Policy briefing

Inviting Scandal

DfID’s dangerous plans to expand its controversial private equity arm

Dec 2016

On 16 November 2016 the UK government introduced a bill in parliament that, if passed, would allow it to give billions of pounds of taxpayers’ money to CDC Group plc, the controversial private equity arm of the British overseas aid programme.\(^1\)

Wholly-owned by the Department for International Development (DfID), CDC invests in private businesses in developing countries, often via private equity funds. It has been repeatedly criticised for supporting projects with questionable impacts for poor communities – the explicit, intended beneficiaries of UK development spending.\(^2\) CDC itself says it is too early to tell what impact reforms over the last five years have had.\(^3\) Meanwhile it has not yet presented a strategy for 2017-2021 and does not have a new chief executive in place.\(^4\) Despite this, DfID has asked parliament to approve a bill allowing total UK taxpayer assistance for CDC to increase from £1.5 billion to £6 billion – with the possibility of raising it even higher. Notes attached to the bill say this funding increase is needed to “accelerate the growth” of CDC for it to play “a fuller role” in the UK development programme.\(^5\)

This briefing reviews recent CDC investments and shows how serious questions remain about its impact on poverty reduction. It shows that there is still little evidence to support its current development impact claims which are largely based on assumptions – rather than proof. It argues that dramatically increasing its size and influence is a premature and potentially dangerous move.

Introduction

The CDC Group is a company owned by the Department for International Development (DfID). Its purpose is to fight poverty by investing, often via private equity funds, in private businesses in developing world economies. A bill currently making its way through parliament aims to increase the amount of aid money which DfID can give to CDC Group, up to a limit of half of the current annual aid budget – perhaps even more.

Global Justice Now opposes this bill. We believe that CDC Group’s controversial history makes it an inappropriate body to be receiving aid money. In spite of reforms since 2012, CDC’s investments in private equity funds remain a major part of CDC’s operations, amounting to £238 million new commitments in 2015. These funds are particularly problematic because:

- Many funds are based in tax havens – 28 of CDC’s 38 new investments in funds since 2012 are located in Mauritius, the Cayman Islands, Guernsey, and Luxembourg
- The nature of these investments undermines the accountability of the Secretary of State for aid spending
- There is likely to be even less understanding of “development” on the part of these funds than CDC itself – at best development is assessed on the basis of vague calculations of job creation

We believe that no additional funding should be given by DfID to CDC, and in fact DfID’s entire relationship with CDC should be fundamentally reconsidered. Although a case can be made for supporting local business as one part of a much broader aid strategy, CDC fails fundamentally to fill that role.
What is CDC?

CDC Group plc is a private equity company owned entirely by DfID. It was first created in the late 1940s, as the Colonial Development Corporation, to invest in businesses in British colonies. Today it is the UK government’s development finance institution, and part of the British aid programme.

Its mandate is to invest in private enterprises in developing countries to meet DfID’s overarching objective – as enshrined in law – to help end global poverty. Through its investments in business projects, it is supposed to create jobs, and encourage other investors into developing countries. But CDC is also supposed to make a profit – to re-invest in new deals, and to cover its operating costs including executive salaries and bonuses. Since 2012, CDC’s financial returns from its investments have averaged 10.3% a year -- far above its 3.5% target, though still much lower than its astronomic average annual returns of 30% or 40% between 2004-2007.

While owned by DfID, CDC operates with considerable autonomy. It says it works with DfID “to agree our high-level strategy but the Government has no involvement in our day-to-day decision making. This is all carried out by our Board of executive and non-executive directors” – most of whom have significant private investment, but relatively little development or human rights, experience.

CDC’s reform promises

Until 2012, CDC invested solely through intermediary third-party investment fund managers. It attracted sustained criticism for years that its operations had questionable impacts for poor communities and was more focussed on securing financial return, that it was not transparent enough, that the funds it invested in made extensive use of tax havens, that it focused on investments that wouldn’t have struggled to attract private capital from elsewhere and that its executive salaries were extraordinarily high for an organisation with a supposed development mandate.

In response, under its 2012-2016 strategy, its new investments were refocused on companies operating in Africa and South Asia and CDC started making direct investments in businesses as well as through intermediary funds.

Commonwealth Development Corporation Bill 2016-2017

The Commonwealth Development Corporation Act 1999 transformed CDC into a public limited company, with all shares owned by DfID. This act also set a limit on how much taxpayer money it could receive: £1.5 billion. This limit was met last year, after DfID announced a £735 million capital increase, its first in 20 years. It is this limit which the government is now trying to increase.

The Commonwealth Development Corporation Bill 2016-17, currently before parliament, would amend the 1999 act and quadruple this limit to £6 billion. It would also allow this limit to rise to £12 billion without the need for further primary legislation. The government has attempted to underplay the significance of this bill, by saying that it would only raise the potential to increase financial assistance, and that it alone doesn’t authorise an increase.

But DfID’s intentions are clear: it wants CDC to grow and says additional taxpayer money is needed for “a planned programme of sustained expansion aimed at significantly increasing the scale of investment and development impact of the company over the next 15 years.” Former Secretary of State Andrew Mitchell set the case out clearly back in 2013, when he said: “It is not an unreasonable proposition to suggest that in 50 years’ time the CDC will be seen as the principal British development structure – rather than DfID.”

A Delegated Powers Memorandum attached to the current bill suggests that DfID plans to increase CDC’s funding limit periodically. In other words, parliament has been asked to pre-approve potential multi-billion pound increases in CDC’s taxpayer funding, without seeing in advance any concrete plans of where this money might go. Some MPs raised this and other concerns during the bill’s second reading in the House of Commons on 29 November 2016, but it has now progressed to committee stage. A date for its third reading has not yet been announced.
Today CDC:
• buys shares in companies,
• gives loans and guarantees,
• invests indirectly in businesses through fund managers.

In November 2016 the National Audit Office (NAO) published an assessment which said CDC has “an efficient and economic operating model” and that it has indeed followed its strategy, making new investments only in Africa and South Asia, and investing directly as well as through fund managers. But, it said, there are serious shortcomings including CDC’s inability to prove its “actual development impact.”

By the end of 2015, CDC’s overall portfolio included 1,293 investee businesses and was valued at £3.9 billion – up 16% from 2014 (£3.37 billion) and more than three times that in 2004 (£1.2 billion). Last year alone it invested £712.9 million in private businesses (up from £296.8 million in 2014). This included £237.6 million in private equity and investment funds, and £475.3 million in direct investments, all in its priority regions.

The NAO said average salaries at CDC had dropped 27% from £123,000 to £90,000 over the past five years. But it suggested this could change with “revised remuneration framework” expected to be submitted for ministers’ approval by March 2017. Already there are 35 employees who make more than the UK prime minister. Last year, CDC’s outgoing chief executive, Diana Noble, took home £302,576.

But the ultimate objective of the review was sharpened development impact, and on this crucial point, five years on, there is still little evidence to support its claimed impacts – that it is helping to end poverty by creating millions of jobs and investing in businesses that can’t access other capital. The NAO noted that, despite setting aside £5m last year for evaluations of CDC investments and their impacts, no contracts had even been awarded for this research. It said CDC is still measuring prospective rather than actual development impacts. It concluded that “a clearer picture of actual development impact” is necessary to demonstrate CDC’s value for money.

Show me the evidence
CDC often justifies its model on the basis of the number of jobs created by its investments. In 2015, it claims that its investee businesses created “1.03 million new jobs.” But this can be misleading: it counts both direct jobs created (just 24,673) and “indirect jobs” which account for 97% of the total, and are based on estimates of potential knock-on effects in supply chains and local markets.

It also says nothing about the quality of jobs created. This is clearly problematic as not all employment is empowering. CDC has said it is “interested in increasing our understanding…of job quality” but this is not currently monitored in any rigorous way. The NAO noted that CDC has been “considering” how to measure and monitor job quality since 2012, but that “its progress has been slow.”

The data CDC does have on jobs is also incomplete. On its website a disclaimer says: “Data is provided to CDC by its investment partners, including the fund managers that have invested our capital (and the capital of others), and has not been audited or independently verified by CDC.” It relies on companies to self-report employment figures – its central measure of development impact – which are not investigated to ensure jobs come with decent wages and conditions.

Indirect jobs created are meanwhile estimates based on potential knock-on effects. The NAO showed that most of these, in CDC’s calculations, are supposedly created through “additional loans to consumers,” as investments are expected to more broadly stimulate local economies.

To make it even less impressive, the NAO noted that CDC: “does not seek to attribute the jobs created by its investee businesses to its investment,” because this is just one of many things that could impact job creation, it often invests alongside others, sometimes takes small stakes in businesses, and may be either an active or passive investor. “This makes it difficult to determine how much credit can be claimed by CDC,” it said.

Public money, private profit
CDC’s portfolio is still largely in investment funds and wealthier developing countries such as India (which remains under the new strategy) and China (which was dropped). Since 2012, CDC’s investments in private equity funds remains high, amounting to £238 million of new commitments in 2015. It said it would not withdraw from commitments made in other places prior to the new strategy, but that this “legacy portfolio” would soon become less dominant.
Meanwhile, since 2012, CDC’s new investments have included support for:

- **Private hospitals in India:** In 2013 CDC announced a $17.5 million investment in Rainbow Healthcare, which operates a chain of private maternity clinics and children’s hospitals in India. The need to improve healthcare is clear. It is less obvious however how investing in for-profit health care businesses is the right strategy if the goal is to help poor communities. Healthcare spending is already thought to drive tens of millions of Indians into poverty each year. Private equity funds are meanwhile “rushing in – to take a piece of the fast growing maternal healthcare segment.” According to one report, the country’s “maternity and child care hospitals market” could be worth $27.6 billion by 2020, driven largely by a “rapidly increasing aspirational middle class population.” This could make investments in the sector attractive on commercial, financial terms. But the goal of UK development spending is to reduce poverty.

- **Private schools in Kenya:** In 2014, CDC announced a $6 million investment to support the expansion of Bridge International Academies, a chain of “affordable” private schools. Founded in 2008, the company has already opened hundreds of “academies” in Kenya, where CDC says parents pay an average of $6 a month per child and that the company keeps costs down with “a new model” of teaching using “computer tablets to deliver dynamic, scripted lessons.” But the company has become increasingly controversial and in Uganda the High Court has recently ordered its academies to shut down saying that they put the “life and safety” of students at risk with unsanitary conditions and unqualified teachers. Meanwhile, CDC has also invested $45 million in a company called GEMS Africa, which also operates private fee-paying schools including an international boarding school with pilates classes in a “leafy, residential” suburb of Nairobi where tuition costs up to 1,287,000 Kenyan shillings (£10,000) a year.

- **Controversial palm oil plantations in the DRC:** Since 2012 CDC has also invested $41 million in Feronia Inc, a company that runs palm oil plantations that were first set up in the early 1900s under Belgian colonial rule. CDC is now Feronia’s largest shareholder, with 67% of its shares. It says the company is the country’s largest private employer, with 9,000 permanent and temporary employees. But it has also been linked to repeated allegations of land rights and labour violations. A November 2016 report by a group of NGOs said local communities “never consented to the company’s operations on their territories, nor did they approve of the destruction of their palm groves for the establishment of plantations,” and that “living conditions for communities within Feronia’s oil palm plantation concessions remain abysmal. The company occupies lands that are essential to the livelihoods of local people and fails to provide decent wages and basic services.”

- **Upscale real estate in Kenya:** In 2014, CDC announced an investment of $25 million in Garden City, a large-scale real estate development outside Nairobi including a 50,000 square meter mega-mall, along with offices, luxury apartments and a park. It said the project would create over 650 direct jobs during construction and 800 more afterwards. If true, this works out to just one direct job created for every $17,000 spent, with almost half of these jobs being temporary while the development is built. Meanwhile, the Garden City mall’s Twitter account says it offers “shopping therapy at its best.”

- **Big agribusiness in Zambia:** In 2016, CDC invested $65 million in Zambeef, one of the largest meat producers in southern Africa which is listed on the London Stock Exchange and exports in Africa and also to China, India, the UK and Italy. Zambeef is also one of the largest landholders in Zambia, with more than 100,000 hectares. Those supporting the company have previously been accused of facilitating the concentration of land in the country into just a few hands, while the vast majority of the population are subsistence farmers and have on average just 0.6 hectares per household. The company’s stock reportedly soared by more than 50% as a result of CDC’s investment.

CDC also continues to channel millions of pounds through intermediary investment funds. It says this “remains a key part of what we do” and “allows us to reach small and medium-sized businesses.” This is despite extraordinary rates of return being made by some CDC-backed funds. One of CDC’s major funds, Actis, formed in 2004 following the restructuring of the CDC, has revealed that it has made $2.2 billion from the $867 million it has invested in infrastructure and other projects since then.

A 2014 report from the parliamentary Ombudsman meanwhile said that CDC still has limited oversight of investments funds that receive its money and that even after CDC required fund managers to
sign up to its new investment code, it has only "limited rights" to their records and accounts.57

CDC also continues to invest in funds and businesses domiciled in well-known offshore secrecy jurisdictions. Analysis of CDC data shows that since 2012, it made 38 new investments through funds – at least 28 of which are in Mauritius, the Cayman Islands, Guernsey, and Luxembourg. These investments account for 49% of the total $1.8bn committed to funds over this period.58

Most of CDC’s direct investments are in fact domiciled in developing countries. But some of these direct deals involve companies based in offshore jurisdictions and rich countries too – for example its $41m investment in Feronia Inc, which operates in the DRC but is domiciled in Canada, and its $25m investment in Garden City which operates in Kenya but is domiciled in Mauritius.59

CDC says: “We never use offshore financial centres to avoid tax. We use them so that we can invest alongside other international investors.” It says: “many developing countries do not yet have stable administration and legal systems necessary.” Elsewhere it has acknowledged that “certain investments may include structures that reduce the tax burden on investors,” and said that it “will only acquiesce to such structures in order to facilitate a developmental impact.”60

But investing through offshore entities doesn’t help developing countries build the stronger administrative and legal systems that CDC says are lacking. It enables secrecy, and if CDC cannot convincingly prove its development impact, it is hard for it to justify investment through offshore jurisdictions based on that impact.

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Serious questions remain about CDC’s supposed development impacts. Meanwhile it has not yet published its investment strategy for 2017 to 2021, and it does not have a new CEO in place. CDC itself says it’s too early to tell what impact its reforms have had. “It is relatively early days,” it has said, “as results from new investments...will typically take five to ten years to materialise fully.”66

CDC’s direct investments continue to include examples of projects with questionable impacts for poor communities – the intended beneficiaries of UK development spending – and its continued investments through intermediary investment funds, many of which are located in well-known offshore secrecy jurisdictions, continue to pose severe challenges to transparency and accountability.

At the bill’s second reading in parliament, UK Development Secretary Priti Patel said: “We will shortly be setting out a new investment policy for the CDC, covering the next five years. That will include a new reporting framework to better capture the broader impact of investments on development.”67 Any consideration of increased taxpayer funding for CDC is, at this stage, clearly premature.

DfID is essentially asking parliament to pre-approve increased funding for its controversial investment arm before presenting a worked through strategy or plan for how this money will be spent and how

Diverting aid to private business

The UK has enshrined in law its commitment to spend 0.7% of Gross National Income as official development assistance (ODA), the OECD’s term for aid.62 Under little-noticed but important changes to how the government reports its aid spending, any new capital increase for CDC could count as ODA and come out of the aid budget – meaning less money for other projects.63 This is concerning given CDC’s own admission that it is “not designed to solve all development challenges.”64

It is also concerning as, in the past, not all of CDC’s activities have themselves met the OECD’s criteria for aid spending. According to a report prepared for the House of Commons, between 2012 and 2015, only 68% of CDC’s new commitments were eligible to be counted as ODA. The remainder did not count usually because loans lacked the required grant element of at least 25%.65 This suggests that, in some cases, CDC has been lending at rates more similar to a commercial bank than a development agency.
taxpayers will be assured that it helps meet the official mission of this spending: ending global poverty. This raises serious concerns as this bill could clear the path to a massive diversion of public aid money towards private businesses—without sufficient transparency, accountability, or proof of impact.

Proposals to expand CDC also ignore the controversial experiences of other development finance institutions, including the World Bank’s International Finance Corporation whose investments have been linked to land rights violations and violence against peasants in Honduras, and numerous cases of evictions and forced displacement worldwide. In CDC’s own 2015 Annual Review, it suggested it struggles to find businesses that can meet both of its official objectives, “having a development impact as well as providing a financial return.” It said the “pool of potential investments” is small.

The obvious question is: what would CDC do with billions of pounds in extra taxpayers’ money and how will it ensure this funding helps the intended beneficiaries of UK aid? Assumptions of trickle-down development—namely that the accumulation of wealth by the richest will also benefit the poorest through consumption, investment and employment—are not good enough. Public money must be used to help the poorest and most marginalised, and to tackle inequality—not finance private businesses for its sake alone.

Increasing CDC’s size and influence is not a recipe for sure-fire development impact: instead, it is an invitation for scandal.

Our recommendation

Global Justice Now recommends that the Commonwealth Development Corporation Bill is not passed. We further believe that DfID’s relationship with CDC be opened to a fundamental review as we do not believe that CDC is currently performing a justifiable role in the eradication of global poverty.

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2 See section: CDC’s reform promises. The requirement that UK development assistance be focussed on reduction of poverty is enshrined in the 2002 International Development Act: http://www.legislation.gov.uk/ukpga/2002/1/section/1

3 “It is relatively early days, as results from new investments...will typically take five to ten years to materialise fully.” “New CDC Bill: our briefing,” CDC Group, 22 November 2016, http://www.cdcgroup.com/Media/News/News-New-CDC-Bill-our-briefing/#fhash.c7t7WOQM.dpuf


6 CDC was previously known as the Commonwealth Development Corporation and before that: the Colonial Development Corporation. It is the world’s oldest DFI, established by the 1948 Overseas Resources Development Act which first set it up as a statutory company to invest in British colonies.


8 The Development Secretary does, however, in circumstances of consistent or extreme underperformance, have the power to make changes to CDC’s structure and management and to review the Board’s composition. “Department for International Development: investing through CDC,” National Audit Office, 28 November 2016, https://www.nao.org.uk/wp-content/uploads/2016/11/Department-for-International-Development-through-CDC.pdf, p.13

9 CDC’s Board, CDC Group, http://www.cdcgroup.com/Who-we-are/Our-People/Board-and-CEO/


13 CDC for example has explained: before additional...


45 See: CDC Direct Investment Information, as of September 2016: http://www.cdcgroup.com/Global/CDC%20Direct%20Investment%20Information%20as%20of%202016-09-15.pdf


47 "CDC and Feronia," CDC Group, http://www.cdcgroup.com/Global/Statements%20and%20QA%20on%20Feronia%20or%20CDC.pdf,


50 Garden City Mall Nairobi, Twitter, https://twitter.com/GardenCityNbi


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63 Until 2015, new CDC investments counted as positive ODA, and returns to CDC as negative ODA. Now, what counts is the capital flow from the government to CDC. Thus, last year the UK reported its £450m capital increase as aid. See: Steven Ayres and Rob Page, Commonwealth Development Corporation Bill 2016-17, House of Commons Briefing Paper Number 7809, 25 November 2016, http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7809, p.8

64 FAQs, CDC Group, http://www.cdcgroup.com/Corporate-information/FAQs/#sthash.VAuWhy2d.dpuf


