DEVELOPMENT FINANCE INSTITUTION FAQ

ENGINEERS WITHOUT BORDERS

Background and the Canadian Context:

What is a Development Finance Institution?

A DFI uses government funds and expertise to attract private investment to promote market growth and job creation in developing countries.

What is the problem that a Canadian DFI is trying to address?

Businesses in developing countries typically lack access to financing because they are deemed as too risky by investors. This prevents crucial job creation and limits overall GDP growth and tax payments to governments within developing countries. As such, many low-income and middle income countries are dependent upon international assistance from developed countries including Canada. The problem becomes significant when natural disasters or conflict occurs in these regions and local governments are unable to cope, which can destabilize entire regions for years and sometimes decades.

There is approximately a $3 trillion funding shortfall to achieve the UN Sustainable Development Goals (SDG) and international assistance will not be enough. DFIs act as one way to help spur private investment in developing countries which has the potential to close this shortfall.

Who does the DFI target?

DFIs create the conditions for a strong middle class in developing countries. Promising businesses in low-income and middle-income countries struggle to find the necessary financing to grow, create jobs and reduce poverty. Private lenders typically find it too risky to provide affordable capital to entrepreneurs in these regions. A DFI can close this finance gap to create opportunity while also offering returns on investments.

How does it work?

DFIs provide financing to small, medium and large enterprises in countries where access to capital is limited and within sectors where growth leads to jobs, such as manufacturing, agribusiness, infrastructure, financial institutions, construction, health and education.

The federal public service identifies projects that require much needed investment and who are providing social value to communities. These can include critical service providers that contribute to sound infrastructure such as clean water and electricity utilities. Unlike conventional development assistance, it can also target other valuable infrastructure such as communications that help create other business opportunities and lift people out of poverty.

The DFI would develop blended investments where the private investors work with government to build these local enterprises.

How much would a Canadian DFI cost?

The Government of Canada has committed $300 million Budget 2017, and we hope to see it increase in size as it progresses.

How is it different from international assistance?

The DFI fills the gap between international assistance (foreign aid) and private investment as it is focused on both poverty reduction and job creation through enterprise development. Hence, it has both financial and social mandates, whereas international assistance is generally not ideal for delivering on the former.

International Assistance, otherwise known as Official Development Assistance (ODA) has a strong mandate solely for poverty reduction, human rights, and taking in perspectives from the poor is mandated by a piece of legislation called the Official Development Assistance Accountability Act (ODAAA) which ensures that Canada's aid dollars are being deployed to maximize humanitarian needs.

As DFIs serve as an economic development tool with a social mandate, it serves to complement and sharpen Canada's ODA delivery.

Why should Canadians be concerned about this and how does a DFI help an average Canadian citizen?

DFIs are another way for Canada to contribute to long-term efforts to reduce poverty and instability in developing countries. Focusing on economic development within these regions today could result in requiring needing to spend less later to deal with conflicts and natural disasters -- an ounce of prevention is a pound of cure.

Canadians can be confident in a market-based initiative to drive economic growth in developing countries through job creation while maintaining a social mandate. Enabling job creation is a critical way to grow a middle-class which in turn create peace and stability in parts of the world where infrastructure and services are lacking.

What is the benefit to Canadian businesses?

A DFI is an opportunity to bring Canadian ideas, innovation and expertise to help solve the world's biggest problems. Successful projects have been proven to attract dollars from private enterprises by creating the capacity and infrastructure necessary for economic growth. This opens up new opportunities to invest in both Canadian and non-Canadian businesses operating abroad.

What is the difference between Convergence and a Canadian DFI?

Convergence was announced by the Government of Canada in 2016 and is an initiative focusing solely on blended finance, whereas a DFI is an institution with blended finance acting as just one of the instruments that can be harnessed. The Canadian DFI has capital over a 5-year period whereas Convergence does not.

Why should Canada implement its own DFI instead of directing money to existing multilateral development banks such as the International Finance Corporation (IFC)?

Implementing the DFI enables a "made in Canada" institution to its own development toolkit with full oversight, thus boosting our country's reputation as a thought-leader in innovation. A Canadian DFI can also co-invest with multilateral bodies and add to private investment efforts overseas while reaping the rewards of returns.

Doesn't this mean that a Canadian DFI could engage in tied financing where Canadian companies are benefitting at the expense of communities in developing countries?

Canada's DFI must be focused on enabling local economic development with an emphasis on local poverty reduction and job creation. As such loan recipients should not have restrictions in procuring goods and services from the country of their choosing. We believe that tied financing will inhibit the DFI.

Where will a Canadian DFI be housed?

The DFI will be housed at Export Development Canada (EDC) with a separate mandate. We believe this is the right location for the DFI as EDC has the institutional experience with regards to investment, financial services, bonds and assisting Canadian investors. EDC is a self-financing crown corporation.

Engineers Without Borders and DFIs

Why does EWB care about DFIs?

Engineers Without Borders Canada is a Canadian registered charity working to tackle poverty and inequality. Our experience over the past 15 years has taught us that foreign aid works well in some contexts and financial investments work well in others. That is why for the past few years we have been calling for both increases in international assistance funding as well as campaigning for the creation of a DFI. Our efforts promoting the creation of a Canadian DFI were successful with $300 million dollars allocated in Federal Budget 2017. We were thrilled with this policy win and have since been advocating for its operationalization.

As part of our work, EWB also functions as an impact investor for small and medium enterprises by providing seed funding, talent and mentorship to social entrepreneurs throughout sub-Saharan Africa. One of the ventures we invest in is VOTO Mobile, a Ghana-based tech startup that is making it easy for businesses, government departments, social institutions and NGOs to communicate with local communities. Using any mobile phone, the platform instantly reaches across distance, language and literacy barriers to deliver vital information and give underserved communities a voice.

How does EWB want to see Canada implement its DFI?

For Canada to successfully implement its DFI, it needs to fulfill a number of important criteria including being complementary to ODA, focusing on poverty reduction, providing patient capital and catalytic financing.

We are calling on Canada to operate its DFI in the following ways:

- Focus on **profitable commercial support** to businesses building markets in developing countries.
- Use a **broad range of financial instruments**: loans, equity investments, guarantees, risk insurance, et al.
- **Catalytic financing**: small amounts of public finance strategically designed to mobilize private capital.
- **Unconstrained by nationality**: able to work with businesses and entrepreneurs from any

country.
- **Distinct from other public development efforts**: not a grant provider or a channel for industrial policy.
- **Profitable and self-sustaining:** profits are retained to finance the operations of a DFI.
- **Patient capital:** backed by government, able to borrow at low rates and invest in long-term returns.
- **Additionality:** a complement, not a substitute, for Official Development Assistance (ODA).

More In-Depth Q's About DFIs

I heard DFIs invest in primarily high-income countries and engage in corporate welfare?

The Overseas Private Investment Corporation (OPIC) has received allegations of corporate welfare; however, approximately 1500 projects were examined in 2016, and less than 8% of commitments over 15 years have involved Fortune 500 companies.

The majority of OPIC's commitments have fluctuated between upper-middle income countries and lower-middle income countries, where in 2015, 32% of OPIC's commitments went to upper-middle income countries, and 62% went to lower-middle income countries.

FMO (the DFI in the Netherlands) focuses 30% of its investments in low income countries and 50% in lower-middle income countries.

What is the difference between a DFI and a typical commercial bank?

Please refer to Question 13 in the document below:
http://www.adfiap.org/wp-content/uploads/2009/10/Development-Banking-Primer.pdf

Can DFIs pay back into national treasuries?

OPIC has paid returns into the US treasury for 37 years where last year, it had contributed $358 million dollars into the US federal budget last year.

How profitable are DFIs?

Based on 2012 figures, DFIs in Japan, France, and Italy generated $1 to 51 million USD in net profit. The DFIs in the United States, UK, and Germany generated between $173 to 352 million USD in profit. (Haga & House, 2014)

What are typical returns on investments for DFIs?

Based on 2012, returns range from anywhere between 0.4% to 2% for DFIs in the US, Germany, Italy, France, and Japan whereas the UK DFI had a return of about 9%. (Haga & House, 2014)

What are the different types of products/instruments that DFIs offer?

DFI's typically offer the following products:

- Loan Guarantees;
- Direct medium and long term loans at fixed and variable interest rates;
- Direct and indirect equity investments (through funds);
- Co-investing with other bilateral or multilateral DFIs;

- Technical advice for capacity building;
- Specialized services for national businesses;
- Political risk insurance

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