SADEV
SWEDISH AGENCY FOR DEVELOPMENT EVALUATION

Evaluation of Swedfund International

An analysis of private sector development impacts

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Preface

The Swedish Agency for Development Evaluation (SADEV) is a government-funded institute that conducts and disseminates evaluations of international development cooperation activities. SADEV's overriding objective is to contribute to the achievement of the goals of Swedish development cooperation.

Evaluation activities at SADEV are conducted along two major strands. The first of these involves the organisation of international development cooperation, and focuses on issues such as the management and monitoring of executive organisation, the choice of modalities, donor coordination and the internal efficiency of donor organisations. The second area is concerned with the short- and long-term impact of development assistance on global poverty. Results of SADEV's evaluations are published in series, which are available electronically from SADEV's website, and in hard copy.

This Report constitutes an attempt to evaluate one aspect of Swedish support to private sector development in developing countries through the Swedish Development Finance Institution named Swedfund International AB. By studying a number of development indictors, the Report focuses on the outcomes of a sample of investment projects undertaken by Swedfund. The Report is primarily based on interviews with staff at Swedfund, desk studies of investment files, and questionnaires sent to Swedfund's portfolio companies and field studies. The Report argues that Swedfund should develop better in-house capacity for monitoring and evaluation of its investments.

April, 2008

Lennart Wohlgemuth
Director General

Executive summary

Private sector development is one important component in the Swedish international development cooperation. Most Swedish support to this sector is channelled through Sida. Sweden however also has other instruments for supporting the private sector in developing countries, one such instrument is the Development Finance Institution Swedfund International. By studying internal investment documents, by interviewing Swedfund staff and with the help of a questionnaire to Swedfund's portfolio companies in developing countries, this evaluation tries to assess to what extent Swedfund have fulfilled the goals laid down for the organisation and then especially what private sector development effects Swedfunds investments has resulted in. No such externally initiated evaluation has previously been undertaken.

RESULTS

This study mainly for methodological reasons covers the period between 1991 and 2002. The year of 1991 was chosen as a start year because it marks the transition of Swedfund from a foundation to a limited liability company. There seems to exist international agreement on that it is good practice not to initiate ex-post evaluations of investment projects earlier than five year after the start of operations. No investments initiated after 2002 have therefore been included.

The guidelines to Swedfund have gradually become more specific during the period of investigation. It is however not until 2007 that these guidelines can be said to clearly specify the owner's intention with Swedfund and how Swedfund should work to accomplish these intentions. This situation has created some difficulties when it comes to the question of what to measure Swedfund's performance against.

Because of the situation described above we have with some modifications tried to take into consideration the scope of evaluation agreed upon by the Multilateral Development Bank's Evaluation Cooperation Group. We have tried to take into consideration the evaluation criteria established by the OECD DAC Evaluation Network. Because of Swedfund's mandate and type of business we have chosen to focus on the first performance dimension given by the MDB-ECG, namely development outcome and further within this dimension to concentrate on the project's contribution to private sector development. For the second performance indicator, the investment profitability of the MDB, we have not as stipulated calculated the projects financial rate of return. We have only looked into this issue as far as it is covered by effectiveness and relevant criteria according to the OECD-DAC evaluation framework. Of special interest are the criteria which assess whether a successful business venture was established or developed because of the intervention.

We have also looked into the additionality dimension which basically assesses how important the organisation was to make the project happen. The fourth dimension specified by the MDB-ECG which we have tried to cover at least partially is that of

work quality. In addition, we have briefly touched upon the issue of environmental performance. This is really an indicator used to measure total developmental impact and not just private sector development outcome. Swedfund has however since 1999 been instructed to promote sustainable development and a sound environment in countries where the investments take place. This aspect has been included in the assessment on these grounds

When it comes to the evaluation criteria stipulated by the OECD-DAC we have looked at impact; relevance; effectiveness and sustainability. The efficiency assessment has been left out because it was felt that in relation to the objective of the evaluation it would be too resource demanding to assess the level of efficiency for the individual investment projects.

The data for this report consists of investment information from Swedfund's files, interviews with investment managers, the former managing directors and members of Swedfund's board of directors, a questionnaire sent to the portfolio companies abroad and information from the four field visits.

For each business sector around 50 percent of the investments initiated during this period have been randomly chosen for assessment. Swedfund's investments are thinly spread over a large number of sectors and countries. This fact contributed to making it difficult to draw general conclusions about the private sector development effects of the investments. This was made even harder due to the fact that Swedfund has not systematically and over time collected the type of data necessary to draw conclusions on impact issues.

One important conclusion is that the material – the information which has been the base for the conclusions on private sector development effects has not been sufficient to answer the questions posed to a satisfactory degree. It is also clear that the results which we have still managed to deduce in many cases point in different directions.

Considering the private sector development effects of the investments there are indications that a majority include some education of the workforce in the respective developing country, so called knowledge transfer. We did not find technology transfer to the company in the developing country to be as prevalent as the efforts to transfer knowledge. We have come across investments which appear to have clearly contributed to competition within a given market segment. We have however also come across investments in sectors where there has clearly existed competition for qualified labour.

Our overall opinion is that environmental considerations seem to have been taken when the different investment proposals have been made. What is lacking is easily accessible information on how the environmental issues have been handled after the investment has been made.

Regarding work quality a tendency appears to be to put more emphasis on "developmental issues" in investments later in the period compared to the earlier work. However during the period studied here we have seen substantial variation between the different investments proposals regarding the extent potential development effects have been elaborated upon. How thoroughly the various investments have been

documented also vary substantially. This has contributed to making it difficult to compare the investments in the sample. The monitoring of the investments has also in many cases been difficult to follow. This is probably partly a result of different filing practices among the investment managers. One result of this is of course that it becomes difficult to trace the events of an investment cycle, besides the strictly financial information. This situation is made more difficult due to the lack of follow up on exited investments.

The level of additionality of the fund in its investments has been difficult to establish. Information from Swedfund's portfolio companies however indicates that not only investments which could not be financed in other ways have been approved by Swedfund. The degree to which Swedfund improves the structure of the ventures they get involved in appears to vary substantially between investments. One crucial factor here is at what point in time that Swedfund gets involved in a certain venture. If Swedfund enters when the venture per se has been launched and there is only a need for additional capital, Swedfund's role naturally becomes more limited. In other cases when Swedfund is on board from start they can be very active in setting up the investment.

Swedfund had several goals during the period studied here; to promote the establishment of profitable companies in developing countries; to support Swedish industry in establishing itself abroad by giving priority to joint ventures with Swedish companies, to promote a good environment in developing countries (both external environment and working conditions). The organisation has gradually been imposed with a requirement for profitability. The intentions with investments assessed here can to a varying degree be said to fulfil at least one of these goals. In other words, it has been difficult to find investments that are outright irrelevant given the set of goals mentioned above.

Swedfund works with a variety of partner companies in their portfolio investments and in a majority of the cases a Swedish strategic partner is involved. Careful studies of the investment files show considerable differences in quality and rigour regarding how the portfolio companies report to Swedfund. The larger investment partners seem generally to possess a higher level of discipline compared to smaller companies when it comes to ensuring that the portfolio companies provide Swedfund with the required information. Generally the projects involving larger, more established partners appear somewhat better prepared than those projects involving smaller Swedish entrepreneurs. The former have usually for example delivered detailed feasibility studies, which we rarely found with smaller partners.

Swedfund's activities are generally focused on the micro level of the economy. If an organisation such as Swedfund was to be fitted into the wider Swedish support to private sector development, its activities would therefore belong to the so called pro-poor growth paradigm. Investments in our sample cannot however be said to consistently have been chosen on the basis of their potential to have an impact on the situation for poor or disadvantaged groups in a particular setting. When this has been the case it appears more as a positive side effect to a potentially profitable investment. Given that Swedfund should make a profit it is difficult to criticise this strategy. However, a higher demand for Swedfund's services during the period studied could have allowed for more strategic picking and choosing between different investment

proposals. Such a strategy could possibly have produced an investment portfolio that did not contain examples of projects with only minor socio-economic benefits.

RECOMMENDATIONS

We are of the opinion that as more funds from the state budget are allocated to Swedfund, some of these resources should be reserved for monitoring and evaluation activities. Swedfund's larger counterparts have independent monitoring and evaluation units. If Swedfund is to grow, (a decision which was actually taken before any independent evaluation was undertaken) one should be able to demand that the organisation possesses the capacity to effectively monitor and evaluate its investments. This becomes crucial since the official secrecy act which protects the trade secrets of firms makes it difficult for an external agency to fully take stock of Swedfund's activities without Swedfund's consent. In this lies also a recommendation to develop more stringent procedures for documenting the investments. This should be done both to make it possible to trace the events (other than purely financial) of an investment and to make possible the comparison between different investment projects.

To avoid a situation where all employees need to be experts in the whole spectra of the company's activities we feel that the work of the investment managers should continue to be focused at doing business, the way it is today. Therefore, the analytical and monitoring function ought to be separated from the work of the investment managers. It also seems desirable that the regional and business sector competence within the company should be further specialised. One possible organisational model would be to have teams with regional knowledge (for example of Sub-Saharan Africa, Latin America etc.) combined with investment teams with special sector knowledge of investments in for example information technology, energy etc. Such an arrangement could possibly make it easier to attract partners from the Swedish industry. This could in turn give Swedfund a larger pool of interesting investment proposals with clear private sector development prospects to choose from. Such a strategy could help secure higher "development returns" from the investments.

List of acronyms

CDC	Commonwealth Development Corporation
DFI	Development Finance Institution
EDFI	European Development Finance Institutions
FDI	Foreign Direct Investment
FMO	Netherlands Development Finance Company
MDB	Multilateral Development Bank
ECG	Evaluation Cooperation Group
IFC	International Finance Corporation
IFI	International Finance Institution
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
WGPSE	Working group on Private Sector Evaluation
XASR	Expanded Annual Supervision Report

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[1] None of the parties mentioned in the acknowledgments bears any responsibility for the arguments presented in this evaluation or for any errors that might appear.

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1 Introduction

Private sector development is high on the agenda of the donor community and Sweden is no exception.[2] The overall objective of the Swedish policy is to contribute to "equitable and sustainable global development" on the basis of "a rights perspective and the perspectives of the poor" (MFA, 2003:20). To achieve this goal, eight mutually reinforcing elements have been identified. One of these elements is economic growth, which is identified as a necessary, although not sufficient, condition for equitable and sustainable development (MFA, 2003:28). Support to the private sector is considered to be one of the key factors necessary for economic growth and hence, poverty reduction (OECD, 2005:33).

Sweden has a variety of instruments to support private sector development. A majority of these instruments is administered by Sida. A growing amount of resources is channelled through Swedfund International, a government owned risk capital firm. The role of Swedfund is to offer financing and competence for investment projects in developing countries, and after 1991 also in Central and Eastern European countries.[3] Swedfund was originally set up as a foundation in 1978 with the aim of transmitting Swedish business knowledge to less developed countries. It was reorganised in 1991 as a private equity firm, owned to 100 per cent by the Swedish government. The primary instruments of Swedfund are medium and long-term loans, loan guarantees and equity investments. The basic motive for using a Development Financial Institution (DFI) such as Swedfund is the idea that there are socially and economically profitable private investments which are not undertaken due to financial market imperfections. A DFI is set up as a separate organisation because it is supposed to be a financially self-sustainable organisation and because special competence is needed to identify commercially interesting investment opportunities.

An ordinary risk capital firm is supposed to undertake investments in certain sectors and maximise the return of its investment portfolio above a specified risk level determined by its owners. Swedfund as a DFI owned by the state has other goals and restrictions compared to an ordinary risk capital fund. During the period studied here the instructions from the owner has however been rather unspecific but the level of detail has increased over time.

- In 1997, the Ministry for Foreign Affairs stated that Swedfund should combine "development goals with a business driven approach" and the cooperation in the developing countries should be concentrated to the poorer countries and only by exception take place in countries with an average per capita income above 3000 USD. Swedfund should aim for that the proceeds of a project should amount to 40% of the expenses for the project over a rolling three-year period.

[2] Evidence of this can, amongst others, be found in the formulation of the national poverty reduction strategies of several developing countries (United Republic of Tanzania 2000: 18, Government of Peoples Republic of Bangladesh 2005: xxi, Republic of Nicaragua 2005: 30 ff.).
[3] Swedfund is not allowed to invest in countries who are members of the European Union.

- In 1999 the guidelines were extended in that Swedfund should contribute to the development of sustainable companies in developing countries and in countries in Eastern and Central Europe. Swedfund was also to contribute to promote a sustainable development and a good environment in regard to both working conditions and the external environment. This should be accomplished by risk capital investments either by investing in stock or giving loans to joint ventures and to risk capital and investment funds. The importance of supporting the Swedish industry was emphasised by the statement that Swedfund were to prioritise joint ventures with Swedish partners. In regard to profitability, the costs of a project should be 100% covered by the proceeds from the project over a rolling three year period.

1.1 Evaluation Objectives

Swedfund's goal of combining development with a business driven approach, makes Swedfund a development agent working with a form of private sector development. The primary focus of this evaluation therefore lies in clarifying if and in what type of private sector development effects Swedfund's activities have resulted in. This evaluation therefore has mainly two aims. It seeks to assess whether the activities of Swedfund International AB, during designated period, worked to fulfil its own goals and whether Swedfund's activities furthered the goals of the Swedish international development cooperation policy in general. Hence, the evaluation will take stock of what activities Swedfund have been/are involved in and assess their relevance and effectiveness.

1.2 Methodology

In this study we have randomly sampled 50 per cent of the Swedfund's investments during 1991 to 2002. The sampled investments have then been subject to a qualitative judgement of various development effects. Investments in countries which today are members of the European Union are excluded because those investments were not made within the traditional framework of international development cooperation.[4] The sample size is relatively large but is motivated by the diversity of Swedfund's portfolio in terms of different countries, sectors and choice of financial instruments.

To ensure that the sample describes the whole portfolio we stratified the sampling process by randomly selecting at least one investment from each sector. The timeframe 1991 to 2002 was chosen because Swedfund reorganised from a foundation into a limited liability company in 1991. The timeframe ends in 2002 because the Multilateral Development Banks Evaluation Cooperation Group recommends that ex-post evaluations should not begin earlier than five years from the time of start of operations.[5] Table 1.1 and Figure 1.1 below describe the similarities between our sample and Swedfund's total investments during the period.

[4] Swedfund is moreover not allowed to invest in countries who are members of the European Union which today goes for many countries in Eastern Europe. This made these investments even less interesting from a learning perspective.

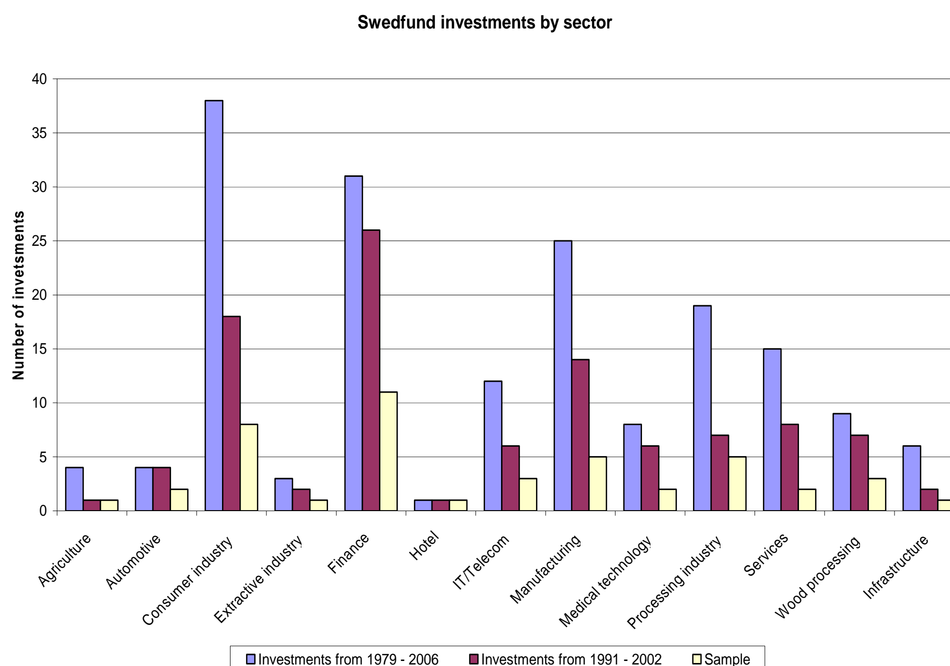
[5] IEG-IFC 2006, Preparing an Expanded Project Supervision Report, Instructions for Non-Financial Markets Projects, p.2 . Compared with the recommendations of this group our sample is small. They recommend a sample size of 65per cent. This is so because they aim for continuous evaluations, there are evaluation parameters collected from the beginning in each project, which holds down the costs of the ex post evaluations. And, most likely, by aiming for an extended sample size and continuous evaluations they want to mitigate fraud and corruption at the same time.

Table 1.1 Sampled investments out of total portfolio per sector*

Sector	**1979 - 2006**	**1991– 2002****	**Sample**
Agriculture	4 (2.2%)	1 (1%)	1 (2.3%)
Automotive	4 (2.2%)	4 (4%)	2 (4.5%)
Consumer industry	38 (21%.)	18 (18%)	8 (18.2%)
Extractive industry	3 (1.7%)	2 (2%)	1 (2.3%)
Finance	31 (17.7%)	26 (26%)	11 (25%)
Hotel	1 (0.5%)	1 (1%)	1 (2.3%)
+IT/Telecom	12 (6.9%)	6 (6)	3 (6.8%)
Manufacturing	25 (14.3%)	14 (14%)	6 (13.6%)
Medical technology	8 (0.46%)	6 (6%)	2 (4.5%)
Processing industry	19 (10.9%)	5 (5%)	3 (6.8%)
Services	15 (8.6%)	8 (8%)	2 (4.5%)
Wood processing	9 (5.1%)	7 (7%)	3 (6.8%)
Infrastructure	6 (3.4%)	2 (2%)	1 (2.3%)
Total no. (frequency)	175 (100%)	100 (100%)	44 (100%)

* *Numbers within parentheses are frequency*
** *Includes countries that later have become members of the European Union.*

Figure 1.1



The sampling process did run into some difficulties due to the lack of a coherent sector classification at Swedfund. In Swedfund's annual report of 2006 all previous investments were divided by sector but active investments were divided by region. In Swedfund's internal document listing all active investments for the same year the categorization by sector was somewhat different. The classification by sector in this evaluation is based on the categories in the 2006 annual report and presently active investments have been put into these categories after closer analysis of investment documents and consultation with Swedfund staff.

1.2.1 Indicators

As discussed earlier, the goals for Swedfund have gradually become more specific but were during the sample period in this evaluation rather unspecific. This makes it difficult to assess the effect or impact of chosen activities, and to know against what they should be measured. As stated in the evaluation objectives we have interpreted stated goals such as "combine sustainable development with a business driven approach", "contribute to development of sustainable companies in developing countries" etc., to be an expression for a higher aim, namely to support private sector development in developing countries. The lack of specific goals and indicators for goal fulfilment for Swedfund made us look towards other and similar institutions for finding tools to evaluate the organisation's performance. The Multilateral Development Banks Evaluation Cooperation Group (MDB – ECG) has agreed upon good practice standards for evaluation of the performance of these institutions. The International Finance Corporation (IFC) is one of the multilateral institutions which have adopted this good practice while the Netherland's FMO is an example of a bilateral DFI which also adhere to this good practice. In an attempt to analyse the impact of Swedfund through our sample, we have used indicators established by the MDB – ECG.

What we have tried to achieve is to take into consideration the scope of evaluation which the MDB – ECG covers with some modifications but also to try to take into account the evaluation criteria established by the OECD DAC Evaluation Network which stipulate that the evaluation should assess the relevance, efficiency, effectiveness, impact and sustainability of the evaluated intervention. This combined approach was chosen because the activities of Swedfund in some ways can be said to have more in common with private risk capital institutions/organisation than with traditional development cooperation. We realise however that this approach was probably somewhat over ambitious and because of severe limitations in the information available to us, as well as in resources available for the evaluation, not possible to fully fulfil.

The good practice standards for evaluation agreed upon by the MDB – ECG concern self evaluation and evaluation by central evaluation departments at respective banks and are directed at extensive data collection during the life span of the investment project, so called expanded annual supervision reports (XASRs). Swedfund does not in fact have any such internal or external function (which according to the MDB – ECG standard should "have unrestricted access to MDBs staff, records, co-financiers, clients and project") (MDB-ECG- WGPSE 2006:1). This makes the conditions for this evaluation very different from those carried out by the evaluations departments at respective banks.

The XASRs and performance evaluation reports agreed upon by the MDB – ECG should evaluate the following performance dimensions:

- The development or transition outcome of the project,
- The MDB investment profitability (contribution to corporate profitability objective),
- The MDBs additionality, and
- The MDBs work quality

Because of the focus of this evaluation we choose to pay most attention to the first performance dimension; namely the development outcome of the project and then specifically the projects contribution to a country or region's private sector development. In the XASRs, contribution to private sector development is only one dimension (and rightly so) of the overall development outcome. We have however chosen to focus on this particular dimension, since this is most relevant to the mission of Swedfund. The International Finance Corporation (IFC) has their own manual for preparing what they call expanded project supervision report, (XPSR). As the name suggests this is IFC's version of the XASR. Since IFC activities are more comparable in type (although vastly larger and more encompassing in scope) to the activities of Swedfund than the MDBs, we have also used their indicators for private sector development impact. We have shown their indicators in brackets along with those of the MDB – ECG. When assigning ratings for the impact on private sector development in the XASRs the following factors are taken into account:

- Competition. "the project contributes to greater efficiency, quality, innovation or customer orientation of other suppliers through competitive pressure ..." This is counted as positive, the contribution could be negative if the project for example had contributed to restrictions on competition (IFC: greater competition and competitiveness)
- Market expansion. This factor concerns how the project company interacts with the local and international economy through forward and backward *linkages*. (IFC: significant upstream and downstream supply linkages to local private business)
- Private ownership and entrepreneurship. This factor is considered positive when it points at increase or consolidation of private provision of goods and services. (IFC: see point on transfer and dispersion of skills)
- Frameworks for markets. This factor concerns the creation or strengthening (if positive) of private and public institutions that supports the efficiency of markets. (Not on IFCs list)
- Development of financial institutions and financial markets. (IFC: domestic capital market development)
- Transfer and dispersion of skills. (IFC: introduction of new technology, know-how, development of management skills and employee training, enhanced private ownership).

- Demonstration effects (can for example be new investments stimulated by the project). (IFC: broad demonstration effects in the local economy).
- Standards for corporate governance and business conduct. (IFC: introduction of international accounting standards or enhanced disclosure standards).
- Development of physical infrastructure used by other private parties (MDB-ECG- WGPSE, 2006: 13). (IFC: development of infrastructure available to other private users).

When we have studied the chosen investments we have tried to structure the information around the indicators presented above. It is important to bear in mind that these indicators are *not* connected to specific goals set up for Swedfund. We view them as an analytical framework which can indicate what types of effects one should look for when assessing the investments/projects. As the presentation of the results will show, not all indicators used by these organisations to measure a project's impact on private sector development are all that relevant when studying the activities of Swedfund. The difference in for example the size of Swedfund's projects in relation to those of the largest multilateral makes it unrealistic to assume that they could have the same type impact. One example of such an indicator is "frameworks for markets". Swedfund's projects are rarely of the kind that could be expected to create or strengthen public or private institutions that support the efficiency of markets. Still we have kept an open mind to the possibility that some projects could have this impact although more indirectly.

The second dimension covered in the XASRs; the MDB investment profitability is, in our analysis, partially covered by the effectiveness and relevance criteria stipulated by the OECD-DAC Evaluation Network, but only insofar that we have tried to consider whether the stipulated goals with the investment was reached and whether a profitable business venture was established or further developed because of the intervention. We have not measured the financial rates of return for the investments included in our sample.

For the third dimension, the MDBs additionality, the following indicators or factors are used by the MDB-ECG:

- "Terms, would the client have been able to obtain sufficient financing from private sources on appropriate terms?"
- "Was the MBD (because of its being an MDB) needed to reduce risks or provide comfort (i.e., improve the investors' perceptions of the risks involved) … ?"
- "Was the MBD needed to bring about a fair, efficient allocation of risks and responsibilities e.g., between public and private sectors?"
- "Did the MBD improve the venture's design or functioning … ?"

Again the size and role of Swedfund compared to the mandate of the MDBs is very different and the third factor mentioned above on the role of the MDB in allocation

of risks between different parties is not a factor which we have consistently addressed.[6]

- Environmental performance

This is actually an indicator used by the MDB – ECG to measure total developmental outcome of their projects and not an indicator used to measure the private sector development outcome. However, from 1999 and onwards Swedfund has been instructed to help to promote sustainable development and a sound environment. These more specific instructions hence came in the latter part of our period of investigation. We have still found it reasonable to at least touch upon this aspect. The MDB –ECG primarily assess the environmental performance of a project based "on the MBD's specified standards in effect at investment approval …" (MDB-ECG-WGPSE 2006:16). In the absence of such standards for Swedfund's projects during the period under assessment here, we have merely tried to assess how environmental concerns were handled in the chosen investments.

Finally when it comes to the fourth dimension which considers the work quality of the MDB we have primarily looked at the two first categories of factors discussed by the MDB-ECG,[7]

- the at entry screening, appraisal and structuring work and,
- the monitoring and supervision quality.

Besides the various indicators or factors presented here we have, as stated above aimed at fulfilling the evaluation criteria as stipulated by the DAC network. One of these criteria has however been left out of the evaluation, namely the efficiency assessment. In relation to the objective of the evaluation we are of the opinion that attempting to assess the efficiency of the individual investment projects would have been too resource demanding. However, in chapter 2, and more extensively in Appendix A, we discuss the profitability and financial return of Swedfund as a company.

The remaining four criteria will be taken into consideration as follows;

- impact: will be considered as the impact on private sector development and will assessed as described above;
- relevance is to be assessed on three different levels; how did the aim of the investment relate to the stipulated goals of Swedfund; did the investment lead to the establishment of a profitable company; the relevance of the investment in relation to development goals of the country in which the investment took place; the relevance of the investment in relation to Swedish policy for development cooperation;
- effectiveness: here we will look at goal fulfilment at individual project level;

[6] The question of additionality is included in what IFC call "the Role and Contribution of IFC". We found that the dimension is more clearly laid out by the MDB-ECG and we have used these factors for trying to assess the additionality of Swedfund.
[7] The dimension of work quality is included in the broader IFC category of "role and contribution".

- sustainability: will finally be assessed by simply establishing whether the project company has survived Swedfund's exit from the investment.

1.2.2 The Data

The most important source of information has come from extensive studies of Swedfund's project files. A questionnaire has also been sent to the portfolio companies or to Swedfund's investment partners when the first alternative was not an option. Investment managers at Swedfund responsible for investments included in the sample have been interviewed as well as current and former members of Swedfund's board and the company's former managing directors. Only two representatives of Swedfund's Swedish partners have been interviewed since focus of this study was not primarily on the value of Swedfund to its Swedish partners. Field visits to four investments in four different countries in Asia and Africa have been carried out. These investments were in different sectors and two of them were ongoing while Swedfund had exited the other two.

Using a questionnaire to gather information proved to be difficult for a number of reasons. First of all it was not possible to send the questionnaire to all companies in the sample. We only managed to send the questionnaire to 24 companies; this low number is explained by a combination of factors. Fifteen of the investments had either been liquidated or were under liquidation (12) or Swedfund had exited them before 1997 (three) which for the latter meant that they had been removed from Swedfund's archive. For some of the other exits it was also difficult to establish who to send the questionnaire to. One example is a company which Swedfund exited fairly recently. The Swedish "strategic partner" with whom Swedfund had entered the investment had years before been bought by an international player with no real interest in the investment in this developing country. After Swedfund's exit the relations between the buyer of Swedfund's share and Swedfund became strained. In such a case it becomes difficult to find the right person to address with questions on development effects linked to *Swedfund's* involvement in the company. The remainder were companies which did not exist in their original form any longer, leaving no one to send the questionnaire to, funds where Swedfund was a clear majority owner (1), a fund with no clear development profile, and a bank (for which our questions did not apply). Of the twenty-four companies we did send to, 12 answered the questionnaire.

Our original sample contained 11 investment funds. Given our chosen method for investigating outcomes and development, it has been difficult to analyse these in the same manner as used for direct investments. This was mainly due to that i) these funds disclose little information of the type we are looking for and ii) it was in some cases difficult to judge what was Swedfund's contribution to the success or failure of each fund.[8] This is worth keeping in mind when studying the results in chapter 3 as the relatively large number of funds in a majority of cases contributes to raise the number of "no information" cases.

[8] In retro perspective these types of indirect portfolio investments in 'local' development funds would have been better saved for a separate study.

2 Development Finance Institutions

This chapter describes briefly how DFIs work and how they describe themselves. The organization of European DFIs, EDFI of which Swedfund International is a member, says their aim is "to bridge the gap between commercial investments and government development aid". They claim that "the investment activities of DFIs, which focus mainly on economic performance and return on investment, not only mark a departure from the past in a bid to reduce dependence on development aid, but encourage the entrepreneurial spirit of millions of individuals and companies worldwide on both sides of the economic divide". Swedfund states that they can "act as an important bridge between poor countries and the industrialised world … With its particular expertise in investing in developing countries Swedfund can contribute to growth and the creation of profitable companies and help to reduce poverty" (http://www.swedfund.se/default.asp?p_id=322&top_p_id=46 2008-01-09).

The Dutch DFI FMO puts it this way; "Through our special capital structure, we are able to provide financing which other parties are unable or unwilling to provide in sufficient amounts or under reasonable conditions" and "FMO's role supplements that of the market as we can go beyond the point where other parties are forced to stop" (http://www.unepfi.org/signatories/index 2007-07-09).

More generally, DFIs can be described as government institutions that offer financing where the regular market fails. DFIs are used by many governments to promote business development in general, to support specific sectors such as agriculture, or to assist low-income households. They are usually owned to 100 per cent by the government, but can be part-owned by non-government organisations and private investors. In foreign development assistance, the motive for using DFIs is that investments are the key to economic development and therefore to poverty reduction. However, due to financial market imperfections, not all socially and economically profitable investment projects are undertaken.

The reasons behind the market failures are usually that the markets cannot deal with risks associated with the project, and that the local financial market is underdeveloped and segmented from the rest of the world.[9] As a consequence, some investors with good projects are not able to find financing, or are offered financing at costs that make the project unprofitable. In this situation a DFI can provide financing in various forms. A DFI can buy equity and become part owner in the project. This will also give them some additional control and influence over the project if combined with board membership. Alternatively, they can offer a loan or sell a guarantee to the investor. Selling a guarantee means that the DFI, in return for a fee, becomes an underwriter to a part of a loan given by another credit institution. The practical outcome of a guarantee is that another credit institution can extend a loan to the investing firm because the credit risk of the firm is reduced.

[9] For a detailed discussion of various market failures that motivate interventions see Honohan and Beck (2007).

The direct cost for the society of running a DFI is that the total assets of the DFI would yield a higher alternative return if invested in similar risk activities on the existing financial markets. The benefit to society is that social and economic returns from the investments are supposedly higher than costs, so that the net outcome is a higher standard of welfare for the whole country.

2.1 DFIs as tools for economic development

The specific role of a DFI is to improve on some weak parts of the existing financial markets. A well-functioning financial market performs a number of important tasks, which all contribute to optimise the allocation of resources so that a society can maximise and increase consumption over time. A DFI needs to mimic these tasks to be successful. In the context of development assistance there are three things that a DFI can do to improve the working of the financial markets.

First, financial markets screen all possible investment projects and allocate resources (savings) to projects with the highest risk-adjusted return potential. By selecting projects with the highest expected returns, conditional on the risk of the project, financial markets both satisfy people's needs and provide optimal resource allocation over time. In other words, if successful they create more resources than what is needed for financing the project in the first place. The outcome is a higher economic welfare in the economy. Thus, by screening and promoting economically high yield projects DFIs help to generate more economic resources, which is a pre-requisite for reducing poverty.

Second, financial markets reduce and manage risks associated with investments. In order to take on a high risk project an investor will demand a return that compensates for the risk. In under-developed financial markets, a number of investment projects will not be undertaken because the risk is too high in relation to the expected return. Banks often require some form of collateral for granting a loan. If the loan is for a start-up and the investor is financially challenged at the beginning of the project he or she will be unable to get bank loan and a number economically interesting projects will never be undertaken.

A typical example is the following. For say a small or medium sized software developer in Sri Lanka it might be impossible to get a loan from a bank. A small or medium sized software developer in Sri Lanka has no land or machinery that can be used as collateral. Even with a good financial history with stable cash flows, with financial statements based on best practice and a good auditor, it is difficult to get a bank loan to expand. In this situation a DFI is not supposed to ask for collateral but to focus on the expected outcome and suitable ways of financing the project. Since DFIs are supposed to take higher risks for a given expected return than the existing market they can, after analysing the underlying causes behind high risk premiums, contribute to working of the markets so that more investments will be made.

Third, financial markets monitor investment projects. When selecting investment projects markets seek to determine the willingness of borrowers and project managers to service their part of the contract. On a stock market, one part of the monitoring process lies in changing the relative prices on traded assets of individual firms so that resources flow to the better firms. Another part of the monitoring process is that

financial markets demand information continuously, in the form of financial reporting and additional disclosure from firms. In addition, the market designs incentive contracts for borrowers and managers and in some situations gives advice to management through repeated contact with credit institutions.

An important aspect of the monitoring process is that the market will force bad projects out of the market. If a project turns out to be not profitable, markets will close down the project and allocate resources to other sectors of the economy to make sure that limited resources are used in the most productive way. When investing in less developed markets, DFIs have important monitoring roles to play by demanding correct financial information and other information that affects the outcome of the project. They can give advice to the project management and help to transfer management knowhow. And, if necessary they can contribute to quickly closing down projects that turns out to be unprofitable so that valuable resources are not wasted. An example is the transformation of state-owned firms to private firms or public firms whose shares will be sold on a stock exchange. In this process a DFI with experience from private firms and stock markets can help by giving advice during the privatization process.

To a large extent DFIs resemble investment firms and venture capital firms that already exist on the financial markets. For a limited period of time, they supply capital to establish financially sustainable private firms. There are, however, important differences between DFIs and investment firms related to the outcomes of a project in terms of financial, social, environmental and development effects. Even though we expect existing market investors to focus on social, environmental and development outcomes the difference between the existing market institutions and DFIs is more a matter of degree than of kind.[10] If a project has negative social and environmental outcomes these are often associated with high political risks that affect the expected return. The higher the expected return of a project, the greater the expected impact on economic growth. However, since DFIs are run by governments, the acceptance for possible negative outcomes are lower and due to market imperfections DFIs might substitute some expected financial return for higher expected non-financial outcomes.

DFIs and private investment firms have partly the same financial objective, to create financially sustainable firms. Since DFIs work with a lower return requirement they can take higher risks and invest in more risky projects than the ordinary market. In this context, there are important differences in the working of an ordinary risk capital firm and a DFI. A risk capital firm is directly competing with other institutions on the capital markets. Further, a risk capital firm will always buy a sufficiently large share of the equity to secure that the management of a project is maximising their effort to create a profitable and financially sustainable project[11]. If the management is not performing, the risk capital firm will replace the management. Sometimes this can

[10] A number of banks and DFI have signed the “Equator-principles” for dealing with social and environmental risks, see www.equator-principles.com.

[11] A venture capital firm will try to maximise the economic return of a project by aiming for a return that is higher than the existing market cost of capital of the project. In finance terms, they will try to create real economic profits meaning a return that compensates for more than the risk associated with the project. From the perspective of a DFI such real economic profits indicate that they are subsidizing the investment and create a transfer of wealth to the other investors in the project. This might not be an acceptable outcome for the government.

involve removing the original entrepreneur from the management. In addition, the risk capital will seek to maximize economic profits from a project.

DFIs on the other hand, if they decide to buy equity, are typically operating with minority equity holdings. Thus, DFIs cannot replace management and thereby can not fully control the expected cash flows of the project. In addition, DFIs are not supposed to compete with the existing capital market. They should only invest in projects that are otherwise rejected by the market. For a DFI, the project and its expected return is given since they have no other information about the project than other investors on the market and no controlling share of equity in the firm.

The main instrument a DFI has is the financing cost of the project. By analysing the potential failure of the existing market, in combination with a cost-benefit analysis for the society, DFIs help to establish financially sustainable businesses where the existing market are rejecting the projects. The financial result should be a return for the other participants that compensates for the risk they are taking in the project. In principle, the return should not exceed the actual economic cost of capital, to avoid a situation where the DFI is transferring wealth to other owners. The outcome is increased resources for the economy, which can be measured in terms of the value created by the projects. This is the essence of the concept "additionality"; the additional value that a DFI can create by offering financing to financially sustainable projects which would otherwise have been rejected by the existing capital market.

Social outcomes of a project refer to labour issues such as wages, the right to form unions, working conditions in general etc. Social outcomes also have an effect on the local community. Large investments can lead to an increased demand for schools, health care, water and sanitation but also to various social problems. One important question is if the local community can deal with such increased demand for services and infrastructure. DFIs are typically required to analyse and consider social outcome effects carefully when deciding on projects. The basic principle is typically to follow the international guides for best practice in these matters and improve on these if possible. The same type of reasoning holds for environmental outcomes.

Development outcomes refer to how DFIs contribute to development goals, including economic growth, in countries in which the investments are made. When choosing among projects it might be better to accept projects with a relatively large impact on the local community in terms of use of local inputs and produce for local demands rather than exports, at the same time the growth potential of the sector is of interest. DFIs should not create monopolies or disturb the local competition among firms. Other aspects of development outcomes are the transfer of knowhow, and improvements in best practice frontiers regarding labour, managerial, social and environmental standards.

The evaluation guidelines of large DFIs, such as IFC and FMO look at outcomes along the lines described above using both qualitative and quantitative methods. In practice it is not easy to separate financial, social and environmental effects from each other and so a general evaluation of development outcomes might include aspects from all types of outcomes.

Even though the outcomes of a DFI are no harder to evaluate than those of many other development agencies, there are some factors to keep in mind. Some transactions and calculations are classified financial data which cannot be made public. Investment decisions are made based on incomplete information. The risk, which is a natural component in investment decisions, has the effect that some investments will go wrong due to unforeseen events. This means that it makes little sense to look at the outcome of one or a few investment decisions. A DFI must be judged by the outcomes of its investment portfolio not by the outcome of an individual investment.

In addition, the costs and complexity of performing *ex post* evaluations of general development effects can quickly become extremely high. IFC, as an example, tries to quantify some aspects of the development effects by estimating the present values of additional indirect cash flows caused by the investment but not included in the investment analysis. To gather such information *ex post* for a large number of investments is associated with high costs. One conclusion for DFIs, as for many types of development assistance, is that the costs of evaluating will be lower and net benefits will be higher if evaluation process is built into the decision process on an *ex ante* basis.

2.2 DFIs and foreign direct investments in developing countries

One aspect of DFIs such as Swedfund is that they promote foreign capital flows in the form of foreign direct investments (FDI) in developing countries. Swedfund's focus in their activities has been on creating direct investments. There exist differing views on how such activities affect the economies of developing countries. A conclusion drawn by Kagstrup and Matar (2005) is that the benefits of attracting FDI to emerging markets cannot generally be determined by theory alone; it ultimately becomes an empirical question. Some indications as to where and when FDI can have a positive impact on economic growth in developing countries can however be drawn.

The evaluators of the Norwegian DFI Norfund mention the following factors as important for the impact of FDI; the set of domestic policies that facilitate industrial growth (includes such various factors as level of education, business regulations, fiscal stability, etc.), what type of FDI that enters the country and how competitive the existing domestic industry is (Evaluation of the Norwegian Investment Fund for Developing Countries 2003: 14).

When it comes to Greenfield[12] and take-over FDIs a specific sector analysis is always needed in order to draw conclusions regarding the possible growth and development impacts of the investments. The evaluators of Norfund point to the importance of being realistic as to what the baseline scenario or the alternative to a proposed FDI looks like when performing such an analysis. The issue of crowding out domestic industries is one point in question. It could be that labour intensive domestic industries would have to close down because of international competition, even without the entrance of a capital intensive FDI (Evaluation of the Norwegian Investment Fund for Developing Countries 2003: 14)

[12] Investments in new assets

Another conclusion is that different types of FDI have different development outcomes. While for example export oriented companies in a more straight forward manner creates jobs (with less risk of crowding out domestic industries), the linkage effects (such as for example technological spillovers to other companies) are greater for domestic oriented FDIs.[13]

[13] For a more thorough discussion on potential drawbacks and benefits of FDI in developing countries see appendix B

3 Swedfund – Description of operations

3.1 The principles guiding Swedfund's activities

Swedfund is a state-owned company with a board of directors where the owner is represented by staff from the Ministry for Foreign Affairs which is the ministry responsible for Swedfund. The principles that should guide the activities of Swedfund are laid down by the Ministry for Foreign Affairs and agreed upon at the general meeting of the board.

During the time span which is under consideration here, the attitude of the owner towards Swedfund has undergone some changes. A clear trend is however an increased interest from the owner regarding Swedfund's activities. The first formalised and written guidelines (delivered by the Ministry for Foreign Affairs) to Swedfund were issued in 1997.[14] These were rather unspecific and basically stated that Swedfund should combine "development goals with a business driven approach" and further that the cooperation in the developing countries should be concentrated to the poorer countries and only by exception take place in countries with an average per capita income above 3000 USD.

It is interesting to note that the annual reports from 1990/91 and 1991/92 contain specific guidelines for Swedfund's activities, which discuss the role of Swedfund, the role of its Swedish partner firms, the local partners etc. These guidelines, according to the managing director at the time, were an outcome of internal processes at Swedfund to guide its activities and not directly the expressions of the owner's intentions (Correspondence with former managing director of Swedfund). In these guidelines accounts are also made of project criteria, i.e., how Swedfund should choose what projects to engage in. Besides pointing at factors of importance when assessing projects, such as for example the creation of new job opportunities, the prospects for integration in the local economy and society, it is also stated that Swedfund should seek confirmation "… that the project is in line with the (host) country governments priorities …" (Swedfund 1991:14). Compared to the directives that began to be issued by the Ministry for Foreign Affairs in 1997 the level of detail and expressed ambition in these early guidelines set up by the fund itself is striking.

The directives from the Ministry for Foreign Affairs have then, after 1997, step by step become more specific. The owner's interest (as expressed by the representatives of the owners on the board) used, according to one former managing director for Swedfund, to depend on who happened to be on the board. Also more generally there appears during the time under consideration here to have been some hesitancy as to what purpose Swedfund was to fill (Karlström 1998:4 and Wall 2006:6). In 1999 the guidelines had become somewhat more specific in that they stated a goal for Swedfund, namely to contribute to the development of sustainable companies in developing countries and in countries in Eastern and Central Europe. Swedfund was

[14] Correspondence with the Ministry for Foreign Affairs (2007-05-15).

also to contribute to promote a sustainable development and a good environment in regard to both working conditions and the external environment. This should be accomplished by risk capital investments, either by investing in stock or giving loans to joint ventures and to risk capital and investment funds. In these guidelines from 1999 the importance of supporting Swedish industry was emphasised by the statement that Swedfund were to prioritise joint ventures with Swedish partners. The instruction on what countries to invest in was no different from the 1997 instruction.

Another set of guidelines was presented in 2005 and has hence not influenced the investments included in this study. The Policy for Global Development had by then been ratified by the Swedish Parliament and Swedfund's business should hereafter as stated in the guidelines be guided by the goals expressed in this policy. The content of the guidelines had not changed that much compared to 1999. It was stressed however that competition with private financiers should be avoided and only such projects where financing from other suitable sources were deemed out of reach should be approved. Swedfund were to continue to prioritise investments in the least developed countries which qualified for ODA. Investments in countries higher up on the income scale could be considered if there existed so called market imperfections.

2005 guidelines still contained no clarification as to which of the goals (promotion of Swedish companies, sustainable development and profitability[15]) should be given highest priority when investments were selected. Informally it appears however to have been clear that the development aspect should have the highest priority in the investment selection process (Interview with former managing director for Swedfund, Olle Arefalk 2007-10-08).

The lack of written instructions and clear intentions from the owners seems however to have created some flexibility about what to prioritise in different circumstances. In some cases the value of establishing a Swedish company on a new market/region appears to have been considered more important than the fact that the development impact prospects of a particular investment may have been limited. This relative freedom of interpretation was finally abolished with the guidelines of 2007. Here it is clearly stated that the number one goal of Swedfund's activities "is to contribute to the goal for Swedish development cooperation by means of investments that contribute to sustainable economic development in those countries in which Swedfund invests." (www.swedfund.se /Corporate Governance/ Guidelines)

Since Swedfund was established in 1978, originally as foundation and after 1991 as a limited liability company, the Swedish government has, up until 2006, disbursed mSEK 920 to the company. Of these, mSEK 465 were designated to the company's activities in developing countries and mSEK 455 have been allotted to investments in Central and Eastern Europe. In the amount reserved for activities in Central and Eastern Europe, mSEK 240 were for a special initiative to rehabilitate the financial sector in the Baltic countries. This initiative was handled by a Swedfund subsidiary. In

[15] The profitability requirement on Swedfund had been gradually sharpened during the 1990s. In 1997 the business goal had been that the proceeds from the investments would cover 40% the costs of the investments over a rolling three year period. In 2005 Swedfund were to strife against achieving a return on their capital equivalent to the yield on one-year Treasury bills. In April 2007, the return requirement was adjusted to cover the average yield on one-year Treasury bills over a seven year period. A seven-year horizon was chosen to reflect the return over a typical business cycle and not one or three years only.

2006 Swedfund appropriated bSEK 1 to be disbursed over a period of three years beginning in 2007 (Prop. 2006/07:1, p. 59).

3.2 The size and allocation of Swedfund's investments

In 1993 Swedfund had an investment portfolio of 47 companies, in 25 countries, with a value in terms of total commitments equal to mSEK 122. At the end of 2006, the value of the total commitments had risen to mSEK 1 289, and 66 firms in 31 countries. Figure 3.1 below shows how total commitments have risen over the years and Table 3.1 below presents summary statistics of Swedfund's portfolio.

The value of Swedfund's portfolio has grown significantly over time, while the number of firms and the number of investment countries have remained more stable. The result is an increase in value of each commitment with the average commitment increasing from around mSEK 2.5 in 1993 to mSEK 19 in 2006. The number of portfolio companies has ranged from 47 during 1993/94 to a maximum of 72 around 1999/2000. The value of invested shares, loans and guarantees has risen by more than 460 per cent since mid 1993.

In comparison with other DFIs, Swedfund's portfolio is relatively small. The Association of European Development Finance Institutions (EDFI) reported that its members had bEUR 10.5 invested in 2843 projects at the end of 2005. Thus, the average project size of these DFIs was mSEK 34.4 (mEUR 3.7) to be compared with Swedfund's average project size of mSEK 15.28 (mEUR 1.6). A comparison of portfolio value with the European sister organizations in EDFI sets Swedfund at place number 11. The European DFI with the highest valued portfolio in 2005 was the German DEG with mEUR 2 750, the British CDC with mEUR 2 090 and the Dutch FMO with mEUR 2 0341. The comparable multilateral institution IFC had a portfolio value of mEUR 15 839 in June 2005, more than 100 times larger than Swedfund. The relatively small size of Swedfund suggests they have a large cost per investment. For 2005, total commitment per employee was around mSEK 65. The comparable figure (approximation) for FMO was mSEK 95.

Table 3 1 and Figure 3.2 below reveal that Swedfund, during 1993 and 2005, invested relatively more in shares than in loans and guarantees. This profile does not look the same for all the EDFIs, some like British CDC only invest in funds while others like German DEG focus more on loans. Lindahl (2006) claims that Swedfund by choosing to focus on direct investments through Swedish companies have chosen a profile more akin to private risk capitalists than to that of traditional international development cooperation.

Table 3 1 Description of Swedfund's investment portfolio

	1992/93	1993/94	1994/95	1995/96	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
No. of countries	25	28	29	31	33	31	33	34	31	32	26	28	30	31
No. of portfolio companies beginning of the year	49	47	55	54	64	71	72	72	66	67	61	54	55	66
New invest. Companies during the year	4	11	5	22	17	7	7	7	8	6	5	9	14	6
No. of divestments	6	3	6	12	10	6	7	13	7	12	12	8	3	5
No. of portfolio companies at the end of the year	47	55	54	64	71	72	72	66	67	61	54	55	66	67
Value of shares (mSEK)	73	117	91	222	314	347	311	237	290	255	249	278	398	376
Value of loans (mSEK)	49	41	62	132	154	174	157	92	39	49	146	178	238	312
Value of guarantees (mSEK)	1.5	0.3	0	8	14	14	47	54	81	59	57	50	22	0
Sum of shares, loans and guarantees (mSEK)	122	158	153	362	482	535	515	383	410	363	452	506	658	688
Sum of investment value per portfolio company (mSEK)	2.63	2.88	2.83	5.66	6.79	7.43	7.15	5.80	6.12	5.95	8.37	9.20	9.97	10.27
Contracted undisbursed investment end of year (mSEK)					103	97	100	140	201	185	216	151	526	360
Total committed	122	158	153	354	731	829	939	720	758	677	825	851	1350	1289
Total commitment per portfolio company (mSEK)	2.60	2.87	2.83	5.53	10.30	11.51	13.04	10.91	11.31	11.10	15.28	15.47	20.45	19.24
Return on Equity (%)	5.4	0.9	2.5	2.5	2.6	-1.5	-0.4	14.7	4.1	3.2	2.4	9.9	4.8	6.6
One-year Treasury bill rate	7.80	8.16	9.30	5.89	4.51	4.35	3.55	4.50	4.12	4.33	3.07	2.32	1.88	2.74
No of employees		12	13	17	16	16	19	21	18	16	16	16	18	19

All values are in millions of Swedish kronor (mSEK). Values of shares and loans are book values. Return on equity is "Net Income" (corresponding, after tax) over the book value of "Shareholders' Equity" taken from Swedfund's financial statements.

Figure 3.1 Total commitments (mSEK)

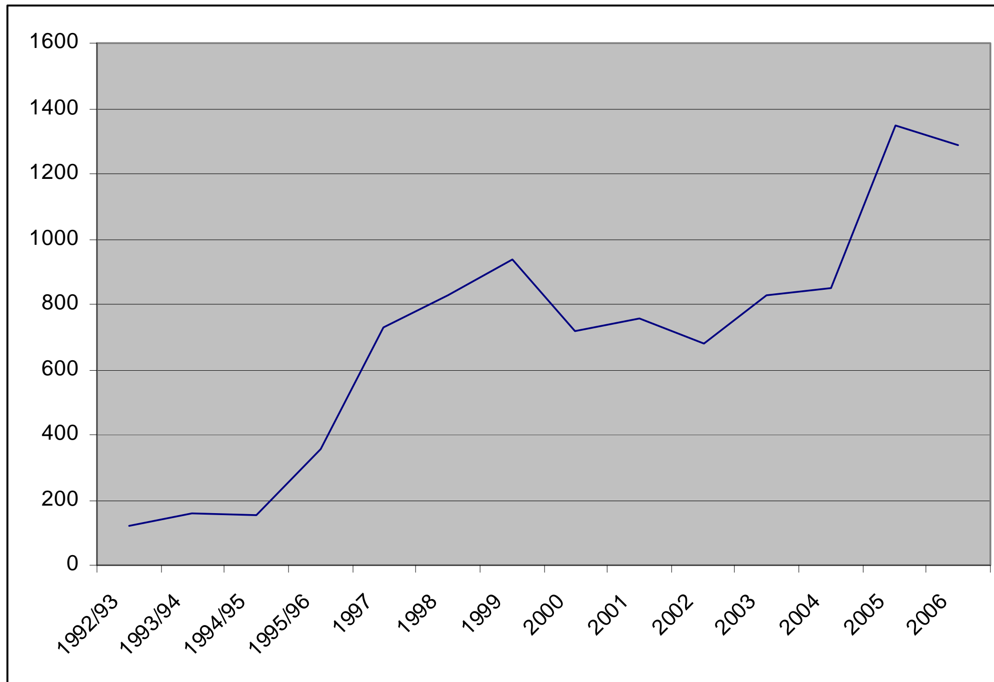


Figure 3.2 Book values of shares, loans, guarantees and undisbursed commitments (mSEK)

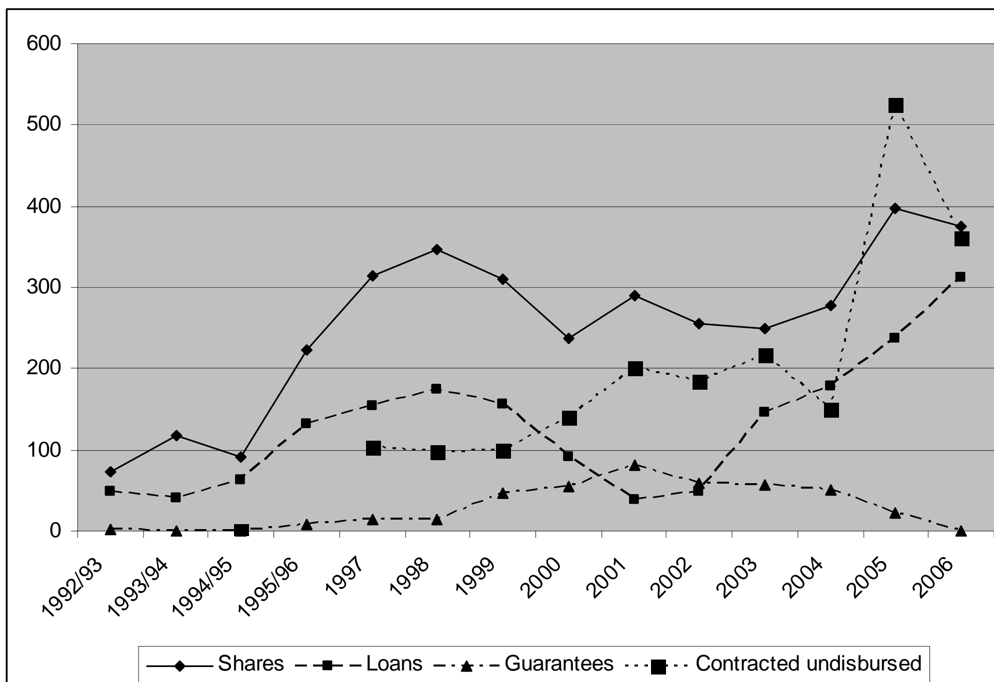


Figure 3.3 below shows disbursements to different continents and Figure 3.4 disbursement over different sectors. It is difficult to trace any strong geographical

trends in Swedfund disbursements between 1999 and 2005.[16] This is mostly because single investments have a heavy impact on the portfolio composition. When it comes to numbers of investments to different sectors, infrastructure and energy, financial services, manufacturing, agro business and services dominate.

Figure 3.3 Disbursements to different continents (mSEK)

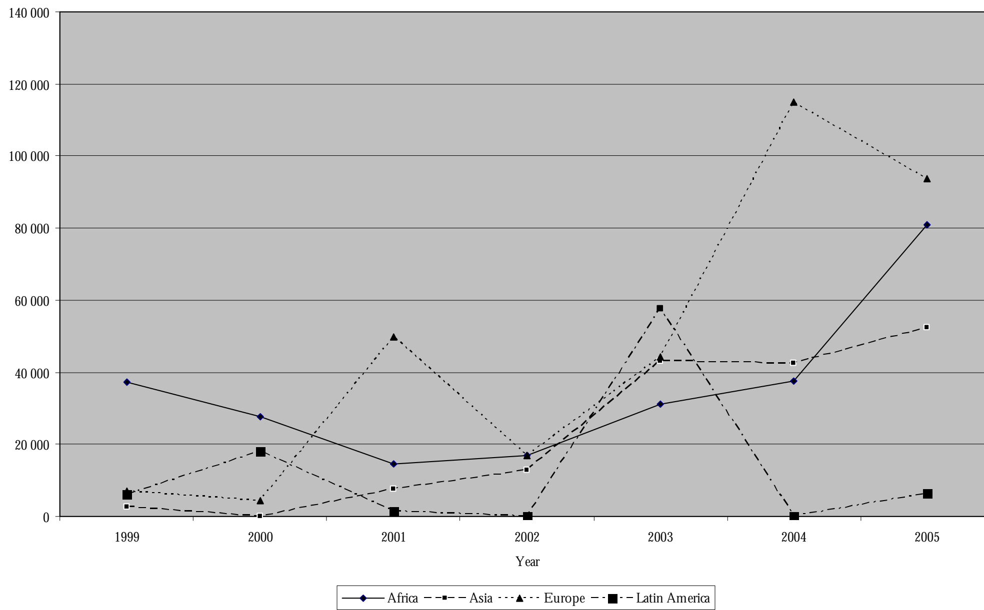
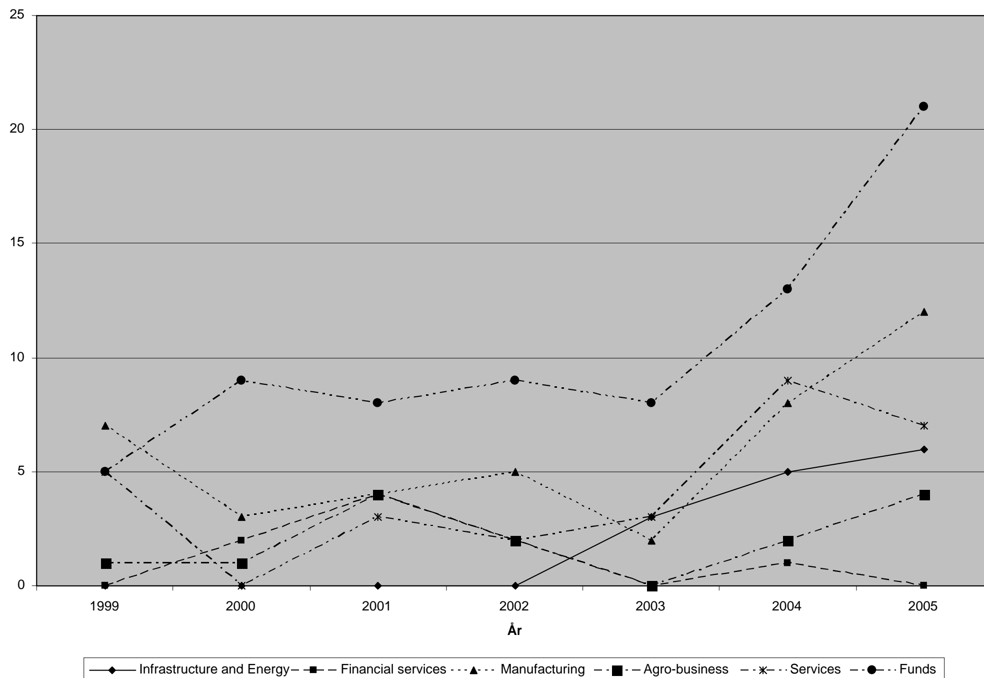


Figure 3.4 Number of disbursements per sector and year



[16] For these graphs, at the time the data was collected, we were only able to obtain data from 1999 up to 2005.

3.2.1 Earlier reports on Swedfund

No independent evaluations initiated from outside Swedfund have so far been performed. Different reports have been written on for example the possible future direction of Swedfund's operations. One such report was written by Bo Karlström in 1998. Swedfund had then in 1996 and 1997 requested additional capital. Karlström wrote that this request ought to be granted (which it was), but that it should be followed by a thorough evaluation of the business and its results after some seven to ten years. (Karlström 1998:3) Carin Wall wrote a similar report in relation to Swedfund's request for additional capital in 2005, a request which was granted despite no evaluation of the type recommended by Karlström having come about. (http://www.regeringen.se/content/1/c6/02/39/60/a5417095.pdf 2007-11-20). Andante Consultants conducted, on the request of Swedfund in 1997, a study over what had happened to 37 companies after Swedfund had made its exit. This report has some similarities to the evaluation undertaken by SADEV in that the focus is on "development effects". They found that slightly more than 70% of the companies had some type of production going although this was not always profitable. The original business concept had survived in not quite 50% of the companies which had continued to exist. They also found that there was only a minority of small projects among those that could be considered successful and just one large project among the failures (Forss et al., 1997).

There are most likely several reasons as to why no evaluation of Swedfund has been initiated from outside of the organisation. One reason is probably that no organisation with the specific mission to evaluate all Swedish official contributions to international development cooperation has previously existed. Another reason could be that Swedfund unlike Sida and other organisations within the framework of Swedish international development cooperation is a joint stock company with limited liability. This has special implication as to how accessible the information on Swedfund's activities is.[17] The fact is that the more detailed information on the investments is not accessible at all unless Swedfund gives their consent. Such consent has in the case of this evaluation been dependent on SADEV signing a document stating our obligation to preserve the secrecy of the companies included in the study. This situation can be attributed to the official secrets acts which exist to protect companies' trade secrets.

SADEV has had full access to Swedfund's archives but this state of affairs of course has implications as to how we can present our results and conclusions. This is made even more true since Swedfund's investment are spread over many sectors and countries. This makes it impossible to talk about for example the success or failure of investments in the food industry in South East Asia. If Swedfund had participated in such investments it is likely that this would concern a single company in a single country which would then be very easy to identify.

[17] There are of course agencies such as Statskontoret and Riksrevisionen which could have been assigned to do an evaluation of Swedfund. The fact remains however that no such evaluation has been undertaken.

4 Performance

4.1 Private sector development outcomes

In the following sections we present the results of the qualitative analysis of the sampled investments. The analysis is structured around specific indicators which correspond to those discussed in section 1.2.1. We have studied all information available to us on the individual investments and have, case by case, tried to form an opinion on whether factors necessary for the different indicators appear to be present. Is there for example anything in the documentation which shows that the project company will link up with domestic suppliers or purchasers? If this is so, one can assume that the investment in question should have some type of market expansion effect.

The fact that Swedfund's investments are thinly spread over a number of sectors and countries makes it difficult to say anything general about the private sector development effects of Swedfund's investments. This state of affairs is not unique to Swedfund. Impact assessment of Swedfund's Danish counterpart IFU, showed that since IFU (just as Swedfund) had not systematically kept in contact with exited projects it was difficult to assess their long term development effects. Such an exercise is made even harder since it is always difficult to attribute changes in the economy to one individual investment. This is especially true of investments which take place in large economies (Danida 2004:53).

4.1.1 Competition

Competition is one of those indicators where only field visits can really determine how the competitive situation has been affected by a certain investment. We have found that 15 of the companies can be said to have contributed substantially to competition within their sector. These are companies which we judge have either improved on a monopolistic situation or more generally contributed to create a more competitive market situation. 11 of the companies appear not to have contributed to the competitive situation[18] and for 18 companies we do not have enough information to comment on this issue. (8 of these were funds). The results appear to be very mixed here and this is one type of indicator which can be interpreted in several different ways. That competition is something positive which should be encouraged must be considered to be a generally accepted idea. DFIs can however end up in cumbersome situations if they invest in markets where there for example is already a high domestic demand for a particular type of labour, or invest in funds which face strong competition for profitable investment proposals. We have come across both types of cases when we have studied these past investments. For several of the cases we have looked at there appears to be competition for qualified workers. This was for example so for two of the businesses for which field visits were made. One of these is engaged in software research and development and the other in production of industrial batteries. The software company which is a subsidiary to a Swedish company is

[18] This category mostly contains companies which for different reasons have gone into bankruptcy or which are barely functioning and therefore not likely to be putting up much competition.

located in Sri Lanka where there is a high demand for software developers. However, today's shortage of software developers was not so acute when the investment decision was taken. It is more a reflection of what has now become a successful growth sector in the Sri Lankan economy. For the Indian company that produces industrial batteries, the issue seems not to be to find engineers or blue collar workers but to find accountants, which is a worldwide phenomenon.

It is not that it is inherently wrong to enter a competitive market, but the value added of such an investment should be lower than for alternative investments.

We have examples of where an investment has clearly raised competition in a certain sector and thereby drawn resources and employment opportunities to under-developed regions. When an investment introduces new or very improved technology into a country, this company can get a competitive edge which allows it to take a dominant position on a particular market. From the perspective of the national economy this is however not necessarily a bad thing. It can be that this "new" production provides goods which have previously been imported. We also have examples of when the portfolio company in which Swedfund has invested has broken a previous monopoly and in this directly contributed to higher levels of competition.

4.1.2 Market expansion

It is clear that the potential for linkages to the surrounding economy varies substantially with the type of investment at hand. Among the cases in the sample there are examples of advanced technology investments with a small number of employees and where equipment has been imported from for example Sweden. In these cases the backward linkages must be rather weak. In 15 of the cases we have concluded that there have been none or only minor linkages to the surrounding economy. We have however also seen examples of where the start-up of a production facility has meant that poor producers have found a commercial outlet for their produce which did not exist prior to the investment. In other cases, notably the IT/telecom sector the linkages are primarily forward, creating for example a better infrastructure for information. This enables for example a smoother market interaction between producers and potential buyers. In 11 of the cases we have concluded that there should be substantial linkages to the surrounding economy. For 18 of the investments we have not been able to gather enough information to be able to assess the existence of backward and forward linkages from the investments. Of those 18 investments 11 were in funds.

One contribution to the academic discussion on productivity gains of foreign direct investments maintains that these gains are more likely to take place through backward compared to horizontal linkages. They are also according to this line of argument more likely to take place in domestic market oriented rather than in export oriented industries.[19] We have therefore tried to study the orientation of sampled companies in relation to export and domestic industry orientation. A majority of the companies in this sample have primarily targeted the domestic market in the respective countries rather than focusing on exports, which could be regarded as positive in light of the theoretical discussion referred to above. Where they source their inputs to production

[19] See discussion in appendix B

is of course also of vital interest here. Here there results are more mixed. Also within the different sectors it is difficult to discern any pattern in what would be most common, domestic sourcing of inputs or imports. Quite a number of companies appear to import a major share of their inputs (besides labour) and sell their produce on the domestic market.

4.1.3 Private ownership and entrepreneurship

Because Swedfund's investments are demand driven and the focus is on joint ventures between Swedish and local investors, in combination with some limited investments in local investment funds, they have not participated often, or specialised in the transfer of ownership of state-owned firms to private ownership. Likewise Swedfund cannot be said to have promoted local entrepreneurship by actively investing in local start-up firms. Instead Swedfund has chosen to invest in local investment firms, which in turn directly invest in local firms. In that sense, Swedfund indirectly promotes local entrepreneurship.

Two cases in our sample have contributed to the privatisation process in two African countries. In addition, we have two examples where Swedfund has participated in a so-called BOT investment, short for "build – operate – transfer". These two investments are of very different character. One concerns a large infrastructure investment where a group of private and institutional investors have taken over the management of the facility from the state for a designated period of time. The other case is a start-up, a so called green field investment which has been given tax exemption for a number of years on the condition that the investment will be transferred to the state after the stipulated number of years. Taken together this still means that within this sample Swedfund cannot really be said to significantly have expanded private ownership at the expense of public ownership.

4.1.4 Frameworks for markets (Creation or strengthening of public and private institutions that support the efficiency of markets)

Not surprisingly given the small size of Swedfund's operations, we have seen very few indications of such effects. In the cases where the investors actually managed to successfully lobby for such a thing as changed regulations which we have found in four of the cases, Swedfund rarely appears to have been active in the process. One opinion from within Swedfund is that they are generally too small as an organisation to be able to influence these types of issues. Affecting internal rules and regulations of a specific country can also however be difficult for bigger actors. The cement producing company Cimbenin in Benin is one case in point where owners and diplomats have been trying unsuccessfully to convince the government of Benin to liberalise the price of cement for several years. Cimbenin states that this is set at too low a level in relation to the prices of raw material needed for production. According to Cimbenin and Swedfund the factory is modernised and effective but still has to struggle to survive due to the imbalance in cost of production in relation to that of inputs. This type of behaviour from governments could send negative signals to potential investors in other sectors.

4.1.5 Development of financial institutions and financial markets

Besides the fund investments we have not been able to find that Swedfund's investments have contributed to the development of financial markets. It seems on the other hand reasonable to assume that it is primarily those types of investment that can actually contribute to such development.

4.1.6 Transfer of technology, knowledge and business practice

In our opinion it is more common than not that investments during this period contained some type of education of the workforce, what can be called knowledge transfer. We estimate that some type of transfer of knowledge and business practice took place in 21 of the studied investments, for 15 we do not have enough information to come to any conclusion. In 8 of the cases we have not found any indication that such transfer took place. There are examples of industry specific training as well as more general training in accounting, management, sales and marketing. If a trend can be discerned in this it is that the larger the company is, the more dedicated they are to these types of activities. It is, however, symptomatic that even companies that have been established in developing countries for many years are often still dependent on expatriate expertise for the management of the company. How much focus there has been on education and knowledge transfer also generally varies substantially between but also within the same sectors.

One aspect of knowledge transfer is how the surrounding economy benefits from this increased competence. That is to say, how can anybody else except for the concerned company utilise the transferred knowledge? The only straight forward way in which this can happen is when employees shift workplace and take their acquired competence to a new company. This in turn however requires industrial mobility. A majority of the companies who answered the questionnaire stated that they had a low level of turnover of their work force. This implies that the companies are either providing attractive workplaces or that there are few alternative employment opportunities available, or a combination of these factors. In either way this raises some doubt over the degree to which other domestic companies can benefit from the knowledge transferred through the Swedfund portfolio companies.

Technology transfer appears, perhaps somewhat contradictively not to be as prevalent as knowledge transfer. Our conclusion is that 13 of the investments in the sample contained this component. For almost the same amount of investments, 14, we have not enough information to comment on this issue. In 17 of the cases we have not judged this component to have been present. This depends of course on how one interprets the concept of technology transfer. It seems however relatively uncommon that a certain technique introduced into a portfolio company has been totally novel to the country in question. We have come across such cases in for example the consumer industry sector, but more commonly the new or expanded companies have brought modified, more effective and in some cases what appears as more environmentally friendly ways as opposed to totally new ways of producing a good or service.

4.1.7 Demonstration effects

The occurrence of demonstration effects has been difficult to establish and yet it is commonly argued that this is an important contribution of the DFIs. The only way to

determine with any accuracy if demonstration effects have taken place is probably through thorough field visits. In 23 cases of the sample we do not have enough information to comment on the possible existence or absence of demonstration effects. 11 of those were fund investments. In the cases where companies for different reasons have gone into bankruptcy this could send negative signals to other potential investors and in that way function as a negative demonstration effect. We have deemed that there are 11 such cases in the sample. This category then also includes examples of investments that are continuously struggling to survive or that encounter constant problems in the country of location. We have also come across examples in the material of investments which have been at the frontier of certain markets and where followers have copied the strategies of the companies which Swedfund has been engaged in. In 10 of the cases we feel that we have enough information to conclude that the companies in question should have generated positive demonstration effects.

4.1.8 Standards for corporate governance and business conduct

A majority of the portfolio companies who answered the questionnaire stated that Swedfund had taken an interest in the company's accounting standards. During the period of investigation, Swedfund did not have a code of best practice, something which has been developed later. One can perhaps assume that there was an implicit code applied in the screening of the projects and that in the cases where Swedfund has had a board representative they worked to improve corporate governing practices. We have seen examples of such efforts in the correspondence between Swedfund staff and other board representatives when meetings have been called with too short notice or when other standard procedures have not been followed. To make any quantification on this influence is however difficult.

4.1.9 Development of physical infrastructure used by other private parties

From what we have been able to conclude quite a few of the portfolio companies have brought about infrastructure that has been available to or used by other parties. Information about this issue has not been directly available in Swedfund's documentation. To form an opinion on this issue we have looked at what type of investment has taken place and used information from the questionnaires. In four cases such infrastructure appears to have been developed. An example of this is for example an access road to a port and cold storage facilities. For 15 investments we have judged that no such infrastructure has been developed. For as many as 25 of the investments we have not been able to assess whether such development has taken place or not.

4.2 Environmental performance

That the instructions to promote a sustainable and healthy environment were not formulated before 1999 does not, of course, mean that such considerations were not taken earlier. There is however a considerable variation in how explicit environmental concerns have been accounted for in the investment proposals presented to the board. This pattern has some logic in that it is generally the bigger projects, that one can assume will have a bigger impact on the environment, which are more thoroughly analysed in terms of environmental impact. In these situations, the investment partners have generally included environmental reports along with the business proposal.

Overall our opinion is that environmental concerns appear to have been taken when investments have been proposed. What we find lacking in the documentation is relatively easily accessible information on what has happened with the environmental issues after an investment was made. It has in some cases been difficult to find out if suggested improvements have been carried out or not. There has been scarcely any information on the observance of environmental regulations during the period under consideration here.

4.3 The additionality of Swedfund

We have some indications that not only investments for which other financing could not be found have been undertaken by Swedfund. Of the 12 companies who answered our questionnaire, 8 stated that the investment would have gone ahead without Swedfund.[20] We also have an example of a company who have not answered the questionnaire but where Swedfund themselves state that it is doubtful whether the investment would not have gone ahead without them. In this particular case, it is stressed in the investment proposal to the board that the parties are financially strong and have experience of joint ventures abroad. Then there are less clear cut cases where a majority owner states that the project would not have gone ahead if this type of financing (not strictly commercial) had not been available. Because of the involvement of other DFIs they are however less certain on how important Swedfund's role was. This discussion points at a difficulty that is so to speak inherent in the business of a DFI like Swedfund. If they only accept investment proposals after all other possible financiers have declined, they run a risk of getting a portfolio which does not generate any or very low returns.

The issue of additionality is complex and concerns other aspects than merely whether the investment would have gone ahead without the involvement of Swedfund. One aspect is also how an actor like Swedfund has improved on the design and function of the investment. We have discussed the issue of involvement in structuring the ventures with a number of the investment managers concerned. How involved they have been appears to vary considerably with the different investments. In some cases Swedfund has come in after the venture per se has been launched and additional capital is needed. In these cases Swedfund for natural reasons have not been deeply involved in how the investments were structured. In other cases, Swedfund might have been contacted at a much earlier stage and by partners without any experience of working abroad and in developing countries. In these cases Swedfund can be heavily involved and even assist the companies in writing their investment proposal. All in all of the cases we have looked at we are of the opinion that Swedfund's additionality has been high in 12, medium in 4 and low in 13 of the investments. In 18 of the cases we do not feel that we have enough information to form an opinion on the issue.

4.4 Swedfund's work quality

This is an aspect where we feel the need to stress that the routines practiced by Swedfund can have changed, because the investments in our sample have all been

[20] Companies may have an interest in not fronting that they have been short of funds or have had difficulty in obtaining credit on commercial terms, these answers should therefore be regarded with some caution.

approved before 2003. We know that work has been initiated parallel to this evaluation in transforming the internal routines. This means that our results should be reasonably applicable at least up to recently. Here we have primarily looked at screening procedures, monitoring and documentation of the investment cycles.

The screening processes come out as more standardised and therefore easier to compare than many other aspects of the investment cycle. The screening documents generally include a so called SWOT analysis (Strengths, Weaknesses, Opportunities and Threats). In what detail these factors are treated however varies between the investments. We see a tendency to put more focus on the development aspects of the investment the later in time the investments have been made. Still there exist substantial variations in how much potential development effects are elaborated upon in the different investment proposals. It cannot be ruled out that these variations partly reflect the different priorities of the investment managers as well as the possibly varying motives for the investments.

The monitoring of the investments has been much more difficult to follow. There seems to be several different reasons for this state of things. We have concluded that one reason for this is the varying filing fervour of the investment managers. Although all the project files contain a table of content, for many of the investments the various labels were not filled with any information.

"Difficult investments" as compared to "good investments" does according to the investment managers we talked to, generate more correspondence to file. This will give a "false impression" that the former has been better monitored. In general, problem free investment does not need as much monitoring as the more difficult ones. This could be the case for many of the investments. However, we have found examples of investments which have so to speak gone down the drain and that appear to have been "monitored" mostly over the phone. This monitoring has hence not left any traces in the written documentation.

At Swedfund, some investment managers appear at times to hold different views on how the supervision of the investments should be documented. This is apparent in, for example, the correspondence between different managers when the responsibility of one investment has temporarily been taken over by another manager. Complaints have then arisen that it has been difficult to trace the events of one investment.

The consequence of this varying degree of documentation is that it becomes difficult in retrospect to trace what actually happened during the life time of an investment, besides pure financial transactions. Documentation is of course crucial in terms of accountability and if one wants to learn from past experiences. The current situation seems to be that this knowledge rests with the individual managers and this is hardly satisfactory.

4.5 Effectiveness

We have stipulated, with reference to the objectives of Swedfund during the period, that to fulfil the objectives of an individual investment the company should as a minimum requirement become financially sustainable in such a way that Swedfund could exit with a positive return on their investment. We have not considered other

types of development outcomes for those investments which were liquidated during the time of Swedfund's involvement. The fate of the companies even within the different categories varies some. Some have been more successful than others. How well the goals of the individual investments have been fulfilled varies between and within the sectors in the sample. In some sectors all investments have fulfilled their goals while in others a majority has not. We have concluded that 18 of the investments in the sample have fulfilled their goals. In 4 of cases it is yet too early to tell. In 11 of the cases we do not have enough information to draw any conclusions. We consider 11 of the investments not to have fulfilled their goals.

When looking at general effectiveness, it is important to remember the rules of the game. All investments involve risk in the sense that decisions are taken on incomplete information regarding the outcome. Due to unforeseen events, some investments will perform better than expected, others not so well and some will fail completely. Thus, *ex post* it is the outcome of the total investment portfolio that matters, not the individual projects. This is so because in relation to the expected result of an individual investment, the actual outcome is to a large extent affected by randomness. Furthermore, Swedfund operates to a large extent as a venture capital fund. This means that yearly return measurements are not always the most relevant. Venture capital typically operates with longer horizons. A benchmark of seven years is common for these types of investment activities, which represents the time it takes to develop a project into a financially sustainable firm.

One measure of the overall effectiveness is the financial return on investments. Appendix A discusses the financial performance of Swedfund based on their financial statements. Based on historical performance, Swedfund shows relatively low figures for Return on Assets and other standard return measures in comparison with benchmarks such as the return on a global emerging market fund. The difference between the return on an emerging market fund and Swedfund's return represents a real economic cost for the society. Investing in less developed countries involves some degree of risk. Over time, the return on emerging market funds show what investors need in compensation to invest in these particular markets compared with investing in all other markets.

The problem is not that Swedfund show low return figures on their overall investments. The problem is the lack of discussion as to how the low return figures in the financial statements should be understood. On the one hand, Swedfund has only recently been subject to a clear return requirement say in the form of a benchmark figure such as the Swedish one-year Treasury bill rate. The focus has been on private sector development and development effects in general within the Swedish policy for global development. On the other hand, Swedfund is operating together with private investors where the return on investments is the most critical issue of all. In our opinion, nothing has prevented Swedfund from initiating a discussion about the return on their investments to inform the owner about how their business is performing. For instance, Swedfund could in lack of clear return targets have formulated their own benchmark on the basis of an analysis of development effects and the intentions of the Government. In their financial reports they could have discussed if they have been able to keep the real value of their equity at least constant. Other questions that can be raised are to what extent the result has been influenced by cur-

rency losses and gains, to what extent would it be possible to measure if the value of the development goals has exceeded the return of a similar risky benchmark portfolio held by the market? These are examples of additional information that we think Swedfund could have discussed in their yearly financial statements to improve on their accountability to the owners.

4.6 Relevance

Here we have mainly tried to assess whether the investments led to the establishment or development of profitable companies. Because the primary goal of Swedfund is to promote the establishment of such companies, this factor becomes closely connected to the aspect of effectiveness. Because Swedfund's goals were rather unspecific during the period which our study covers, it has been difficult to find investments which do not in some aspects match these goals. If they are not obviously very beneficial to a country's or region's economic development, they can help to establish a Swedish company abroad or focus on promoting more environmentally friendly production. This is just to exemplify the way it is or has been possible to argue for the relevance of different types of investments.

One sector where the relevance level from a private sector development perspective seems to be consistently high is the finance sector which is made up solely of fund or fund management investments. Here the additionality is however perhaps lower and the connection to the Swedish industry becomes weaker if not non existent. Generally one can however conclude that there appears to be high relevance of the investments in relation to the goals of Swedfund.

We had also the ambition to study the relevance aspect of the investments from the perspective of the wider Swedish international development cooperation and from the perspective of the "receiving countries". It became clear early on however that Swedfund had not in any structured sense made these considerations when deciding on investments. This despite that the early internal guidelines stated the intention to make sure that the proposed investment were in line with the concerned country's development plans. Since no official demands of taking such considerations have existed during the major period studied here, it seemed rather ad hoc to try and assess this aspect. This topic is dealt with in more detail below when Swedfund's contribution to Swedish international development cooperation is discussed in more general terms.

4.7 Information from Swedfund's partners and portfolio companies

Swedfund deals with many different types of so called strategic partners, usually a Swedish company. One finds a big difference in the reporting standards when bigger established companies are involved in the investments as compared to smaller more "entrepreneurial" companies. Swedfund's bigger investment partners seem (not surprisingly) better able to press the portfolio companies to send the agreed information to Swedfund compared to smaller companies. The investment managers express a hesitancy to press the portfolio companies too much with what the managers claim that the companies find to be burdensome bureaucracy. The managers also express a certain resignation when it comes to certain portfolio companies' lack of adherence to

the prearranged reporting procedures. To take any more serious measures besides complaining does not appear to be a viable option according to the investment managers we have talked to.

That smaller companies do not always have the administrative capacity to fulfil the agreements on reporting seems to be acknowledged by individual managers. When discussing the exit of one troublesome and small investment in an internal memo, the responsible manager states that it is apparent that the company in question does not have the capacity to deliver the kind of information required by Swedfund. According to the investment managers we have talked to the consequence of this has been a move towards bigger investments and stronger partners. A trend showing certain concentration of investments can also be seen in Swedfund's financial statements (Swedfund 2006: 10).

Not to press the portfolio companies beyond what is reasonable is of course important in order to retain the attractiveness of Swedfund towards its existing and potential clientele. One could however regard it as reasonable for clients to expect somewhat more extensive progress reports compared to what private financiers would demand. This since Swedfund is supposed primarily to provide financing for projects not available from other financiers.

Besides the reporting procedures, other differences between the larger investment partners and the smaller entrepreneurs shows in Swedfund's investment files. It is apparent that the larger companies generally perform more thorough preparations before they enter into an investment project. The larger companies generally seem to produce high quality feasibility studies while we rarely found such studies in the files when Swedfund had cooperated with smaller companies. This is important since it seems as if the investment managers at Swedfund to a quite large extent rely on the information provided by the investment partners when they write their project presentations for the board. This means that the quality of the investment proposals becomes very important compared to if Swedfund staff made exhaustive inquiries themselves before entering into an investment. This is definitely not to say that facts are not checked by the investment managers. When comparing the material sent by the investment partners with the investment proposals presented to the board, it shows that the wording in these two types of documents was in many cases very similar.

4.8 Swedfund as an enhancer of Swedish international development cooperation

When we have analysed Swedfund's investments we have tried to establish whether they can be said to support the policies of Swedish development cooperation policy. One has to take into account of course that this policy is in a more or less constant state of change. Our original intention was to take the Swedish Policy for Global Development as a basis for assessment of Swedfund's effects on private sector development. Methodological considerations on how new investments were to be included in the sample in combination with the relative newness of this policy however made this unpractical.

When it comes to private sector development internationally and in Sweden, interventions are today generally structured around two approaches or strategies, pro-poor growth and creating an enabling investment climate. (These two approaches can be and are of course sometimes combined). How relevant are then the operations of Swedfund in relation to these two approaches? The focus of Swedfund's activities has been and the ambition is to continue to focus on direct investments which target the micro level of the economy. This implies that Swedfund's resources are not targeted at interventions to improve on the investment climate which take place on the meso and macro level. How well then do Swedfund's operations fit in with the other strategy, the pro-poor growth approach? The answer to this question is that it *could* fit this approach very well (if that is what one desires). If it has done so during the period studied here is more questionable.

The ambition to take developmental aspects into consideration has surely been present all along. But from the sample of projects we have studied it has not been clear that investments have been chosen consistently on the basis of their potential to affect poor and disadvantaged groups in a particular society. The logic behind the investment decisions appears rather to have been that as long as the ventures are not obviously harmful, the destination of the investment will in some way benefit. Academic research indicates that such an assumption may be somewhat simplified.[21]. But strictly besides that, this issue definitely touches upon the value added to developing countries by an organisation such as Swedfund and how this value could be raised.

One factor which appears to hinder Swedfund from more actively and strategically enhance the policies of Swedish development cooperation is the fact that the demand for Swedfund's "services" has been too low to allow for strategic picking and choosing between investment proposals. The reality appears to be that there have been so few good investment opportunities that it has been impossible to turn these proposals down on the grounds that they do not fall within the priorities of Swedish development cooperation policy (*or* the policies in the developing countries for that matter).

Whether or not this is a problem depends on the chosen perspective. The prevailing position within Swedfund appears to be that all business (with some few exceptions) is good for economic development and can hence be justified. Without contradicting this position one could argue that scarce resources (i.e. capital available for these types of investments) could be used more effectively by targeting those investments that could give comparably "higher developmental returns."

Another position which is possible to take is that Swedfund could focus only on easing the establishment of Swedish companies in developing countries and emerging markets without having to take into account specific "developmental concerns". This would be the logical consequence of accepting the idea that all business established in a country (except the obviously harmful)[22] are basically positive for economic development. If one accepts this idea then DFIs and perhaps especially those who are so clearly business oriented as Swedfund, stand out as something like an anomaly. The heaviest weighing argument for keeping all these national DFIs instead of chan-

[21] See the discussion in chapter 2 and also appendix B
[22] For example ventures involving child labour, or are harmful to the environment.

nelling money through the multilateral IFIs, must ultimately be rooted in the interest of furthering the home country industry. This since the trend in international development cooperation otherwise is to harmonise, align and untie aid. If the demand for Swedfund's services from the Swedish industry for various reasons is low then one can perhaps question if this is a business which should be administered by a government owned company.

An employee at the IFC voiced the opinion that from an economic efficiency perspective it can hardly be effective to have all these bilateral DFIs due to the overhead costs they bring. It is sometimes suggested that the bilateral DFIs are more flexible and faster compared to the multilateral organisations. This was however countered by an IFC employee with the argument that one has to check thoroughly on what grounds they possess this advantage. If the bilateral DFIs are faster because they do not take all important issues into consideration then this is not such a good comparative advantage. During an interview with staff at the independent evaluation group at IFC the opinion was voiced that if Swedish companies are comparatively better than other companies, have unique products etc., Swedfund could have a comparative advantage vis-à-vis the multilateral IFIs. This argument however rests upon the supposition that Swedish companies would also be less well equipped than others to compete for financing through the multilateral organisations.

5 Conclusions and Recommendations

5.1 Conclusions

One immediate reflection is of course that the material – the information which has been the base for the conclusions on private sector development effects has not been sufficient to answer the questions posed to a satisfactory degree. It is also clear that the results which we have still managed to deduce in many cases points in different directions. For some indicators on the private sector development outcomes the results point in a mostly positive direction. Transfer of knowledge, contribution to competition and relevance are examples of such indicators. Other indicators, for example the linkage factor which primarily indicates the level of integration with local suppliers and buyers indicate less satisfying results.

Given the wide spread of Swedfund's investments into different sectors and countries it is difficult to attribute this contradictory situation to any one specific circumstance. We are talking about widely differing types of companies working in very different circumstances. It is however obvious that there are areas which from a development impact point of view could benefit from more strategic prioritisation. To look more closely into the issue of a company's prospect for backward integration in the local economy is one such area. This since research shows that it is primarily by backward linkages to suppliers that technological transfers take place.

The result of the evaluation raises some questions regarding the additionality of Swedfund in the investments it undertakes. A majority of the companies who answered the questionnaire stated that their particular project would have gone ahead without Swedfund. As pointed out this answer may be a result of an unwillingness to admit difficulties in obtaining credit from commercial financiers. This is a very difficult matter to sort out ex post which makes it even more important for Swedfund to show that they brought some additional value to the investment project which would otherwise not have been brought in.

When it comes to the relevance of Swedfund's investments in relation to the goals of the company, we have found that these were generally fulfilled. However, this could partially be attributed to the fact that during the sample period the goals have not been overly specific. Moreover, the fact that there has been more than one goal directing the activities of the company should make it easier to link the various investment intentions to at least one of these goals.

On the issue of effectiveness i.e., whether the individual investments can actually be considered to have fulfilled the more specific as well as the overarching goals. For several of the other indicators the results are rather ambiguous. For about 34% of the investments in the sample it was either too early to tell whether they will fulfill their goals or there was not enough information to tell. For the rest of the investments there was a larger share that can be considered at least reasonably successful and where Swedfund had made or were about to make a profitable exit.

One conclusion is that the routines at Swedfund during the period studied here have not been designed to answer such questions as those posed in this evaluation. Data necessary for an evaluation purpose has not been consequently gathered during the lifetime of an investment and there seems to have been virtually no contact with exited projects. When discussing the work quality of Swedfund this shortage falls mainly under the categories of monitoring and evaluation. The screening process prior to an investment decision has on the other hand in general generated much *potentially* useful information in regards to private sector development effects.

As already stated the monitoring of an investment during its lifetime appears in some cases to have been quite haphazardly documented. There was no follow-up of exited investments during the period we investigated. Without field visits to each and every exited investment, this lack of follow-up on what has happened with the projects after Swedfund have exited renders all attempts at assessing the more long term effects of investments into at best qualified guesses. Swedfund is not alone in this lack of contact with exited investments. The same problem was pointed out by the evaluators of Swedfund's Danish counterpart IFU. This question of follow-up on exited investments again highlights the question of the dual nature of Swedfund. It is a company owned by the state. Because it should promote sustainable development in developing countries it has a mission which goes beyond just doing profitable business. Being such an organisation it is reasonable to expect that it should be possible to acquire information on what results have been obtained given the resources invested.

Such systematic follow-up on exited investments would require larger administrative efforts than have been applied at Swedfund. If Swedfund were to be a privately owned company with its only mission to ease Swedish companies expansion in developing countries no such requirement could be insisted upon. Then it would only lie in the interest of Swedfund to show its potential customers that Swedfund has a successful business model.

Swedfund cooperates with a variety of partner companies and these partners bring industry specific knowledge into the investment. Studying the documentation covering the chosen investments, it seems generally that the bigger investment partners compared to the smaller partners have exercised more discipline on the portfolio companies on sending agreed upon progress reports. One reasonable explanation to this is that smaller companies do not always posses the necessary administrative capacity to press for the delivery of the required information. When comparing the files for the different investments they also show that the larger investment partners usually prepare informative feasibility studies, which was not the case with the smaller investment partners.

The issue of demand for Swedfund's services appears to be one factor that has inhibited more strategic choosing of investments on a basis of their respective "developmental merits". An opinion voiced at Swedfund is that the good investment opportunities have been too few to allow considerations as to how well an investment fits a specific country's development needs.

5.2 Recommendations

We are of the opinion that the work of the investment managers should be "hands on" much in the same manner as it is today. However as the organisation gets more resources from the state budget it should be reasonable to request that more resources should be allocated to monitoring and analytical follow-up on the investments. Swedfund's larger counterparts have independent monitoring and evaluation functions and if this organisation is to grow this should be expected also from Swedfund. Such a function is also part of the good practice standard agreed upon by the MDB-ECG. It would seem important at least to some extent to separate the functions of the investment managers and an analytical evaluating function. All employees cannot be expected to be experts on everything from doing business to analysing the full spectra of development effects. That the routines for documenting the more qualitative aspects of the investment projects are further developed and streamlined is of great importance since this information will be the foundation for evaluating the projects.

It would rest upon this monitoring and evaluation unit to accumulate comprehensive knowledge about the organisation and to make sure that important parts of this knowledge reach all employees. It is necessary to have a unit which can substantially contribute to the institutional memory within the organisation.

Today the investment managers at Swedfund are expected to evaluate business proposals for everything from hospitals to sawmill companies with the only common denominator of taking place in Africa. To develop a more focused and strategic competence in fewer sectors, preferably of such that are of interest to Swedish industry, could also possibly make the company more attractive to its Swedish business partners. This could in turn give Swedfund a larger pool of interesting investment proposals to choose from. In combination with such a development it is also desirable that special regional competence is developed. One idea is that within a comparably small organisation such as Swedfund this type of competence could be combined with that of the monitoring/evaluative unit. This would broaden such a function beyond merely monitoring and evaluation to becoming an analytical support function within the organisation.

The idea of devoting more resources to monitoring and evaluations has initially met with resistance at IFC, according to staff there. What they are discussing is the data collection and writing of the expanded project supervision reports (which has been pointed out has a far more ambitious coverage than we have covered here). Because of the good results these have generated they claim these procedures now have strong support within the organisation. Staff at IFC also argued that thorough ex ante analysis on both return on investments and development effects along with continuous monitoring should not be seen only as a cost. These activities also constitute a way to reduce risks, both financial and developmental. To say that this is too resource demanding is therefore, according to IFC staff, not a convincing argument. It is also pointed out that mechanisms to collect data for these types of reports have also been developed by organisations such as FMO and CDC.

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Appendix A

Profitability Measures

This appendix looks at profit measurements calculated from the Swedfund's yearly financial statements, from 1 July 1993 to 31 December 2006. During the period Swedfund operated under different 'profit' targets. There is a fundamental, implicit target, to be financially self-sustainable. Being financially self-sustainable means that Swedfund cannot spend all its capital money and then go to the Government and ask for more. In practice, being financially self-sustainable means also that an organization must generate an income that covers its own operational costs and at least keep its real value of equity at a constant level. In 1997, a profit target was set approximately as the income from a project covering at least 40 % of the project's cost over three-year rolling periods. In 1999 the requirement was set to a 100 % coverage of the costs. In 2007, the requirement was formulated as a return on equity corresponding to the seven-year average of the Swedish one-year Treasury bill rate.

It should be noted that Swedfund in their yearly financial reporting, as well as in other material, always presents themselves as very business oriented with a clear goal of creating financial sustainable and profitable firms.

For the Swedish public, profit measures are relevant because the true alternative cost of running Swedfund is the return the equity would yield if invested in a similarly risky portfolio on the world equity market. Since Swedfund invest in high risk projects the public would only invest in such activities if the expected return was sufficiently high to compensate for the additional risk compared with to investing in a default-free government bill. An alternative benchmark which reflects the real economic costs of running Swedfund is the return on a global emerging market fund index. As a benchmark, an emerging market index is on the low side. Compared with an emerging market index, Swedfund's portfolio is more biased towards countries with less developed and illiquid stock markets and countries which are likely to have higher political risk.

In this paper, we have chosen not to compare Swedfund's return with other DFIs. This is so because 1) Swedfund has never been required to show a return in relation to other DFIs, and 2) other DFIs might work with different objectives. Finding that the return of Swedfund is higher, lower or at par with other DFIs doesn't tell us anything unless we could also somehow adjust for differences in risk levels in their investment portfolio. If other DFIs are working with different risk levels in their investment portfolios, it is not possible to compare returns across different DFIs. In addition, comparing with other DFIs tells us little about the alternative economic costs for the Swedish public in running Swedfund. Furthermore, we have not taken foreign exchange losses and profits into account because Swedfund's accounting data is not very informative on these issues.

Common measures of returns are Return on Assets (ROA) and Return on Equity (ROE). Both measures use profit after taxes (Net income) from the income statement. ROA is the ratio of Net income over Total assets, and ROE is the ratio of Net income over Shareholders' Equity from the balance sheet. Table A1 shows ROA and ROE from 1993 until 2006, rows 1 and 2. The problem with these measures is that they are based on book values and not the more correct market values of assets and equity. In addition, the profit from a firm's income statement, as well as the stated cash flow from operations is affected by, to some extent, arbitrary accounting standards.

Table A1 shows the yield on the one-year Swedish Treasury bill in row 8. The Treasury bill rate can be seen as a fundamental floor benchmark for financial self-sustainability in the sense that it reflects the government's cost of replacing Swedfund's capital. For completeness, Swedfund's debt-equity ratio calculated from the balance sheets.[23]

The ROA and ROE in Table A1, are calculated as "Net Income after Taxes (corresponding) and Allocations" over Total Assets measured at the end-of-the previous year. Both ROA and ROE can often be seen as signals from a firm of its long-run profitability. Typically, most firms smooth their earnings over time and only allow larger changes when underlying factors permanently alter future earnings.

It would be a mistake to think about the equity value in the balance sheet as a type of deposit account that reflects the amount of money the owners, in this case the Swedish government, has invested, and only base profit calculations on these book values of equity. The equity value in the balance sheet reflects the accumulated nominal amounts of money invested, at the time they were invested; it does not reflect the real economic value of equity at each point. The correct value would be the market value.

Say that the Government over the years has invested the cumulative sum of mSEK 100 in Swedfund, according to the equity given in balance sheet. If we were to view this stated equity value as a given value of the investment at the end of the year, a reported net income of mSEK 5 the following year would indicate a return on equity of 5 %. From the perspective of calculating the true economic profit, this analysis is wrong due the following conditions. The value of equity is by definition simply a residual item from the value of assets minus the value of debt. The equity value in the balance sheet is misleading because it is based on accounting data. The market value equity, and thus the market value of total assets minus market value of debt, reflects the available amount of wealth that has alternative use in each period. The value of this investment has an expected return over all future periods in relation to risk and alternative investments. If the firm cannot meet its expected return the implication is that there are other investments that are more profitable and therefore make better use of the resources in the economy. The correct economic decision would be to invest the money elsewhere where the return is higher unless the expected cash flows of the firm can be increased. Unfortunately, the market values of Swedfund's equity or asset value are not available.

[23] Under certain circumstances it is related to the estimated cash flows and the return of a firm. Notice that debt requires the management of a firm to generate free cash flows at a level that at least covers the interest payments on the debt. We have not investigated if the government, or the board of Swedfund, has set any optimal debt-equity ratio to maximize the performance of the firm.

The return measures can be improved by approximating the free cash flows from the accounting data and putting these free cash flows in relation to the total assets in the balance sheet. The free cash flows can be defined as the amount of cash the firm generated over a given period available for paying interest on debt, dividends on equity or be reinvested in the firm. The approximation to the free cash flows can be calculated from the financial statement by using the following simplified textbook definition:

Free Cash Flows (FCF) = Operating Cash Flows + Depreciation + Writing-downs – Taxes – Change in (increase) Working Capital.

Cash flows from operations are found from the income statement. The item contains some non-cash flow items, most notably depreciation, and in the case of investment firms write-downs from bad deals. These items are not real cash flows during the period and have to be added back. Changes in working capital are entered with negative signs because an increase in the working capital is taken from the free cash flow. Tax payments are deducted from the operating cash flows under the assumption that the debt equity ratio is optimal for the firm. Since the final aim is to calculate profit measures, we used the tax payments reported under the Statement of Cash Flows under the assumption of an optimal debt/equity ratio. For Swedfund, changes in the working capital are calculated exclusive of investments in new portfolio companies, which becomes an item showing up in the statement of working capital changes. We view the latter as money reserved for investments not cash for running the firm.

It should also be recalled that for an investment firm such as Swedfund the average investment might typically be in the range of 5-9 years. It makes sense to calculate seven-year geometric averages of the return measures.

Table A1, shows ROA and ROE calculations for the period 1 July 1993 to 31 December 2007, rows 1 and 2. In comparison with the Treasury bill rate the ROA and ROE indicate under-performance during the 1990s and early 2000. The performance meets this particular benchmark from 2003 and onwards.

The return measures based on cash flows are presented in rows 3 and 4. Row 3 shows the ratio of cash flows from operation (exclusive of depreciation and write downs) over total assets measured at the end of the previous period. Line 4 shows the ratio of free cash flows over total assets. As expected, both measures are somewhat higher than ROA and ROE, but not at par with the market returns shown in rows 9 to 12. Using the cash flow based measures the results Taking the debt levels into account Swedfund has been able to meet the Treasury bill benchmark, in particular compared with the seven-year average returns.

Three comments are necessary to judge these figures. First, Swedfund has not operated under clear and binding profit requirement during the period. Second, the return numbers are misleading due to possible changes in the market value of the portfolio. The increase in value from the investments should be added to the profit period by period. Third, Swedfund has received additional capital during the period. The increase in capital increases the asset and equity values used in the denominator in the profit measurements. The expected returns from these additional new investments are likely to come at later periods.

Seen over a 12-year period and taking into account that Swedfund can be compared with emerging market funds and emerging market venture capital funds, the estimated return figures are not extremely high when compared year-to-year with benchmarks such as the Treasury bill rate or stock market returns. The typical Swedish investor would require a higher return from these types of investments taking the risk associated with the markets and sectors in which Swedfund are investing. Rows 9 and 10 indicate the market return for global investors. These returns are important because they reflect the real costs for the Swedish society of running Swedfund. The return-gap should be compared with the benefits in terms of various development outcomes. The argument for the Swedish tax payers is that the difference between Swedfund's financial return and the market return on Swedfund's equity constitutes real development effects.

However, since Swedfund avoided the boom and the bust of the IT sector in the yearly 2000, Swedfund's seven-year returns are much more stable than the market. Even though this is a relatively short period, the estimated return figures for Swedfund stand-up quite well, compared to those for the 1990s. A longer average return measure is more appropriate for Swedfund since their investment activities resembles private venture capital more than ordinary stock market investments.

To understand the net benefits we require some monetary measure of the development outcomes from Swedfund's investments. From an economic point of view, one such measure is the increase in market values following Swedfund's investments. Swedfund's business is to consider projects that would be profitable on a well-functioning financial market but are unprofitable today. By investing in such projects Swedfund will turn projects with a negative expected return to projects with an expected return that gives the other investors in the project at least a fair market compensation for the risk that they are taking. If the underlying analysis is correct the outcome will result in development effects, in particular higher economic growth and more resources in the receiving countries.

Conclusions

Return measures are important for companies such as Swedfund not only because there is alternative use of the money. Swedfund works under the requirement to be financially self-sustainable. This means that the investment portfolio must yield a return that covers the direct costs of running the firm and at least keeps the real value of equity constant. From the government's perspective, it makes sense to require a return that covers the direct cost of obtaining funds to invest in Swedfund. Given the restriction to invest only in financially and profitable projects that the existing markets are unwilling to fund, nothing prevents Swedfund from making a higher return then the Treasury bill rate and reinvesting the additional money into new projects and thereby boost the development effects.

Taking the Swedish Treasury bill rate as a benchmark, Swedfund did not perform well during the 1990s. However, the return estimates signal an improvement in relation to the Treasury bill rate during the 2000s. In particular, the average return figures based on the estimated free cash flows indicate a more solid performance with respect to Swedfund's financial return requirement. Whether or not the difference between

these return and the alternative market return on Swedfund's portfolio reflects true additionality is a different question.

Table A1 Return estimates for Swedfund International*

Row no.	Year/Measure	1993/94	1994/95	1995/96	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
1	ROA	0.94	2.40	3.15	2.21	-1.15	-0.33	15.09	3.13	2.91	2.22	8.90	3.94	5.80
2	ROE	1.05	2.71	3.74	2.69	-1.43	-0.41	18.35	3.78	3.29	2.48	10.98	5.07	7.62
3	CF/Assets	4.34	6.05	-1.18	2.54	3.21	2.51	19.81	2.86	1.80	4.20	18.42	6.61	14.16
4	FCF/Assets	6.05	7.22	1.38	0.17	2.63	2.34	18.34	0.18	1.73	5.58	1.69	3.09	11.47
5	Seven year average CF/Assets	-	-	-	-	-	-	5.15	4.94	4.33	5.12	7.30	7.80	9.47
6	Seven year average FCF/Assets	-	-	-	-	-	-	5.30	4.44	3.66	4.27	4.49	4.56	5.84
7	Debt-Equity ratio	0.11	0.16	0.18	0.19	0.19	0.18	0.17	0.11	0.14	0.19	0.22	0.24	0.26
8	Treasury-bill rate	8.16	9.30	5.89	4.51	4.35	3.55	4.50	4.12	4.33	3.07	2.32	1.89	2.74
9	Return on a world market portfolio	3.30	17.14	11.09	13.25	20.52	21.16	-15.14	-19.64	-23.64	26.86	12.08	7.29	16.51
10	Return on an Emerging market portfolio	N/A	N/A	N/A	14.01	-33.26	52.12	-25.21	-23.48	4.63	41.38	30.64	29.90	19.34
11	7-year average return All Countries portfolio	-	-	-	-	-	14.85	9.49	5.63	-0.63	1.27	1.12	-0.55	-1.10
12	7-year average return Emerging Markets	-	-	-	-	-	2.11	-2.04	-5.71	-5.10	-0.29	1.67	11.82	8.01

All measures are in per cent, except the Debt-Equity ratio. ROA: Return over total assets, ROE: Return over equity, CF: Cash flow from operations adjusted for depreciation and write-downs, FCF: Free cash flows, CF adjusted for changes in working capital and tax payments. Seven year average is calculated as a seven-year geometric average. The Treasury bill rate is the one-year (Swedish) Treasury bill rate, yearly average (Svensk Statsskuldväxel, SSVX 12m). Source the central bank of Sweden; The Riksbank, www.riksbanken.se. The returns on the "All countries" (world market) portfolio and the" Emerging market" portfolio are continuously compounded returns calculated from MSCI Barra AC (All countries) and EM (Emerging market) indices, used with permission, www.mscibarra.com. All return series are end-of-year over a 12-month horizon.

Appendix B

Though foreign direct investment in principle is something that benefits the receiving country there are circumstances when these investments should not be promoted or when they might have negative effects. Foreign direct investments basically appear in three forms and are the same for private capital as for DFI's. They are;

- "Portfolio equity investment, which involves buying company shares, usually through stock markets, without gaining effective control.
- Portfolio debt investment, which typically covers bonds and short- and long-term borrowing from banks and multilateral institutions, such as the World Bank.
- Foreign direct investment (FDI), which involves forging long-term relationships with enterprises in foreign countries." (http://www.dallasfed.org/research/eclett/2007/el0701.html)

Most of the debate on investments into developing countries concerns FDI. This is also the activity that Swedfund's owner encourages the company to focus on. The question of whether foreign direct investments support "sound development" and then especially if it contribute to poverty reduction has been posed repeatedly by both researchers and practitioners (Klein et al. 2001:1). This type of investment can be done in several ways. It commonly involves a "parent company" infusing equity capital by the purchase of shares in a foreign affiliate. It can also take the form of reinvesting the affiliate's earnings and long and short term lending between the parent company and the affiliate. For this study the type of foreign direct investments of primary importance are those that involve establishing a foreign affiliate or simply a business owned and controlled by foreign investors. This latter type of FDI comes in two forms; either by the start-up of new production facilities, a so called green field investment, or by acquiring existing entities through so called cross-border mergers and acquisitions (http://www.dallasfed.org/research/eclett/2007/el0701.html).

A key problem in determining positive or negative effects of FDI to host developing countries is that of empirically establishing whether there is a causal link between FDI and growth. In theory FDI has the potential to boost a number of important variables such as technology, productivity, investment and savings (http://www.dallasfed.org/research/eclett/2007/el0701.html). In some studies the existence of this casual links seems to be taken for given (Klein et. al., 2001: 2). Others maintain that most empirical studies show that these effects actually do take place but that estimating their magnitude poses a greater challenge. Just as in the debate on whether there is a casual link between trade and growth (Baldwin 2000: 1), the problem here concerns the direction of causality, does FDI follow growth or does growth follow FDI?

How foreign direct investments promote growth

FDI can affect poverty mainly by contributing to growth and thereby possibly a reduction of income poverty. FDI can theoretically contribute to growth either directly by contributing to gross fixed capital formation and/or indirectly through a number of indirect channels.

One channel through which FDI can work is in transferring new technology and by creating so-called linkage effects. The latter implies that the firm is buying input factors from local producers rather than importing them, and is selling their products or services to local buyers and consumers rather than exporting them. Technology transfers are generally theoretically counted as one of the most important channels through which foreign corporate presence can produce so called positive externalities in the host country where they invest (OECD 2002: 12). To what degree these actually take place is however a contested issue. Four interrelated channels through which technology and diffusion work is identified by OECD, namely "vertical linkages with suppliers or purchasers in the host countries horizontal linkages with competing industries or complementary companies in the same industry, migration of skilled labour; and the internationalisation of R&D (OECD 2002: 13).

In the OECD study it is argued that the evidence for positive technological spill over effects is strongest for vertical, in particular backward linkages with local suppliers in developing countries. Empirical evidence for horizontal spill over effects is according to the same study hard to obtain (OECD 2002: 13). This study points out the importance of the relevance of the technologies transferred and argues that "for technology transfer to generate externalities, the technologies need to be relevant to the host-country business sector beyond the company that receives them (OECD 2002: 13). The authors do however not support their argument with any references to empirical studies.

Human capital is also believed to be a possible channel through which FDI can have positive impact on the host economy. By providing training and transfer of skills, managerial know-how and expertise to local employees and upstream suppliers, FDI could have a positive impact on human capital development in the host economy (Krogstrup and Matar 2005:7).

When discussing FDI and trade, mentioned as the most important trade related positive benefit, it is said that developing countries as a result of FDI become more integrated into the world economy which should lead to both higher exports and imports (OECD 2002: 10). A country's ability to use FDI to boost exports is however context dependent. Inward investments can for example help financially constrained economies with resource endowments to make use of these resources. This line of reasoning goes also for financially constrained countries with a favourable geographical position (OECD 2002: 12).

A situation when FDI might not work is the combination of investments in raw material, a country with weak economic institutions, weak democratic institutions, weak governance of the public sector and some underlying military conflict within the country. It is not difficult to think of situations when a corrupt government is more or less confiscating the profits from an FDI or, scenarios when high revenues from

oil exploitation increase the political conflicts within a country. A weak government might also be incapable of preventing negative externalities on the environment etc.

Impacts of FDI – necessary preconditions

If it is possible to talk about a consensus about the effect of FDI inflows on economic growth in developing countries it seems to be that there can be a positive association between the two, but that this positive effect depends on certain preconditions (Hansen and Rand 2006: 21). In a panel data study from 40 African countries, human capital (measured as the percentage of gross secondary school enrolment) and infrastructure (measured as telephone coverage) were found to influence whether FDI actually contributed to growth (Lumbila 2005:19 ff., see also Klein et al., 2001: 5). In an earlier study by Alfaro schooling this is however stated not to impact on FDI possibility to contribute to economic growth (Alfaro 2003: 11).

The measuring of how a number of institutional capacities influenced the performance of FDI on economic growth showed some interesting results. Countries in which risk was perceived as low generally made FDI work better compared to countries where risk was perceived as high. While this relationship probably makes sense to most readers, the effect of corruption on FDIs ability to contribute to economic growth was somewhat surprising; "countries where corruption is perceived to be high still benefit from a positive impact of FDI on growth" (Lumbila 2005: 23-24).

The argument that countries have to reach a certain level, or threshold of development before they can absorb the potential benefits of FDI, is put forward by Hansen and Rand in a paper attempting to establish the causality between FDI and growth (Hansen and Rand 2006: 23, Blomström and Kokko 2003: 15). How to formally determine this threshold seems however to be an unresolved question (Lumbila 2005: 23-24). This line of reasoning is connected to the idea that spillovers are positively associated with the host economy's capacity of absorbing them. However, not only might the general capacity of the economy matter, weak technological capability at the firm level has also been found to be an obstacle for spillovers (Blomström and Kokko 2003: 14).

The empirical evidence for impacts of FDI

A study by Alfaro (2003) points to inward FDI exerting different effects on economic growth depending on what sector the investment flows into. FDI into primary sectors tend according to this study to have a negative effect on growth, whereas the impact on FDI into the service sector is inconclusive. FDI into the manufacturing sector is however stated to have robust positive effects on economic growth (Alfaro 2003: 13).

Looking beyond the industries in a given host country to overall development of a country, Blomström et al. in a cross-country study of 101 economies, suggest that productivity spillovers are actually concentrated to middle income developing countries. No evidence of such effects was however found for the poorest developing countries (Blomström and Kokko 2003: 15).

Productivity

Theoretically, "productivity spillovers from FDI takes place when the entry or presence of multilateral corporations increases productivity of domestic firms in a host country and the multinationals do not fully internalise the value of these benefits" (Smarzynska: 2002: 4). Aitken and Harrison in a study of what benefits domestic firms accrue from foreign direct investment (measured a raise in productivity), suggest that positive and negative effects for domestic competitors are largely offset against each other. Aitken and Harrison point to several reasons for this result. They do find a positive relationship between increased foreign equity participation and plant performance. This result appears to count only for plants with less than 50 employees. When plant specific characteristics are accounted for, these positive effects disappear for plants with more than 50 employees. *From this the authors conclude that foreign investors are investing in more productive plants.* Interestingly, joint ventures appear to benefit from foreign investment both in the plant and foreign investment in other plants within the same sector (Aitken and Harrison 1999: 610). Perhaps more important is the discovery that productivity in *domestically* owned plants declines when foreign investments increase. This could be interpreted as what takes place being a negative rather than a positive spill over, which is interpreted by the authors as a "market-stealing effect" (Aitken and Harrison 1999: 606).

The Aitken and Harrison study represents an attempt to address the "identification problems" of traditional studies using cross-section data on average industry characteristics. The identification problem lies mainly in the difficulty in controlling all sets of factors likely to influence industry productivity and "multinationality". The method used to try and avoid this problem is "using micro-level, time series data on individual manufacturing plants". This gives the opportunity to see over time how the productivity of domestic plants changes in response to the multilateral presence. By doing this it is possible to control "unobserved factors which influence both the productivity of domestic plants and the behaviour of multinationals" (Hanson 2001: 13-14). The conclusion drawn by Hanson from for example the Aitken and Harrison study, is that "multinationals concentrate in high-productivity sectors and that domestic plants in these sectors … experience even or negative growth in productivity relative to plants in other sectors (Hanson 2001: 14).

A World Bank Research Working paper grappling with the issue of knowledge externalities of FDIs, has used firm-level data from Lithuania to see whether other studies might have looked in the wrong place for these externalities. The study finds that productivity spillovers from FDI do take place through backward linkages. However and in accordance with results from other studies, they found no evidence of spillovers within the same industry, i.e., that is through horizontal channels (Smarzynska: 2002: 3). The same study also detects that higher productivity gains are associated with domestic market oriented companies compared with export oriented companies. No differences in productivity gains were however found between fully owned foreign firms and those with joint domestic and foreign ownership (Smarzynska: 2002: 16).

That the trade orientation of the investing firms could be a significant determinant of spillovers is suggested also by data from Uruguay. Kokko has noted that firms oriented towards the local market had a stronger impact on local technology and pro-

ductivity levels as compared to export oriented firms. A suggested explanation for this state of things is "that local market oriented MNCs may have relatively strong interactions with local firms, both as competitors and collaborators, whereas export oriented foreign investors may often be relatively isolated from the local market (Blomström and Kokko 2003: 15).

A question related to knowledge externalities is if and how the inflow of FDI or more specifically the presence of multinational enterprises (MNE) influences human capital development. OECD states that "while considerable national and sectoral discrepancies persist, MNEs tend to provide more training and other upgrading of human capital than domestic enterprises." The report however goes on to state that the "evidence that the human capacity thus created and that spills over to the rest of the host economy is much weaker." (OECD 2002: 15)

Foreign direct investments – financial volatility and investment decisions

Discussing the issue of whether gains from productivity improvements stemming from FDI are transferred abroad, Klein et al. (2001) argue that this fear is misplaced, at least when foreign investors operate under competitive conditions. They argue that countries that wish to acquire foreign technology and capital basically have a choice between two strategies. They can import capital via bank lending and technology via licensing (the strategy applied by Korea). In this case "the net costs would be interest payments and plus licence fees" (Klein et al. 2001: 7). The other alternative is to attract foreign investments but then they have to accept payments on dividend (to the foreign owners).

Klein et al. argues that what primarily distinguishes foreign investment from other types of development funding is the incentive structure for foreign investors. When projects fail, creditors "often look towards taxpayers to hold them harmless …" (Klein et al. 2001: 7), this goes especially for situations when credits are guaranteed by governments. Foreign investment on the other hand is equity investment. This means that when projects or firms are successful, investors gain but when projects fail, the investors lose. The up side of foreign investments in this context is that it will by definition never lead to a debt crisis. Following this line of reasoning, taxpayers in developing countries will not suffer from possible bad decisions by foreign investors; instead losses will be absorbed by the foreign equity investors (Klein et al. 2001: 7).

Because portfolio equity investments by minority shareholders are susceptible to expropriation by insiders, Klein et al. maintains that FDI is the most efficient form of cross-border equity investment in countries where corporate governance rules and practices are weak (Klein et al. 2001: 8).