SUMMARY

30 - years report

1967 - 1997

May 4, 1999

1. INTRODUCTION

This summary report is based on an extensive survey report prepared on IFU's activities throughout 30 years (1967-97). The survey report is the fifth in the series of reports that aim at analysing and describing IFU's activities every fifth year since its foundation in 1967.

The most recent survey report was the 25-year report which was published in 1993 and which dealt with the period 1967-1992.

Throughout the past 10 years, the world has gone through dramatic events following the collapse of Communism in the East. There has been a global tendency to privatise and deregulate the corporate sector in more or less all the developing countries in which government control once was dominant.

Diminished state ownership in these countries is also accompanied by the fact that private capital transfers to developing countries today by far exceed the governmental flows of development aid and assistance.

Therefore, it is expected that in spite of the ongoing crisis in South East Asia and in certain countries in Latin America, the Danish enterprises will continue to have a strong interest in enhanced internationalisation in both the short and the long term. In this context, IFU is expected to continue to play a major role in connection with Danish enterprises' participation in this process.

The purpose of the report is to throw light upon a number of vital facts and tendencies in IFU's work.

The report should also serve both as a basis for the work of IFU's board of directors and administration in considering goal(s) to be fulfilled and as inspiration for possible improvements and efficiency measures in work routines and methods.

2. IFU's ACTIVITIES

The facts and figures illustrating IFU's operations during the 30-year period, 1967-1997, are divided into the five sections mentioned below:

IFU's production
IFU's projects
IFU's financial status
Comparison with other DFIs
The Danish State as an investor

2.1 IFU's production

A recent board discussion of IFU's goals has led to reemphasize the conclusion that when setting its goals, IFU shall continue to prioritise development.

In addition, IFU shall aim at reaching an operating profit of at least 2% of its equity, which again is conditional upon a net return of 4% on IFU's project investments. In order to realise a return of this size it is imperative that IFU constantly focuses on embarking on high-quality projects, which in no way contradicts the developmental goal.

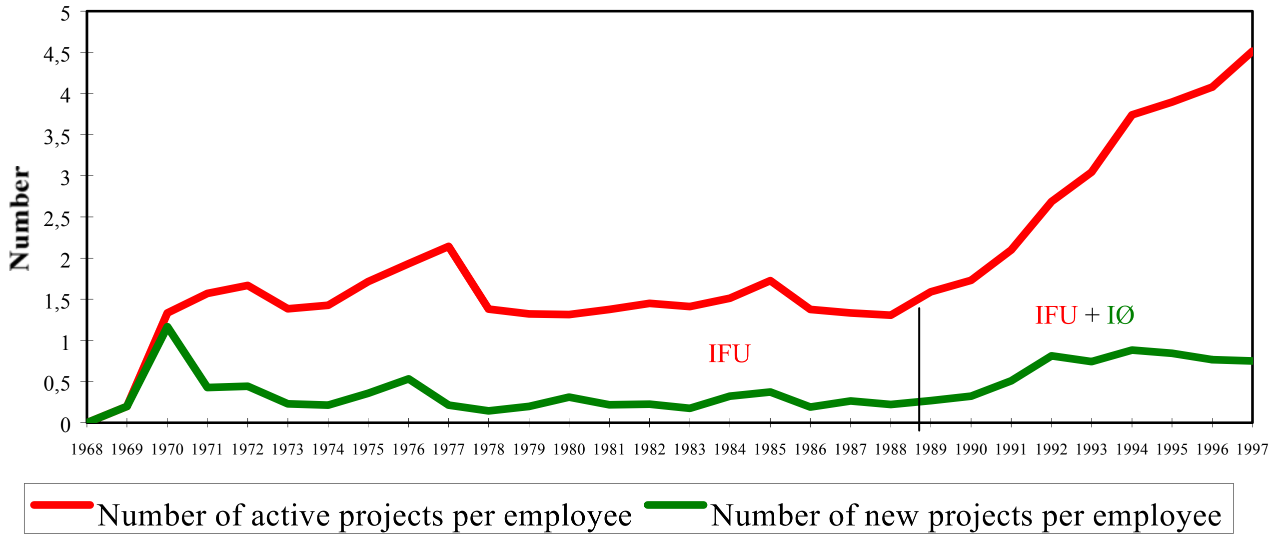
As a result, IFU has launched a number of additional activities during 1998 in order to enhance, among others, a more proactive approach to project appraisal and project participation. However, the financial impact of this initiative will not be measurable until after some years when the ensuing projects are gaining ground.

In 1990, IFU's personnel assumed the administration of The Investment Fund for Central and Eastern Europe (IØ); in 1995, IFU added the Environmental Investment Facility for Central and Eastern Europe (MIØ) to the list, and in 1998 The Investment Fund for Emerging Markets (IFV) became part of IFU's administrative responsibilities. The joint administration of IFU and these funds has implied substantial advantages for our Danish and international partner enterprises, and it has at the same time made it possible for IFU's administration to launch efficiency measures both internally and externally in relation to the contacts and active support to the project companies.

A significant trend in the development of IFU's organisational structure and the number of personnel is that the increase in personnel over recent years has more or less taken place solely in the regional offices. It is IFU's policy that any future increases in the number of employees are predominantly effected through new employees in the regional offices.

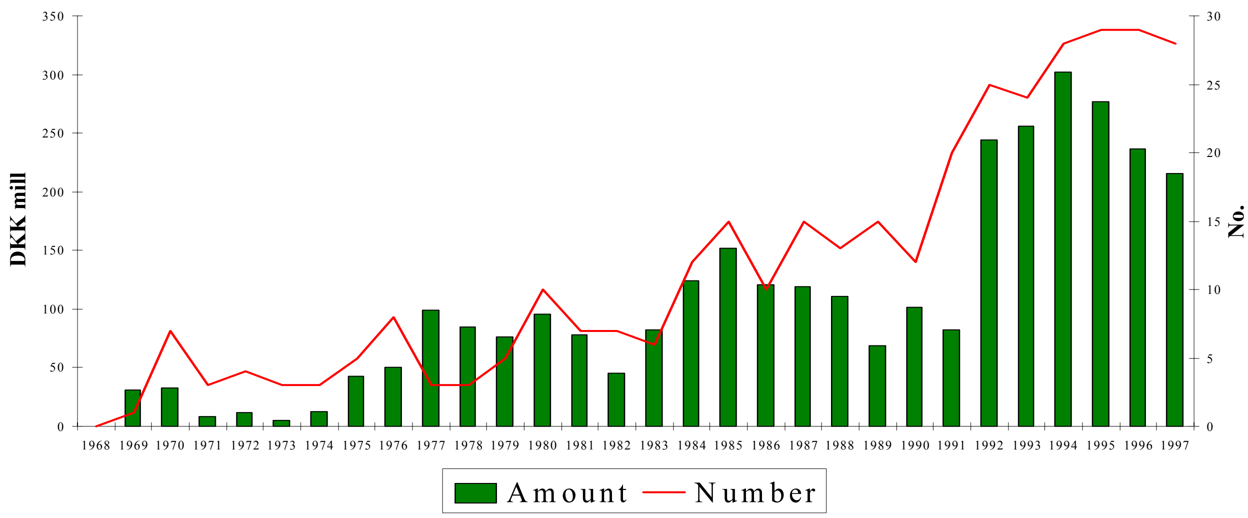
During the past 10 years, IFU's staff has seen a significant increase in productivity, which is illustrated in figure 1

Figure 1 Number of projects within IFU and IØ per employee



The number of new IFU projects launched per year since 1990 has increased heavily and now count as much as 30 per year, cf. figure 2.

Figure 2 New projects per year



It is expected that the number of new projects will continue to run at a level of at least 25-30 per year.

When analysing the cancellation rate throughout the various steps of the IFU-project cycle, there appears to be a declining tendency over the years, which is interpreted as being a result of more critical screening of the project proposals appraised by IFU.

During the past 10 years, considerable investments have been made in upgrading IFU's Information Technology, IT, systems, most recently through the implementation of IFU's new comprehensive database (ODIN) in mid-1998. This has been a necessary precondition in order for IFU to increase productivity as described above, and in the years to come further investments are foreseen in the IT area in order to sustain this development.

IFU has increasingly become engaged in other activities that have indirectly had a favourable impact on its primary activities. One of these activities has been the development of a proactive environmental policy, another a well defined policy on human rights and a third the extension of contacts to other financial institutions, which facilitates and enhances the possibilities of co-financing of projects.

2.2 IFU's projects

During the 30 years that have passed since the startup in 1967, IFU has signed agreements on financing of 350 projects in 68 developing countries. The total value of the investments amount to a total of DKK 34.0 billion, of which IFU's participation amounts to DKK 3.2 billion.

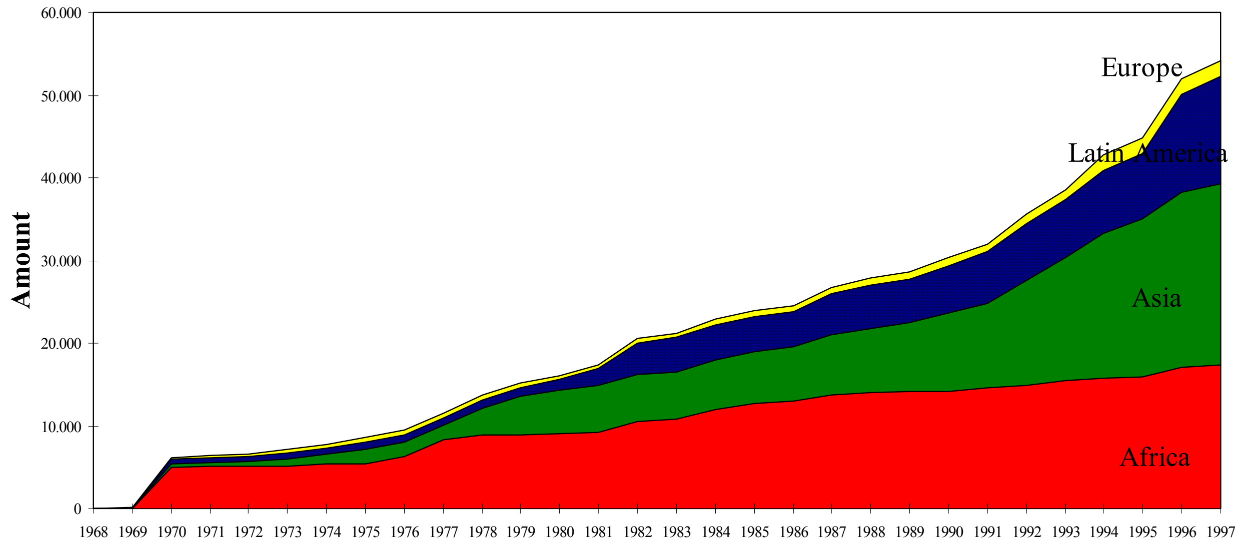
IFU has completed its participation in (exited) a total of 147 projects, following which the portfolio of active projects at the end of 1997 was 203.

During the past 10 years, the number of projects established in Asia has been relatively higher than in Africa, which previously dominated the scene.

Approximately 2/3 of all projects involve less than 100 employees, i.e. the projects are relatively small.

The 350 projects have led to the creation of a little over 51,000 jobs in the host countries. Jobs broken down by continents are illustrated in figure 3. From this figure it appears that jobs in Africa and Asia account for almost 75%.

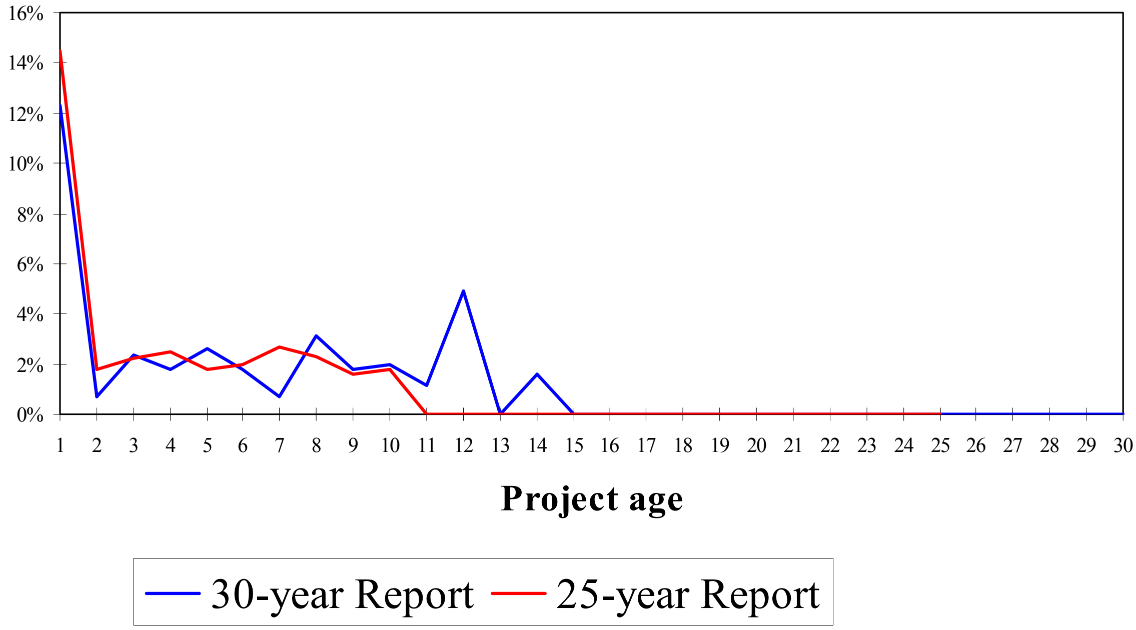
Figure 3 Number of jobs created per continent



As in the 25-year report, an analysis has been made on the cancellation or the closing down risk related to IFU's projects. The closing down risk is defined as the risk in percentage of a project being cancelled or having to close down or being given up as a function of project age. It should be noted that cancellation normally is a risk for small projects wherefore – in money terms – loss rates caused by cancellating or early closing down are relatively small.

This is illustrated in figure 4 below.

Figure 4 Closing down risk, IFU projects



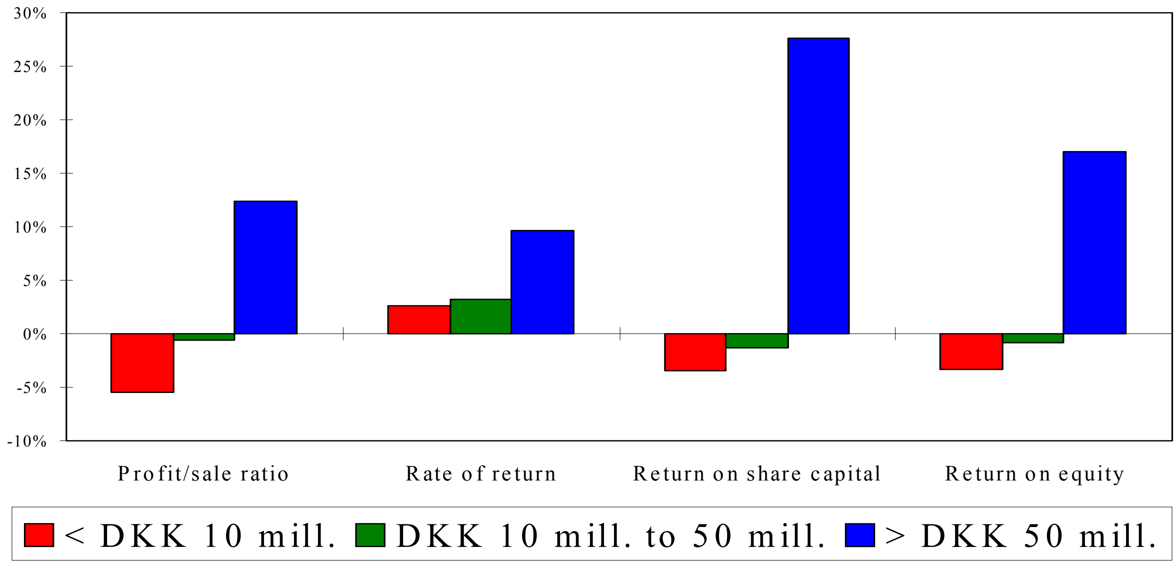
The risk of closing down – or giving up - a project is clearly the highest during the first year of a project's life, when it is as much as 12%. This percentage, however, measured in 1997 is lower than the approximately 14% which appeared in the 25-year report from 1992. There has thus been a reduction in "child mortality". That cancellation is the predominant risk during year 1, is also substantiated by the fact that IFU has not suffered any losses during the first year of the lifetime of the projects.

After the 15th project year, the closing-down risk rate has dropped to 0. All in all, when aggregating the figures mentioned above there appears - based on the figures up to 1997 - to be a cancellation or closing-down risk rate of approximately 35%, which is higher than the rate of 30% established in previous reports.

An analysis of IFU's Danish partners reveals that more than 40% of the projects include large enterprises (more than 500 employees) as partners, 20% include medium-sized enterprises (between 100 and 500 employees) and 40% include small businesses (less than 100 employees). The size of the Danish project partner is of significance, as large resources are required to implement and run projects in developing countries.

An analysis of approximately 700 project financial accounts from approximately 145 projects indicates that major projects (total investments of more than DKK 50 million) are more profitable than small projects (total investments less than DKK 10 million) and medium-sized projects (total investments between DKK 10 million and 50 million), cf. figure 5.

Figure 5 Key ratios broken down by project size



A total view of the projects reveal, not unexpectedly, that project profitability - at least during the first 7-8 years - increases as a function of project age. This is illustrated in figure 6.

Figure 6 Key ratios compared to project age

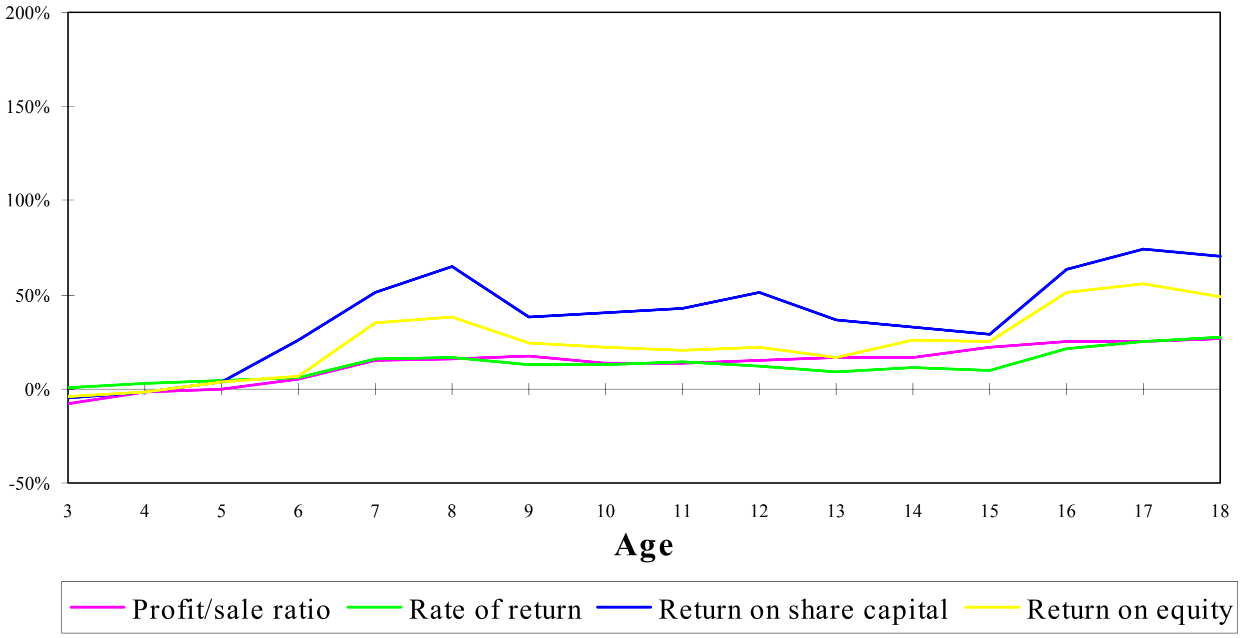
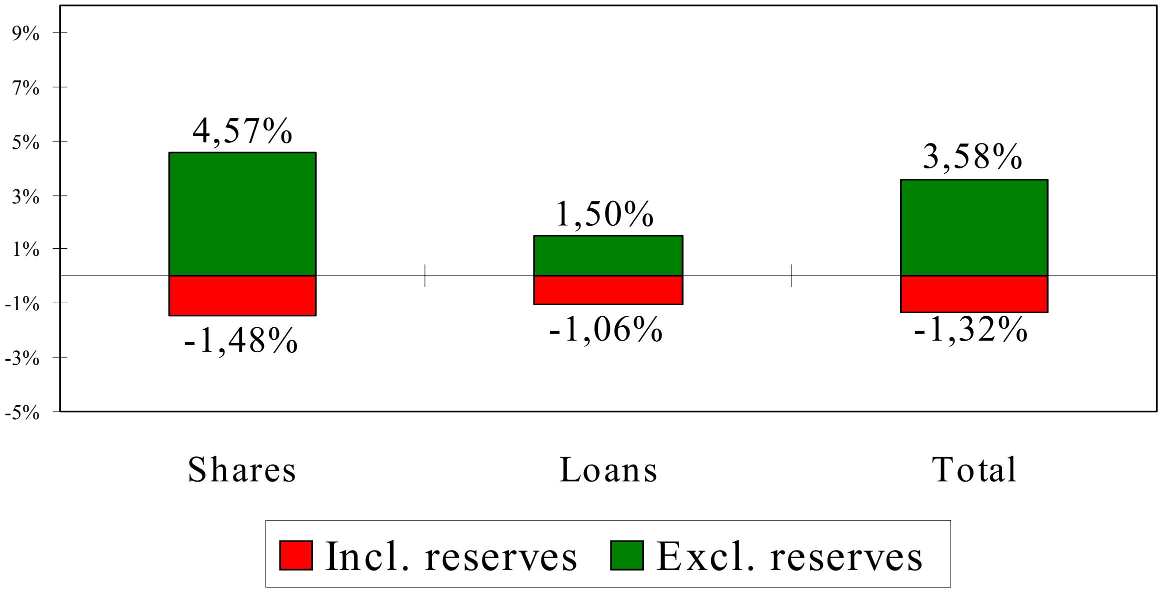


Figure 6 shows that key ratios do not in the average rise above zero until after the 6^{th} operating year.

Profitability from an IFU perspective is illustrated by calculating the internal rate of return (IRR) of IFU's project investments.

Total IRR for IFU’s project investments as at 31 December 1997 is illustrated in figure 7.

Figure 7 IFU's internal rate of return on projects



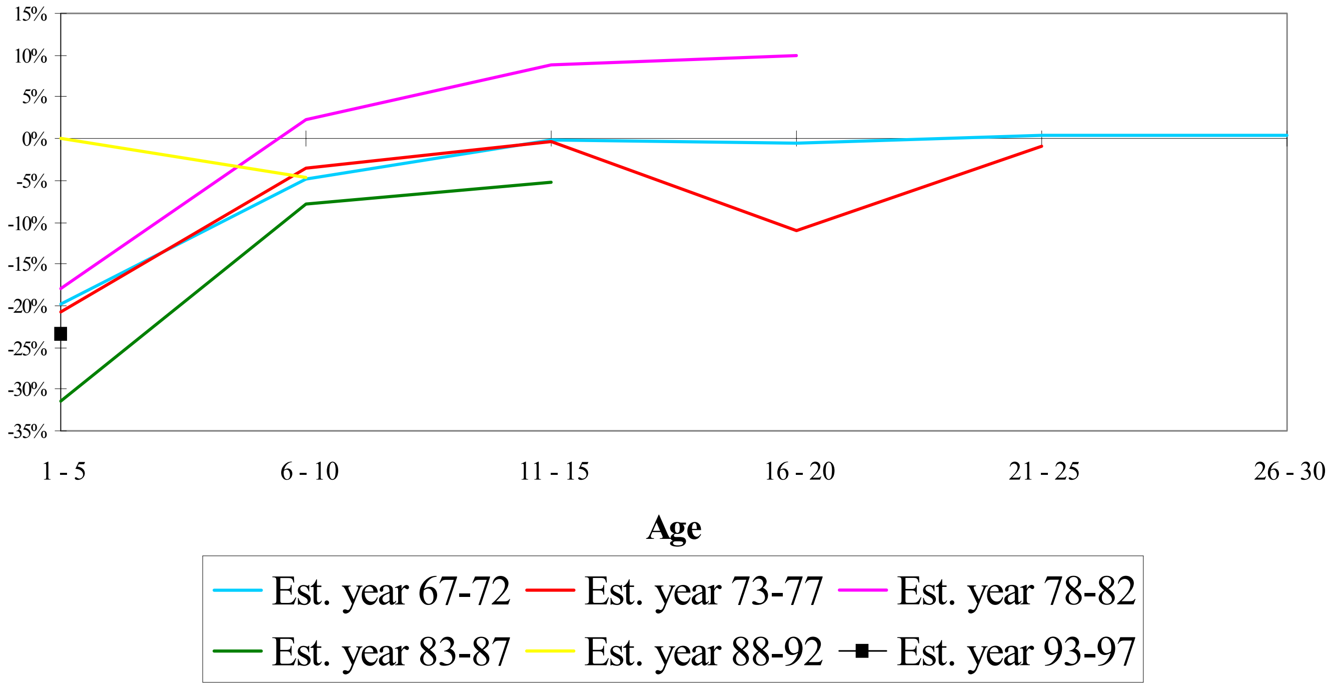
It appears from the figure above that total IRR after full provisions have been made as at 31 December 1997 is moderately negative (-1.32%). The size of the IRR is strongly influenced by recent years' considerable investments, which have not yet yielded significant returns, but have led to considerable provisions against losses which are deducted from the terminal asset value at the time of calculation. When adjusting for this, the total IRR is positive (3.58%).

Large projects and projects with major Danish partners have a higher IRR than the small and medium-sized projects and projects involving small and medium-sized Danish partners.

Projects in Africa have a lower IRR than projects launched in the remaining continents.

For all the project vintages (each "vintage" is defined as group of agregated investments established during successive 5-year periods), IRR appears to be increasing as a function of project age, cf. figure 8.

Figure 8 Internal rate of return by project vintage and age (5-year groups)



Year	1969-72	1973-77	1978-82	1983-87	1988-92	1993-97
Number of projects	15	22	32	58	85	138
Amounts disbursed (DKK mill)	73.1	174.9	333.6	447.3	442.3	843.1

The vintage of projects established during 1978-82 is considerably better than the other vintages, but apart from that, the analysis shows no clear trend in terms of profitability among vintages ("vintage effect"). The analysis, however, clearly substantiates the conclusion made in the project accounts analysis, that the project start period from year 1-5 is somewhat difficult.

The analysis of exports and employment effect in Denmark shows that for each Danish Krone invested by IFU in share capital, exports from Denmark are generated in the amount of DKK 4.3.

When viewing the 350 projects as a whole, it turns out that exports from Denmark amounted to DKK 10.6 billion in 1997 prices. It is estimated that this has led to employment in Denmark of more than 21,000 man years.

As part of its project initiatives, IFU launched an environmental policy in 1995 which covers both the appraisal phase and project monitoring.

In 1998, this was supplemented by a "Code of Conduct" for IFU concerning human rights objectives based on the UN Declaration of Human Rights, Council of Europe's conventions on human rights and 7 central ILO conventions.

For many years, the compliance with the most significant ILO conventions has been registered in IFU's work in connection with the participation in new projects.

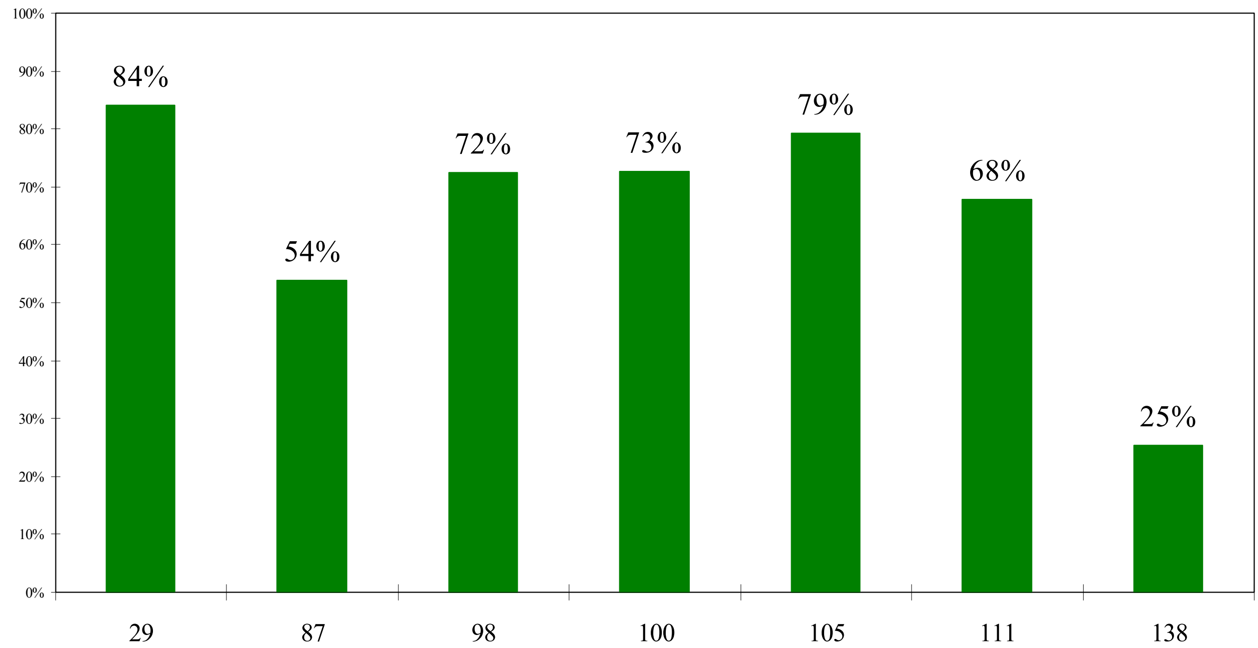
The most import ILO conventions include the following:

No. 29	Forced Labour Convention
No. 87	Freedom of Association and Protection of the Right to Organise
No. 98	Right to Organise and to Bargain Collectively
No. 100	Equal Remuneration for Men and Women Workers for Work of Equal Value
No. 105	Abolition of Forced Labour (suppl. no. 29)
No. 111	Discrimination in Respect of Employment and Occupation
No. 138	Minimum Age Convention

Figure 9 below illustrates the percentage of employees involved in IFU projects and living in countries that have ratified the above mentioned 7 ILO Conventions in 1997.

IFU has in cooperation with its partners initiated a major survey of the environmental status of project companies in India (and for IØ projects in Poland). The results hereof are expected to be available during the first half of year 2000.

Figure 9 IFU project employment rate in countries working under ILO conventions



It appears from the figure that 84% of the employees involved in IFU projects work in countries that have ratified no. 29. As regards nos. 98, 100, 105, and 111, the percentage is between approximately 70% and 80%. As regards no. 87, the percentage is a little above 50%, whereas no. 138 which is also the most recent of the 7 conventions, accounts for as little as 25%. Irrespective of whether the conventions have been ratified or not, IFU will a.o. through its membership of supervisory boards of the individual enterprises actively work for awareness and compliance with said conventions.

2.3 IFU’s financial status

Up to the end of 1997, the Danish Government had injected capital into IFU amounting to a total of DKK 601 million, of which DK 300 million were disbursed to IFU during the years of 1996 and 1997 as part of a planned total capital injection of up to DKK 750 million during a 5-year period from 1996 to 2000.

Throughout the years, a significant part of IFU's assets has, for operational reasons, been kept as liquid funds of which a majority, however, has been earmarked for concrete project proposals (binding commitments) and projects (remaining commitments on agreements). It has been important to administer these liquid funds as optimally as possible in order to comply with the requirements for return, safety and availability.

The major source of IFU’s income throughout the past 30 years has in fact been the return on these liquid funds (bond holdings), which has accounted for 68% of total income. Income from dividends and sale of shares in project companies account for a total of 22% and interest on loans to projects account for 9%.

Income related to sale of shares and dividends have until now been heavily influenced by one single project in Asia which alone generated DKK 120 million and DKK 170 million, respectively.

Losses registrated up to, and provisions against losses at year-end 1997, account for 27% and 35%, respectively, of total expenses during the 30 year period, whereas administrative costs account for 31%. Consequently, losses and provisions are items which significantly affect the accounting results of the period and it should be borne in mind that differences in timing over the project cycle imply that such expenses are incurred well before project income is actually realised.

Following, among other things, the co-administration with IØ, administrative expenses measured as a percentage of amounts outstanding in projects have shown a declining tendency during the past 10 years and now account for approximately 2.5%. From an international benchmark perspective this appears to be a reasonable level.

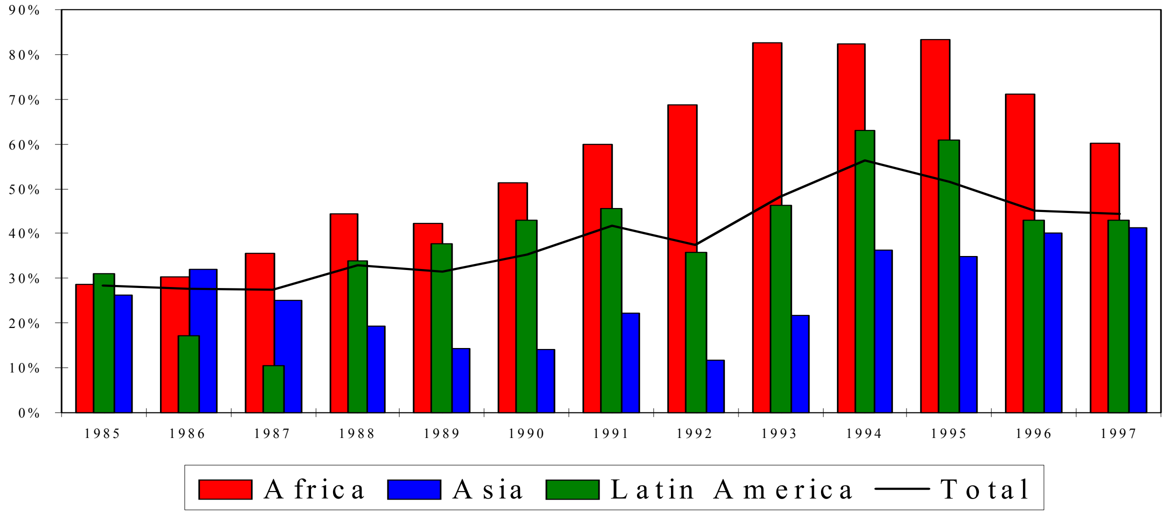
Share capital investments have, right from the beginning, been the most important instrument for IFU and during the past 5 years they have remained the dominant part of IFU activities. Although IFU thus distinguishes itself from a majority of comparable institutions in other countries, including the International Finance Corporation (IFC), which primarily applies loan financing, it is to be expected - perhaps because of the many small and medium-sized partner enterprises in Denmark- that in order to fulfil its primary goals IFU shall continue first and foremost to provide equity capital to projects in developing countries.

During recent years, outstanding amounts concerning projects in Asia have grown compared to outstanding amounts in Africa and Latin America reflecting that Asia has attracted Danish investments to an increasing extent.

Total outstanding amounts in shares and loans at the end of 1997 amounted to DKK 1,387 million, of which share holdings accounted for 70%.

Total provisions against losses (excl. provisions for interest) amounted to DKK 615 million at the end of 1997, corresponding to 44% of the outstanding amount. Since 1994, there has been a declining tendency in the ratio of total provisions to total outstanding amounts, cf. figure 10.

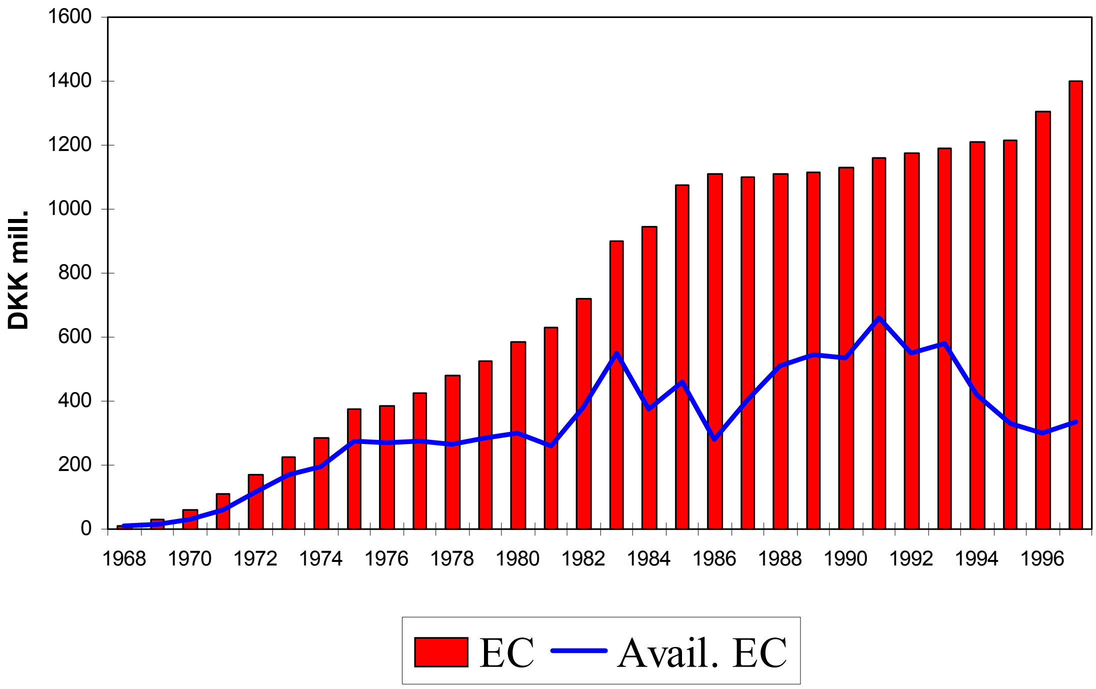
Figure 10 Reserves in relation to outstanding amounts broken down by continents



As it appears from the figure above, the trends vary within the regions as the provisions rate has been decreasing in Africa and Latin America since 1995, but increasing in Asia.

At the end of 1997, IFU's equity capital amounted to DKK 1,400 million and available equity capital to DKK 335 million, cf. figure 11 that shows the trends in these amounts over time.

Figure 11 Equity capital (EC)

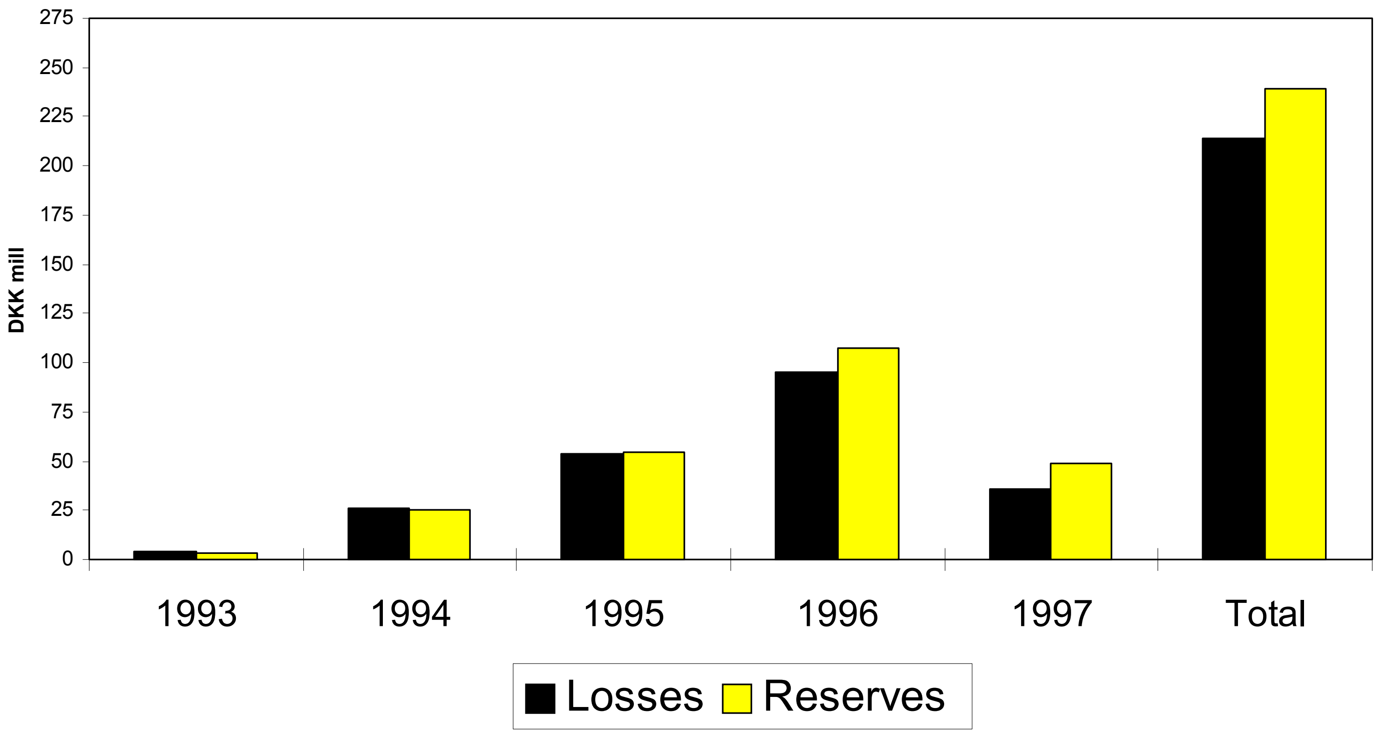


It is IFU's policy to finance its investments solely through its own equity capital, and to maintain at any time sufficient cash reserves to meet all contracted and formal commitments. Available equity capital therefore defines the scope for making decisions for new investments.

This guiding principle has implied the need for maintaining relatively high reserves of liquid funds. From many perspectives, it therefore appears reasonable to endeavour to develop new guidelines with less emphasis on equity availability for example by letting available liquidity itself serve as an alternative guiding factor for the scope of new investments.

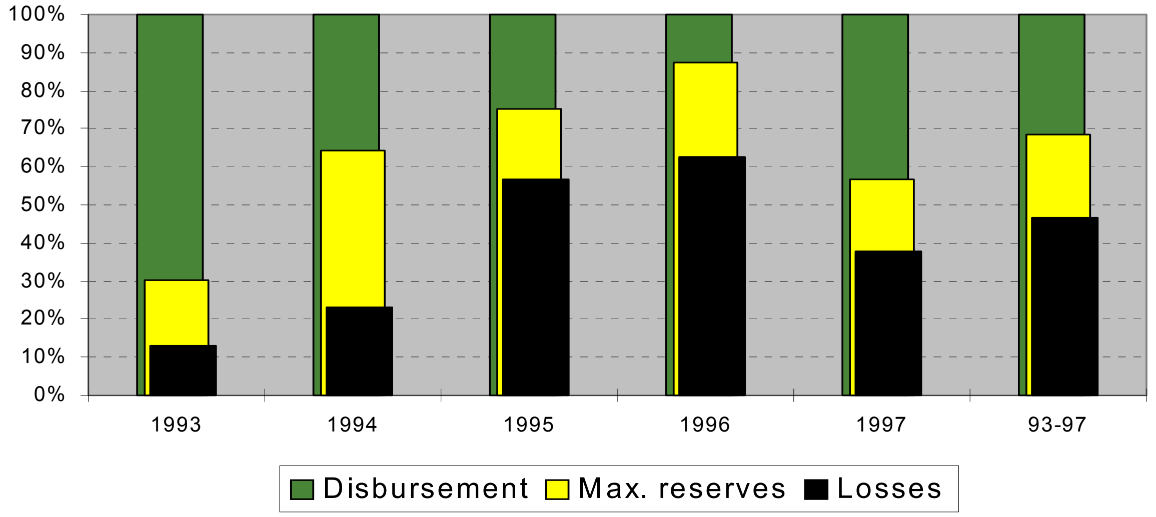
An analysis of realised losses compared to reserves against losses during the past 5 years shows that reserves at the time where losses were booked have exceed actual (realised) losses by 11%. When, in addition, all terminated projects in the period are included in the analysis, the total "excess reserves" are approximately 16%, cf. figure 12

Figure 12 Losses and reserves for losses for all projects terminated in a given year



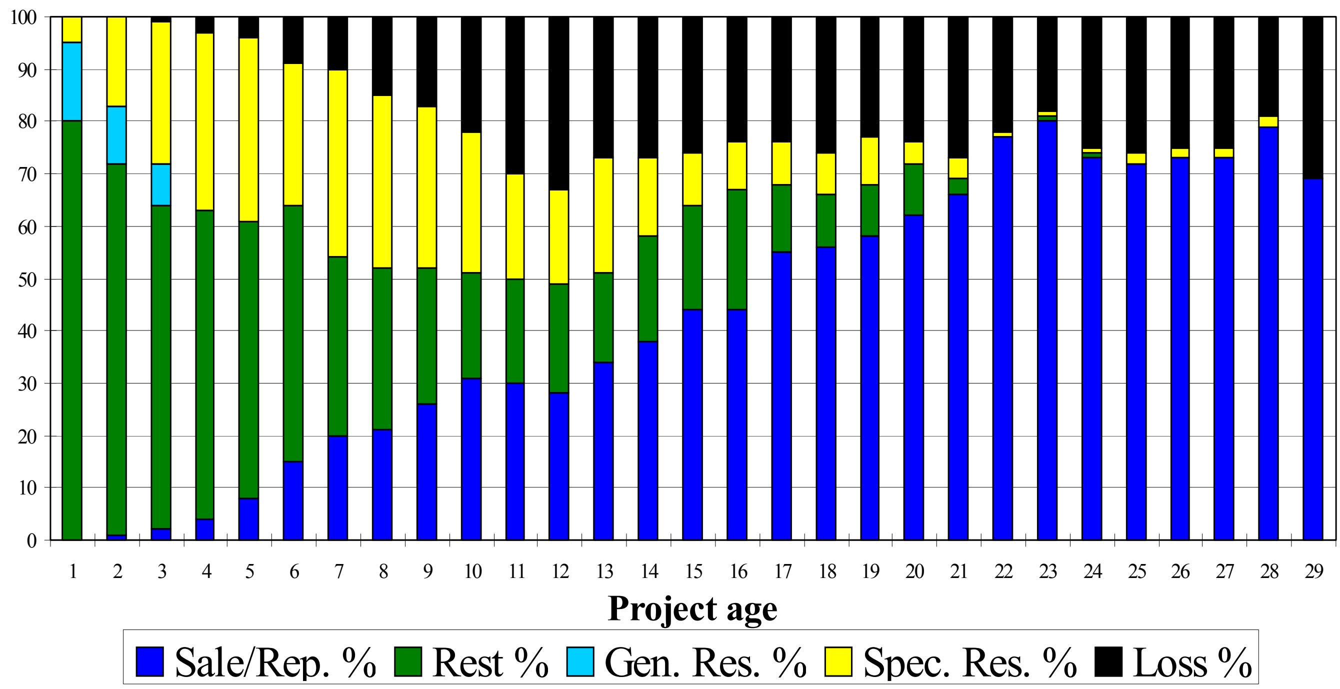
Furthermore, an analysis of the 46 projects terminated during the period 1993-1997 shows that at any given time, IFU has had an excess of reserves by an average of 20% in comparison with realised losses relative to the disbursed amounts, cf. figure 13.

Figure 13 Disbursements, maximum reserves and losses on projects terminated during 1993-1997



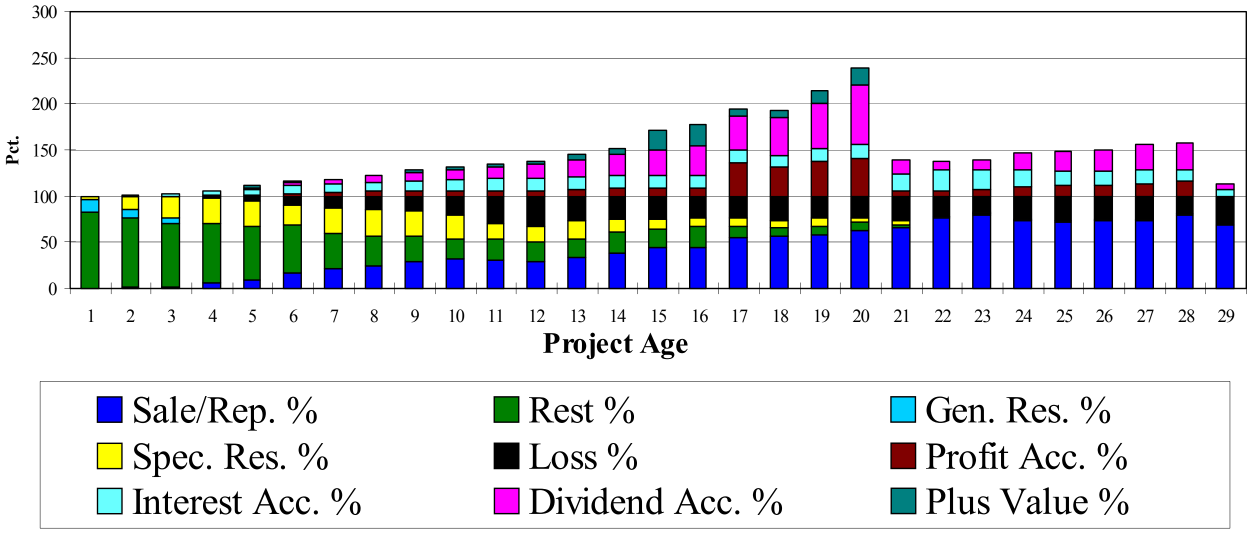
An analysis of reserves against losses and actual losses incurred as function of project age confirms that IFU typically tends to provide amounts of reserves for losses in excess of the actual losses IFU incurs in the long run, cf. Figure 14.

Figure 14 Average development (in percentage of disbursed amounts) in outstanding amounts, sale/repaid, losses and general and specific reserves as function of project age (The "hammock" analysis)



An analysis of project income (upside) reveals that income generated throughout all project vintages, except from the oldest projects, exceeds losses realised, cf. figure 15.

Figure 15 Average development (in percentage of disbursements) in average outstanding amounts, sale/repaid, loss and general and specific reserves as well as "upside" as function of project age



During the past 30-year period IFU has disbursed a total of DKK 2.6 billion to projects. This means that the capital injected by the Danish Government of DKK 0.6 billion has been "recycled" more than 4 times.

2.4 Comparison with other Development Finance Institutions (DFIs)

Compared to a number of other DFIs, IFU shows acceptable figures in terms of project activity compared to number of employees and in terms of administrative expenses compared to project activities. The latter is illustrated in figure 16.

Figure 16 Administrative expenses/outstanding project assets

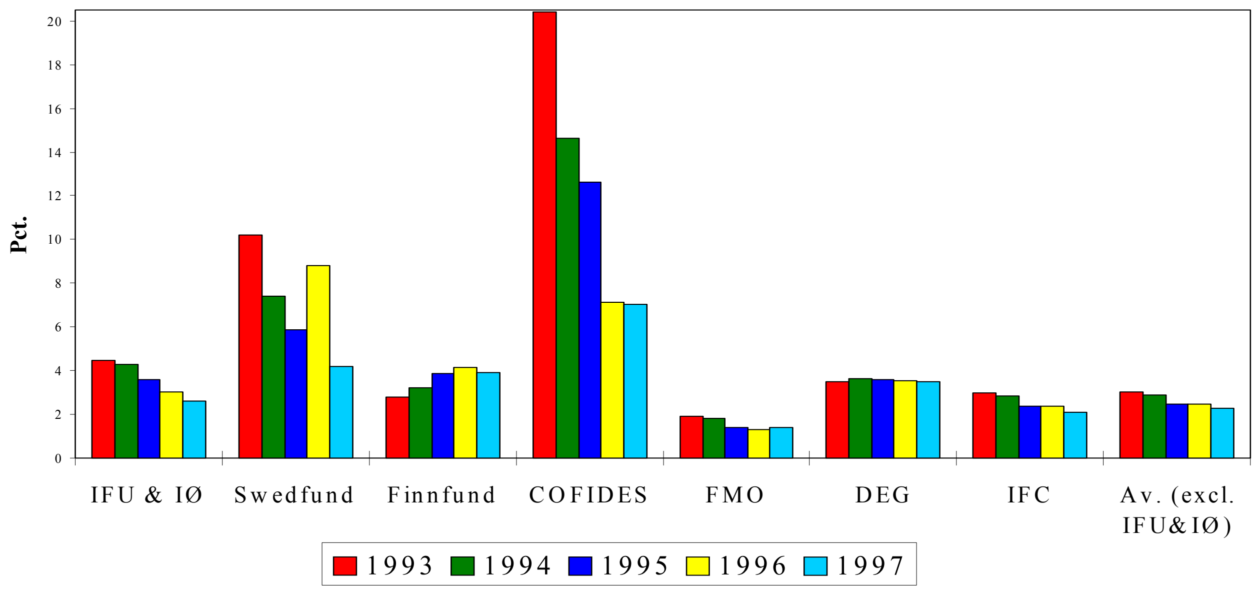
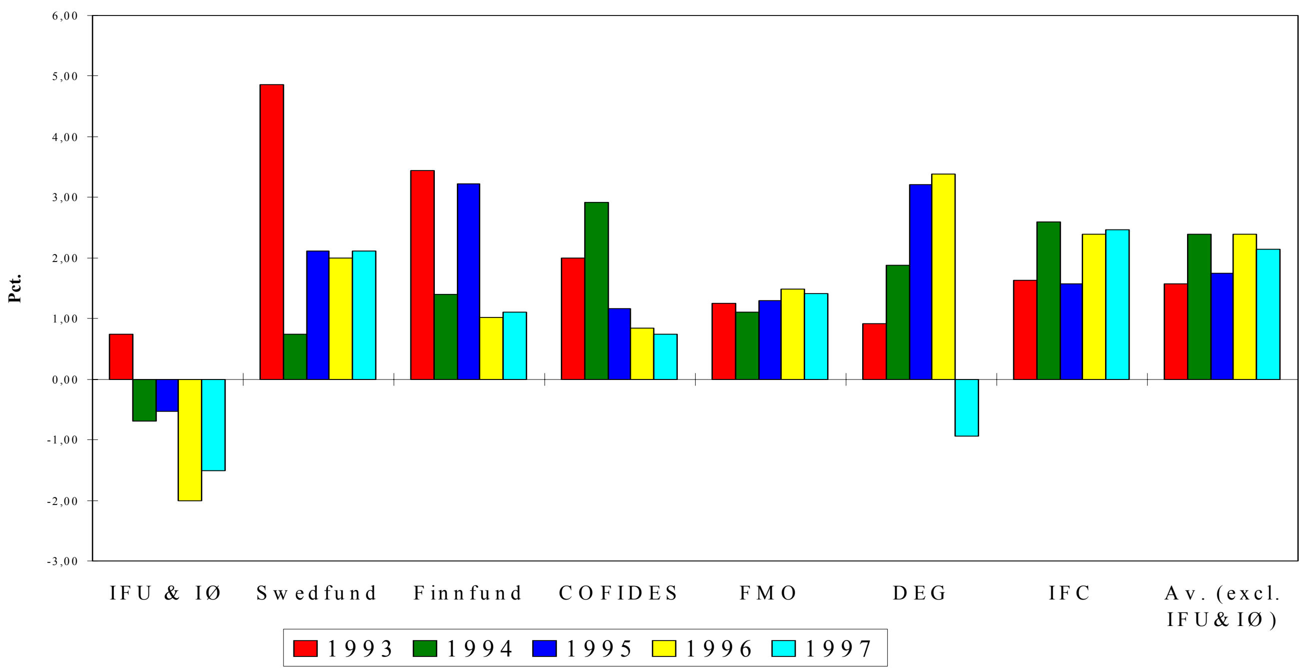


Figure 17 shows net result compared to total assets. Given the very substantial disbursements during the past few years and IFU's conservative provisions policy, IFU's net results are lower than the other institutions.

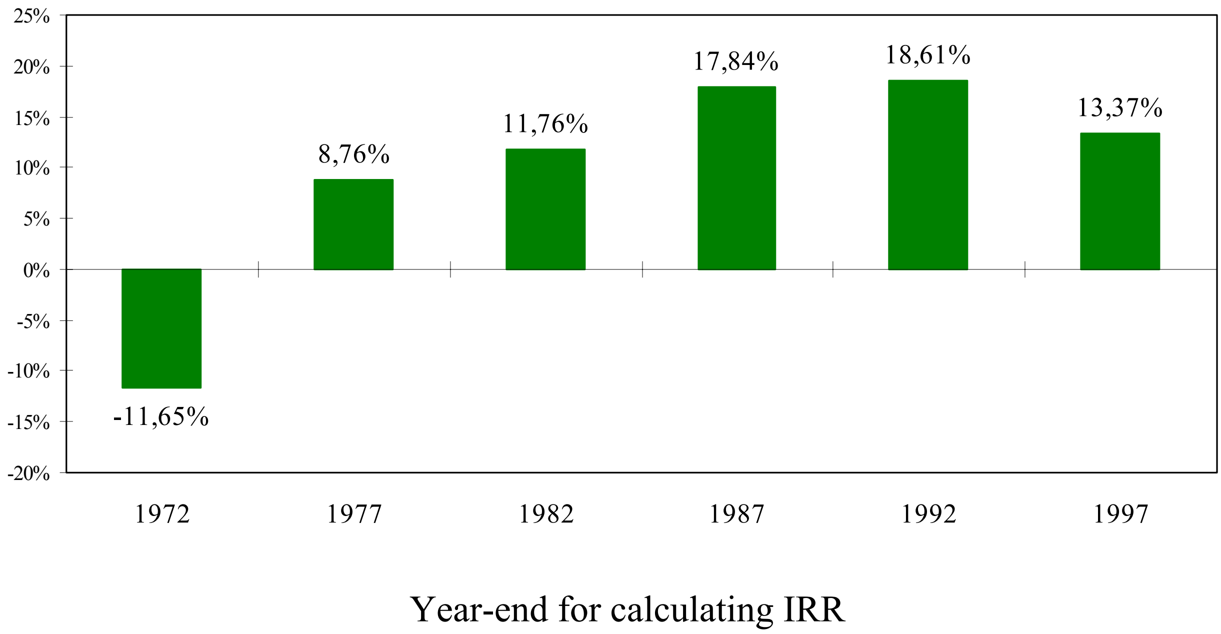
Figure 17 Net result compared to total assets



2.5 The Danish State as an investor

If as at 31 December 1997 IFU had realised its assets at book value less reserves and the proceeds were repaid to the State, the State would have earned an internal rate of return (IRR) of 13.4% on its capital injection in IFU (14.5% when including IFU's share of accumulated reserves in project companies). Up until 1992, the IRR earned by the State had been increasing, cf. figure 18.

Figure 18 IRR earned by the State at 5-year intervals



There are two reasons for the drop in the IRR value from 1992 to 1997. Firstly, since 1994 IFU has made very high investments, which have led to large specific reserves against losses without - as yet - the ensuing project income. Secondly, during 1996-97 new equity-capital totalling DKK 300 million was injected into IFU by the Danish Government, and only limited returns have yet been accruing herefrom. However, the IRR still by far exceeds the target of minimum 2% return on the equity capital.

3. CONCLUSION

The purpose of conducting an analysis every 5th year of IFU (and IØ's) activities is to describe the quality of a number of significant aspects of IFU's project work and to draw conclusions which may prove useful when striving to improve IFU's working methods and results.

One conclusion from the 30-year report is that there is still need for improving analytical methods in various aspects. As an excample, the material does not permit an analysis of the systematic differences in profitability between the different project vintage groups. In order to be able to substantiate and consequently understand these differences, IFU intends to continue working with making this issue more measurable.

The analyses confirm that certain factors already identified in the past still appear to be crucial to explain project profitability, e.g.: Continent (Africa the most difficult), project size and size of the Danish partner. (Small projects and partners most difficult).

The analyses of reserves for losses confirm that IFU pursues a conservative policy given that all analyses indicate that reserves more than cover the losses actually incurred over the 5-year period of 1993-1997. This supports the "hammock" analysis that shows that in the long run it will be possible to write back a large portion of the reserves, and this will have a favourable impact on future profit and loss statements.

Furthermore, the analysis provides a basis for considering whether IFU's liquid funds should be made the determining factor for new investments rather than “available equity capital”. A new cash management system and more precise guidelines should, of course, be introduced and thus ensure that there is always a certain minimum liquidity available even when the equity has been “over-disposed”.

The analysis also shows that it is particularly important to prioritise the technical assistance work in the start-up phase of a project in order to improve project quality, and thus to reduce the risk of loss and the closing down frequency and to increase project profitability.

The analyses reveal how difficult it is to give a clear and fair view of the trend in IFU's financial results in a long-term perspective. Years with very large provisions for losses incurred as a result of major disbursements to projects have, during the period 1992-97, had a negative effect on the Fund's operations, although they actually reflect a positive trend. Major disbursements indicate major activity and consequently the fulfilling of IFU's primary goals. However, differences in timing imply that income is not generated until later and the conservative provision policy adversely affects IFU's profit and loss statement in the short term.

The analysis of the actual return on capital injected by the Danish State indicates that this by far exceeds IFU's goal of minimum 2% per annum. Return on liquid funds, however, has played a major role in this respect.

In connection with the preparation of the 30-year analysis, new IT tools have been introduced which facilitate the making of new, somewhat more comprehensive analyses. These tools need to be upgraded further, in order to achieve new and better substantiated conclusions.