |
| **Private equity (PE)** | Unlisted securities. |
| **SME** | Small and medium-sized enterprises. According to the IFC's definition, small companies in developing countries have up to 50 employees and a turnover below NOK 18 million. Medium-sized enterprises have 50-300 employees and a turnover of NOK 18-45 million. |

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