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INVESTMENT STRATEGY 2015 – 2018

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I. INTRODUCTION

The law on BIO of 03/11/2001 as modified by the Law of 20/01/2014, states that the rules and conditions by which BIO realizes its social objective are governed by a management contract, agreed upon between the Belgian State and BIO and with a duration of 5 years.
The first management contract was signed on 02/04/2014. It is aligned with the objectives and basic principles of the Belgian development cooperation as determined by the Law of 19/3/2013, the national and international normative framework, the international commitments taken up by the Belgian state in matters of development cooperation and the strategic notes of the Belgian Development Cooperation.

According to article 3§1 on the Law on BIO, the social objective of BIO is to invest, directly or indirectly in the development of micro, small and medium sized enterprises (MSME) and social economy enterprises established in developing countries, in the interest of economic and social progress, while having enough return on investment. Since January 2014, BIO also has the social objective to invest in energy projects, projects contributing to combatting climate change in developing countries, and enterprises that provide basic social services to the population in developing countries.

According to the Law of 19/03/2013 on the Belgian Development Cooperation and article 2.3 of the Management Contract, BIO is committed to respect and promote the basic values of the Belgian Development Cooperation:

- Develop a human rights based approach,
- Promote sustainable development in its 3 dimensions (social, environmental and economic),
- Realize the equality of opportunities, in particular gender,
- Work towards inclusive and sustainable growth,
- Respect the principles of good governance,
- Ensure the coordination and coherence with other programmes of the Belgian Development Cooperation.

The Management Contract signed with the Belgian State early 2014 establishes the intervention principles, strategic axes and intervention conditions for BIO, and defines BIO's objectives. This investment strategy describes how these strategic orientations will be implemented by the company, taking into account BIO’s assets in the broad sense of the word (portfolio, human resources, network), its positioning in its sector, and its practical constraints in terms of investment capacity, staffing, etc.
The strategy is determined by the fact that BIO's current capital must be invested with sufficient profitability in order to maintain its "code 8" qualification in the Belgian State's budget.
In the event that BIO should find alternative financing sources, other investment models could be envisaged in terms of risk-return balance.

The philosophy underlying this strategy is that of:

- a focus and specialization on specific investment sectors,
- the search for added value (or additionality) of our activities,
- while retaining a sufficient level of investment diversification to mitigate the risks inherent in our activity and preserving or improving operational efficiency.

The Strategy also takes into consideration the following strategic concept notes issued by DGD:

- Belgian Development Cooperation and local private sector: support for sustainable human development, 2013
- Belgian Development Cooperation in middle-income countries, 2013
- Strategy for the agriculture and food security sector, 2010
- The Environment for the Belgium Development Cooperation, 2014
- Right to health and to access to health services, 2008
- Basic Infrastructure Strategy, 2002

Finally, this strategy takes into account of the recommendations arising from evaluations of BIO performed by the DGD Special Evaluation Unit in 2012 and 2013.

II. SUMMARY OF THE STRATEGY

So as to apply BIO's **intervention principles** as defined in its Management Contract with the Belgian State:

- BIO is in the process of revising the method of measuring its impact on development, in order to comply with the evaluation criteria in the Management Contract, and in view of using this method throughout the investment process.
- In 2014 BIO drafted a manual for the assessment of the environmental and social (E&S) aspects of its investments.
- BIO promotes the principles of good governance in its portfolio companies, and will adopt a more formal and systematic approach on this issue as of 2015.
- In terms of respect for market conditions, BIO will develop a pricing policy based on the assessment of risks related to countries and projects and of comparable transactions.
- Concerning additionality, BIO will for each investment demonstrate its financial role in comparison with private investors. BIO will pay special attention to opportunities for providing non-financial additionality to its clients, in terms of improvement in environmental and social risk management, improvement in governance or a client's technical capacity, etc.
- Maintain its approach of interventions untied to Belgian private interests.
- Ensure a minimum return, in line with the profitability imperative associated with "code 8". This includes setting average rate-of-return targets for the portfolio, strengthening BIO's efficiency, and portfolio risk management.

Concerning BIO'S exit from investments through offshore jurisdictions excluded by the Law, it is noted that BIO'S net commitments through these jurisdictions total 70.5 million € at 31/12/2013. Taking into consideration our current contractual commitments, we will target exiting from these investments by the end of 2017. This time frame should enable us to pursue a proactive exit strategy while taking into account BIO's proprietary interests.

BIO's Management Contract with the Belgian State defines BIO's **priority sectorial strategic axes** as follows:

- **The financial sector**

This sector is addressed in the Management Contract under the subject areas of "financial inclusion of local populations" and "support for eligible enterprises".

There is a strong link between financial inclusion (defined as access to financial services, including savings, insurance, credit, transfer facilities, etc.) and overcoming poverty. The development of microfinance has played an important role in making financial services accessible for the poor but may also have resulted in excessive debt levels. This has led to the promotion of Customer Protection Principles (CPP) and has prompted many governments to better control the granting of credit.

BIO, historically active in this sector, will continue its efforts for improved financial inclusion with the objective of selecting projects that adequately meet local needs, increasing our clients' implementation of the CPPs and, regarding our equity investments and technical assistance programmes, seeking to promote access to financial services for the most 'underbanked' clients. In addition, BIO will seek to adopt a leading position relative to other Development Finance Institutions (DFIs) on the issue of financial inclusion in Africa and in underbanked areas in Asia.

Micro-, Small- and Medium Enterprise or MSME financing is a major issue for the economic development of countries as, according to the International Finance Corporation (IFC), around 400 million SMEs in developing countries are unable to obtain financing from the mainstream financial system. BIO wishes to position itself as a reference for the support for financial institutions targeting small enterprises (defined as requiring loans under €1M) in the regions in which we operate. Financial institutions may include banks that deal with small enterprises, leasing companies, factoring firms, insurance companies, non-bank financial companies, etc. BIO will adopt a proactive equity investment strategy in financial institutions active in the SME sector. Moreover, we wish to use our technical assistance resources to increase our clients' expertise in terms of approaching this customer base.

Furthermore, BIO will support the development, and even the creation of, financial institutions active in supporting the agricultural sector.
BIO will also further explore the insurance sector and the role it could play in strengthening MSMEs.

Lastly, BIO proposes, by means of investment funds, to provide equity to Eligible Enterprises including medium-size enterprises, enterprises in the agricultural sector, and infrastructure projects with a particular focus on renewable energy. These funds can play a major role in the proper structuring of sectors and in the emergence of a formal private sector respectful of environmental, social and governance standards. This focus will go hand in hand with the search for more leverage to ensure the optimal development impact of these funds.

- **The agricultural sector**

The Management Contract specifies that BIO will give priority financing to enterprises developing activities in the agricultural sector which contribute, directly or indirectly, to strengthening food security in the countries in question.

Taking into account this priority, BIO will approach the agricultural sector from the perspective of improving access to market and of supporting inclusive rural development, while minimizing ecological impact and therefore developing sustainable agriculture. Our action will be aligned with the Belgian Development Cooperation's strategic orientations and acknowledge the specific constraints to agricultural sector development (lack of infrastructure, training, inputs, regional markets, etc.).

BIO will centre its activities in the agricultural sector on:

(i) Productivity improvement in the sector through investment in the entire agricultural chain including upstream (inputs, infrastructure, irrigation, etc.) and downstream (processing, storage, packaging, distribution, etc.).

(ii) Support for agricultural operators that play a structuring role in the agricultural chain and that take a proactive stance in including rural populations in the development of their project. Regarding direct investment, we will work with agricultural operators of critical size able to meet the E&S standards required by BIO. The supported projects may target either the export or the domestic market, or enable increased internal demand. BIO will maintain its moratorium on agricultural projects dedicated to biofuels.

(iii) Agricultural processing that enables part of the added value drawn from agricultural commodities to be retained in the developing country.

(iv) Development of rural activities through improved access to financing for small entrepreneurs in agricultural areas.

- **Energy**

We will remain open to all energy generation sources (renewable, conventional, hybrid, alternative) with the exception of biofuel and coal. Energy efficiency and electricity transmission projects will also be considered. Given the scale of energy projects, we will remain a follower on large projects, but will develop our own in-house management expertise for small projects, in particular for renewable energy or biomass projects.

- **Infrastructure of direct relevance for the development of MSMEs**

As a priority on this strategic axis BIO will propose irrigation, telecommunications or transport projects. We will essentially remain a follower on these projects given their scale.

- **Basic services to the population**

Within this sector, BIO will focus on access to basic financial services. Other investment areas (health care, education, production/distribution, water treatment, housing) will be considered in a more opportunity-based way. Our interventions in these areas must be consistent with and complementary to public action.

In terms of channels, we will invest
- indirectly in micro and small enterprises,
-directly and indirectly (through funds) in medium-size enterprises, and
- in infrastructure projects.

In our direct work with medium-size enterprises, we will try to centre our action on the creation of or support for enterprises that have the potential to become leaders and play a structuring role in their market. These should also be enterprises prepared to implement high quality standards and high environmental, social and governance standards. The accent would be on investments between 1 and 5 million euro. Given the considerable risks taken on this line of activity, we will adopt a cautious attitude vis-à-vis start-ups and inexperienced promoters.
Investments of less than 1 million euro can be organized and followed up more effectively by investors that are geographically close to the clients, and will there be done through locally-based intermediaries such as investment funds, banks and leasing companies. To this end, beyond our existing partners, additional partnerships could be envisaged.

In terms of **portfolio balance**, as part of its strategy BIO proposes minimal levels of activity to be reached depending on the types of Eligible Enterprises. At sector level, as well as a minimum 75% to be committed in the priority sectors, BIO will endeavour over 5 years to reach 15% net commitments in the agricultural and rural sector (compared to less than 10% in 2013) and 20% in the energy sector (compared to 11% in 2013).

BIO defines the areas in which it will seek to make a mark and adopt a proactive approach in terms of additionality compared with other development players as follows:

- ⇨ Improve financial inclusion and SME financing in 'underbanked' regions in the form of equity funding (BIO / shareholder) or medium term financing
- ⇨ Play a structuring role for medium-size enterprises in the process of formalization
- ⇨ Support development of a number of specific agricultural produce chains
- ⇨ Develop small / medium scale energy projects in regions with low access to energy
- ⇨ Develop a healthy private sector in Central Africa (DRC, Rwanda, Burundi)

In terms of **instruments,** we will aim for a greater weighting of equity investment with a targeted debt-to-equity investment ratio of 60 / 40 (versus 75 / 25 currently). This shift will result in a more important investment role (role in governance, riskier class of assets).

III. MANAGEMENT CONTRACT: ELIGIBLE ENTERPRISES, VALUES AND INTERVENTION PRINCIPLES

III.1 Eligible enterprises

Extract from the Management Contract:

- *MSMEs in developing countries:* *BIO's corporate purpose is to invest,* *directly or indirectly* *(in particular via the channels described in Article 4.2 of this Management Contract), in the development of MSMEs in developing countries, in the interest of economic and social development of these countries. The target MSMEs for BIO interventions shall have a maximum turnover of EUR 50 million and total assets: maximum EUR 43 million.*
- *Social economy enterprises in developing countries:* *The social economy is made up of economic activities carried out by companies that are mainly cooperatives, mutual societies and associations whose mission is characterized by the following principles: the purpose of the services is to serve the members or the collectivity rather than for profit; autonomy of management; democratic decision making process, primacy of people and work over capital in revenue distribution; financial balance.*
- *Enterprises in the energy field and combating climate change:* *BIO also has the corporate object of investing in Enterprises (including in the framework of public/private projects) active in the energy field and in Enterprises developing projects likely to contribute to combating climate change in the developing countries or to improved energy efficiency.*
- *Enterprises offering basic services to people:* *The basic services targeted in particular are access to basic financial services, health care, education, housing, water and basic infrastructure.*

Whereas BIO's activities until now were directed towards exclusive support for SMEs directly or indirectly (through financial institutions or infrastructure projects), the Management Contract extends the range of BIO's end beneficiaries to social economy enterprises, enterprises offering basic services and enterprises involved in energy and combating climate change. Social enterprises in particular constitute a new area of intervention for BIO.

III.2 Intervention principles

Development criteria: *Relevance, effectiveness, efficiency, viability, impact and sustainability (Article 32 of the law on Belgian Development Cooperation of 19 March 2013). Any financing decision should refer to these criteria.*

In terms of **development criteria,** a review of how we measure impact on development is in progress and will conform to these evaluation criteria.

Environmental, social and good governance aspects (ESG):

BIO shall implement a policy for managing the environmental, social and good governance aspects that it shall apply to all its financing, to ensure the sustainable nature of its interventions.

- *on the social level, BIO shall ensure the decent, productive and sustainable character of jobs to be created with its investments. BIO shall require the respect of the fundamental social rights as defined in the International Labour Organization's Core Conventions and in its Decent Work Agenda;*
- *regarding male/female equality, BIO shall adopt a proactive and systematic policy in all its investments;*
- *on the environmental level, all the investments are assessed in terms of respect for protection and safeguarding of the environment;*
- *regarding good governance, BIO shall promote the principles of good management in accordance with international standards, and require that its Portfolio Companies respect the spirit and letter of applicable accounting and fiscal legislation.*

- Regarding **environmental and social** aspects, a manual has been approved by the Board of Directors in 2014 enabling environmental and social standards to be taken into account more systematically.
- Regarding **gender**, BIO will be vigilant to avoid any negative impact, and proactively seek opportunities for positive impacts.
- Regarding **governance**, BIO is involved in a number of initiatives to promote good governance of enterprises within the framework of its investments[1]. The enterprises' performance in terms of governance forms an integral part of analysis of each financing proposal. BIO promotes the principles of good governance to its portfolio enterprises and contributes to improvement in practices of the enterprises, in particular by issuance of technical assistance grants. In 2015 efforts will be made to systematize analysis of governance of the projects.
- Our commitment to requesting from Portfolio Companies to comply with applicable accounting and fiscal legislation will lead to greater selectivity for our direct enterprise

[1] In July 2007, signature with 30 other Development Finance Institutions, of the document entitled "A Corporate Governance Approach Statement" under which BIO has undertaken to develop procedures and guidelines on enterprise governance in its investment operations, provide training on the subject for its staff, promote the principles of good governance in the portfolio companies, promote the use of international accounting standards and collaborate with the other signatories. In October 2011, membership of the "Corporate Governance Development Framework", set up to harmonize the practices of the various institutions on corporate governance based on a common methodology, while taking account of their specific features.

financing. In the case of funds geared to small enterprises, BIO will require substantive work from its managers to help their clients achieve greater institutional formalization.

Market conditions: BIO's mandate is not to substitute the mainstream financial market, but to complement it. In this respect, BIO's interventions must respect market conditions and cannot lead to market disruption.

BIO will not act as a substitute to the market by subsidizing investments and thereby replacing the private sector. It is sometimes difficult to estimate what market conditions are in circumstances where the financial market is (virtually) non-existent. As far as available human resources allow, BIO intends to develop a pricing policy based on assessment of country related and project related risks of comparable transactions. In all cases, BIO will seek comparisons of interest rates applied by local banks for equivalent financing maturities, or set by the State to refinance itself.

Additionality: BIO must ensure the additionality of its interventions . BIO can only intervene if, for a given financing:
- *there are no private investors*
- *interventions by private investors are insufficient to meet the needs of the project*
- *private investors only offer financing under unsuitable conditions*
- *due to the characteristics of its intervention, BIO plays a specific role, notably (but not only) by playing a catalytic role to mobilize additional financing*

For each project BIO will demonstrate its added value compared with private investors and refrain from investing if this additionality is insufficient or absent. BIO will however continue to work with other development finance institutions governed by the same principles of action in its intervention strategy. BIO also intends to adopt a proactive additionality approach in the sectors and regions in which it can differentiate itself from other development finance institutions (cf. VII.3).

Besides financial additionality, BIO can also bring non-financial added value to its clients: improvement in environmental and social risk management, advice on organization of governance, assistance with developing product lines effective in reaching poorly served population segments, or help to improve the client's technical or managerial capacity. Often, the provision of these services will be (co-)financed out of BIO's MSME Support Fund. In order to maximize the impact of its investments on development, BIO will proactively identify opportunities for non-financial additionality.

BIO will also proactively seek to identify – within its sector and country scope - situations where the market is incomplete, and to remedy this situation through financing of appropriate private initiatives.

Untied interventions: In line with article 14 of the Law on the Belgian Development Cooperation of 19/03/2014, BIO respects the principles of untied aid, as agreed upon in OECD-DAC.

Bearing in mind the principles of untied aid of OECD-DAC, BIO **examines** projects based on their intrinsic qualities for the economic development of the countries, and not on the basis of the origin or nationality of their promoters. This means that promoters can be Belgian as long as the projects meet our intervention criteria. Conversely, BIO must not be bound to reject a project because it could compete with projects involving Belgian interests.

<u>Profitability</u>: "When BIO assesses an investment proposal, it looks for a balance between the relevance of its intervention for development, taking into account the principles listed above, and the financial return. BIO investments must be likely to generate a financial return sufficient to ensure its viability and sustainability".

The return expected by the Belgian State is determined on the basis of its long term borrowing rate. BIO's rate of return is linked on the one hand to the rate of return of its portfolio and its cash position, and on the other hand to its cost structure, including operational costs and the cost of risk (provisions)[2]. The question of profitability must therefore be analysed from several perspectives and, with regard to the investment strategy, in particular from the following perspectives:

- **Portfolio minimum and average rate of return**: We will keep an expected floor annual rate of return of 5% on all our investments (also in line with the objective of retaining classification code 8 for each investment made) and to strive for an average rate of return for our interventions of 6% on debt and 15% on equity investments. These return expectations are in line with the business plan 2014-2019 presented to the Board in September 2013 The minimum expected rate of return for debt is higher than that of our colleague DFIs and often leads us to invest in projects or countries with a relatively high risk profile. Given this return requirement, we plan to use individual country risk cover only in exceptional circumstances.

- **Efficiency**:

  - Below a certain size of investment, it is no longer viable for BIO handle projects directly, in view of the cost of assessing and managing these projects. We will therefore set a minimum amount of €1M for projects to be considered. For smaller investments, it is more efficient that these investments be made by financiers close to the end-beneficiaries. These investments will hence exclusively be done through microfinance institutions, leasing companies or banks. Additional partnership options could also be considered.

  - Another way of enhancing efficiency may be the cooperation with institutions having the same intervention principles. This cooperation enables pooling of resources in the execution of projects. The priority will be to strengthen the partnerships that already function effectively before engaging in new collaborations.
    Partnerships are especially important in a context of squeezed operating costs which reduce the internal capacities for originating, assessing and monitoring projects. Partnership agreements can allow us to focus our teams' work on our main areas of added value as compared to other development finance institutions (medium-size projects, Africa, agricultural and renewable energy sector).

- **Portfolio risk:**

  - The main risk incurred by BIO is credit risk. In the past, this risk materialized primarily on our SME-related activities, in particular small or start-up projects. As corrective measures, we have increased the average size of our investments, and are now focusing on enterprises with a positive track record and with experienced promoters. The team's growing experience and development of our own origination system has also had a positive impact.

[2] In the absence of a third party financing cost

- Given the high risk of these direct SME investments, we will keep our investments within an intervention range of €1 to €5 million.
- Portfolio risk has also materialized on our funds' portfolio. Our track record shows that funds targeting small enterprises have not been profitable. This is connected with the riskier nature of these investments, and also to the high management cost (up to 4% annual) of these types of funds. Experience also shows that funds should have a minimum critical size of €25M in order to be viable. In the future we will only invest in funds with assets below 25 mln € in exceptional cases.
- Lastly, although to date this risk has either not materialized or only to a small extent, we propose to limit the size of infrastructure, corporate and financial institution investments to €15M, in order to preclude any sudden downturn in a project wiping out several years' of BIO's profits.
- BIO also will limit its project financing to 25% of total assets for financial institutions and 50% for enterprise financing, in order to ensure financial risk-sharing.
- Retaining concentration limits should also contribute to the management of portfolio risks:
    - Maximum 5% of financing resources per client
    - Maximum 10% of available resources per group of companies or holding
    - Maximum 10% of available resources per country
    - Maximum 50% of available resources per continent

IV. GEOGRAPHICAL STRATEGY

Excerpt from the Management Contract regarding BIO's geographical scope:

- *Interventions of BIO are oriented towards eligible enterprises in Least Developed Countries (LDCs), Low Income Countries (LICs), Lower-Middle-Income Countries (LMICs), Higher-Middle-Income Countries (HMICs)*
- *BIO shall concentrate its interventions on a number of developing countries limited to a maximum of 52 countries, based on a list fixed by BIO's Board of Directors. Within this framework BIO shall favour a regional approach and complementarities and synergies with other Belgian Development Cooperation players.*
- *BIO shall make special efforts to identify investment opportunities in the partner countries of the Belgian Federal Cooperation and of the Communities and Regions, as defined by Royal Decree. The current list of these countries appears in **Annex 3**. Very particular attention shall be paid to three countries in Central Africa: Burundi, Rwanda and Democratic Republic of Congo.*
- *BIO is authorized to finance Enterprises in Higher-Middle-Income Countries, but must provide strong justification for the additionality of its interventions in this respect. BIO shall in particular strive to make investments likely to contribute to reducing income disparities between different sections of the population, particularly in rural areas.*
- *BIO will not invest in or via certain States, as foreseen in article 3§1, al.6 of the Law on BIO*

IV.1 Investment concentration - the list of 52 countries

BIO will concentrate its investments in the following countries:

Continents	Investment concentration countries
Latin America	Bolivia*, Ecuador*, Peru*, Paraguay, Colombia, Nicaragua, Honduras, Haití, Dominican Republic, El Salvador, Guatemala[3], Brazil
Africa	Senegal*, Mali*, Ivory Coast, Ghana, Guinea, Burkina Faso, Niger*, Togo, Benin*, Nigeria, Democratic Republic of Congo*, Burundi*, Rwanda*, Cameroon, Angola, Uganda*, Tanzania*, Kenya, Ethiopia, Zambia, Malawi, Mozambique*, Zimbabwe, Madagascar, Morocco*, Tunisia, Algeria*, South Africa*
Mekong / South-East Asia	Vietnam*, Laos, Cambodia, Myanmar, Indonesia, India, Bangladesh, Sri Lanka, Nepal, Philippines, Mongolia
Other	Palestine*

** partner countries of the Belgian Federal Cooperation*

In blue, partner countries of the Flemish Government

In green, partner countries of the Wallonia-Brussels Federation Bilateral Cooperation

The list is compiled in view of concentration and increase of efficiency of our prospecting and analysis operations. We will nevertheless still invest in funds active mainly (more than 60%) and not exclusively in our regions of interest. This cannot be avoided because often funds or financial institutions with a particularly high development impact perspective have a continent-based approach (for example, in Africa or South-East Asia) or are theme-based, to diversify their risks. .

Furthermore, during a transition period for which the modalities will be defined, it will be possible to continue with projects that were approved as admissible before approval of the country list on which the country of the project is no longer included.

It should also be noted that this list includes some Higher-Middle-Income Countries (HMICs). The additionality of our interventions will be examined in line with the Strategic Note by the DGD on Belgian Development Cooperation in Middle-Income Countries. In particular the Note recommends concentrating in Middle-Income Countries on specific fields, including inclusive economic growth, climate and the environment.

BIO will also conduct a reflexion on a strategy of regional specialization based on the needs of each region and the role that BIO can play. The Board will accompany this reflection.

[3] As and if it moves to phase II in the classification of the OECD's Global Forum for Transparency and Exchange of Information for Tax Purpose

IV.2 Strategy vis-à-vis Offshore Financial Centres

<u>*Excerpt from the Management Contract:*</u>

- *BIO shall not invest in or via certain States, as laid down in Article 3 § 1, subsection 6 of the BIO Law.*
- *Moreover, when the (potential) beneficiary is not itself located in one of the States targeted by the above mentioned legal provision, and when BIO can reasonably suppose that this beneficiary is controlled, directly or indirectly by an entity established in one of these States, BIO shall take the necessary measures, notably contractual, to ensure that this situation does not have the purpose or effect of improperly removing revenue and wealth from the developing country concerned through BIO's intervention through fictitious transfer pricing mechanisms. "Control" means direct or indirect ownership of at least twenty-five percent (25%) of voting rights or similar rights in the controlled company or the capacity to influence the management and general running of the controlled company or choose the majority of the members of the board of directors of the controlled company, whether this capacity arises from a contract, an agreement or from another means. The Board of Directors shall ensure that BIO defines and implements an adequate policy on the principles stated above.*
- *BIO's Board of Directors shall define and implement, as early as possible, a strategy intended to bring to an end Investments made in or via the States referred to in Article 3 § 1, subsection 6 of the BIO Law before the law comes into force on 21 January 2014 amending the law of 3 November 2001 on creation of the Belgian Investment Company for Developing Countries (BIO), taking account however of safeguarding its proprietary interests and of any legal commitments it has entered into in the framework of these Investments.*

A - Current portfolio in Offshore Jurisdictions excluded by the Law

At the present time, the following financial centres through which BIO has invested in the past are no longer authorized: Bahamas, Cayman Islands, Cyprus, Guernsey, Luxembourg and Panama. As of 12/31/2013, BIO had committed €70.5 million through these jurisdictions in 15 investments.

We will adopt the following approach with the objective of exit from structures in the jurisdictions excluded by law by end 2017:

- In the case of six institutions established in Luxembourg, given that it is expected that the country should be in order by 2015 with the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes and that this jurisdiction should become re-eligible, we will revisit the situation in 2015 and decide then whether a proactive exit approach should be considered.
- For the six investments outside Luxembourg with maturity dates up until 2017, BIO is in the process of gradually liquidating these positions either through repayment of the loan over time, or by exiting investments in the funds.
- For the three portfolio interests with a maturity date after 2017, BIO will make its best efforts to present, for approval of the Board, exit plans achievable before end 2017 along with the financial impacts of these exits. It will be up to the Board, in deciding about exits, to balance the objective to exit by end 2017 with the expected lower returns / losses on the investments.

B - Precautions to be taken on future BIO investments in Offshore jurisdictions not excluded by Law

In the future, we will justify the reasons why a project (fund, investment company or holding) is established in a country that is not that of the end beneficiary: for ex. the added value of using an offshore vehicle rather than doing a direct investment in the targeted companies, , existence or not of an adequate onshore alternative, confirmation that the targeted companies will be subject to taxation in their country of registration as per the applicable laws and regulations, and the status of the country in the peer review process of the Global Forum on Transparency and Exchange of Information for Tax Purposes.

The analysis of potential projects will also include the verification that all flows between parent companies and subsidiaries take place at market value and are not used to disguise a transfer of profits to lower-tax jurisdictions for the purpose of tax evasion. Clauses to this extent will be included in the contracts BIO signs with its clients.

V. PRIORITY SECTORAL STRATEGIC AXES

Excerpt from the Management Contract:

The financial sector: *BIO targets the financial inclusion of local populations through the provision of basic financial services (savings, money transfer, credit) and support for Eligible Enterprises (and more particularly MSMEs and social economy enterprises) through the provision of financial services suitable for their needs and contributing to their development. BIO's interventions in this field are thus oriented towards commercial banks, microfinance institutions and non-bank financial institutions (leasing companies, factoring companies, etc.), cooperative financial institutions, and any other financial organization.*

The agricultural sector: *BIO supports Eligible Enterprises in each link of the agricultural chain and within this framework ensures the coherence of its interventions for the entire chain. An agricultural chain includes four main links: (1) supply of equipment and basic agricultural inputs (fertilizers, animal feed, irrigation, etc.), (2) production, (3) processing and packaging of products and (4) marketing, including transport. BIO shall give* ***priority*** *to financing Enterprises developing activities in the agricultural sector which contribute,* ***directly or indirectly****, to strengthening* ***food security*** *in the countries in question.*

Energy: Eligible Enterprises in the energy and energy efficiency field that contribute to improving quality of life for local populations and development of their economies, and that contribute to the reduction of greenhouse gases (combating climate change).

Infrastructure of direct relevance to the development of MSMEs: *BIO can invest in Enterprises involved in infrastructure of direct relevance to the development of MSMEs and social economy enterprises, such as ports, warehouses, transport infrastructure, storage sites, etc.*

Basic services to people: *providing basic services to the populations of developing countries. The basic services targeted in particular are access to basic financial services, health care, water, education, housing, etc.*

V.1 The financial sector

The financial sector is addressed in the Management Contract under the subject areas of **financial inclusion of local populations** through the provision of basic financial services (savings, money transfer, credit) and **support for Eligible Enterprises** (and more particularly MSMEs and social economy enterprises), through provision of financial services suitable for their needs and by contributing to their development.

The financial sector is composed of banking or non-bank financial institutions which, among other services, grant loans to eligible people and enterprises and through investment funds that essentially provide equity for enterprises.

We define categories of end clients targeted under the financial sector according to the amounts of external financing they require:

- Micro < €10,000
- Very Small Enterprise < €100,000
- Small Enterprise < €1,000,000
- Medium-size Enterprise < €10,000,000

A - The role of financial inclusion in reducing poverty

The issues of financial inclusion and SME financing have become more prominent in the last 5 years, with numerous studies highlighting the link between access to financial services and exit from poverty of populations. The purpose of this section is to put BIO's activity in context in this respect.

a) *The role of financial inclusion*[4]

Financial inclusion is defined as the share of individuals and firms that use financial services. Financial services include not only credit, but also savings, insurance, money transfers, access to electronic banking, etc.

Currently around 50% of the population, in other words 2.5 billion adults, do not have access to financial services. In particular in a number of countries in Africa, South-East Asia and the Middle East, only 20% of the population have a bank account, due to obstacles such as distance, cost and administrative problems. Women appear to be especially disadvantaged in terms of access to financial services, making it difficult for them to save in their own name, receive government allowances or money transfers from abroad, even though they are the cornerstone of family development.

Certain other data highlights the low level of financial inclusion in developing countries:

- Savings: Only 30% of the population in low income countries have access to savings, mainly in a poorly supervised context (collective or community savings groups).
- Insurance: Only 17% of adults in low income countries pay for health insurance and only 6% of people working in agriculture or livestock farming have crop and livestock insurance cover.
- Credit: individual loans in developing countries are mainly from informal sources (family and friends).

[4] The information in this section is essentially taken from the 2014 Global Financial Development Report on Financial Inclusion.

It has been demonstrated that access to financial services (and in particular access to savings, insurance and money transfer) reduces extreme poverty and leads to better income distribution. The private sector has an important role to play in promoting financial inclusion for populations generally, in terms of technological innovation (mobile banking), development of new distribution networks, improving customer identification systems, provision of more appropriate products, development of financial education of customers and generalization of consumer/customer protection principles.

b) Microfinance and financial inclusion

The microfinance sector has been a driving force in strengthening financial inclusion; in 20 years microfinance development has enabled 200 million people to access formal and sustainable financial services structures and be recognized as economic players. The relationship between microfinance development and reduced poverty is acknowledged in the case of saving services, money transfer services and insurance. On the other hand, the contribution of microcredit (small loans) at the economic and social level appears more limited: although microcredit encourages business creation and enables businesses to grow beyond the survival stage, it does not provide the solution for transformation into formal enterprises that are integrated into their country's economy. Most micro-enterprises still tend to be only involved in retail sale or provision of basic services. Furthermore, in several countries, the rapid development of microcredit, bearing no relation to real economic growth, has created bubbles of indebtedness resulting in severe crises (Andrah Pradesh in India, Bosnia).

The microfinance sector has responded to these downsides by actively promoting Customer Protection Principles (better known under the acronym CPP):

- Development of financial products meeting the needs of customers
- Prevention of over-indebtedness: credit institutions must ascertain customers' actual capacity to service their debts
- Transparency: information must be transmitted to customers in such a way that they understand their commitments to the credit institution
- A responsible pricing policy that is affordable for customers and enables microfinance institutions to develop
- Fair and respectful treatment of customers
- Confidentiality of information
- Setting up of complaint and dispute resolution mechanisms

In addition, the microfinance sector has expanded from the original joint-liability group lending model and moved towards individual credit models better suited to customer needs and more flexible. Microfinance institutions now also tend to extend their services beyond micro-entrepreneurs to small enterprises.

The compliance to of these Customer Protection Principles is now monitored through audit and certifications. To BIO, the CPP appear to offer a correct response to the problems raised by the sector’s development that has been rapid and not always well controlled.

Recent criticisms of microfinance remind us that financial inclusion is an objective that must be managed and promoted by governments through improved regulation and supervision of financial institutions, development of credit bureaux so that people's credit record can be traced, and above all by the development of basic education, including financial education.

c) *Support for small and medium-size enterprises*

(i) In the form of credit

There are around 400 million SMEs in developing countries, 70% of which do not use external financing by financial institutions even though they could need it. A study conducted by the International Finance Corporation and Mc Kinsey[5] estimates unmet need for credit at between 2.1 and 2.5 trillion. The majority of these financing needs seem to be in South and South-East Asia and Africa, with Latin America benefiting from better coverage of these needs. Lack of access to credit appears to be even more acute in the case of informal enterprises, meaning fewer guarantees for creditors. Beyond this acute need for improved access to credit, SMEs also need a whole range of financial services (insurance, money transfers, guarantees, confirmations, etc.).

There are numerous constraints as regards access to financing for SMEs:

- Lack of formality of companies (unreliable financial statements, no distinction between the enterprise's and the promoters' assets, lack of management skills)
- Absence of credit bureaux and therefore of access to customers' credit records
- Limited size makes these enterprises more sensitive to internal shocks (for instance death of the promoter, loss of an important customer) and external shocks
- Inability to offer guarantees and securities
- Absence of suitable financing in credit establishments.

Financial institutions able to meet the financing needs of SMEs are banks, leasing companies and factoring companies. The SME clientele requires the creation of dedicated services within financial institutions capable of understanding their needs, analysing their repayment capacity when the business activity is often informal, and of structuring adequate products while limiting credit risk and ensuring adequate monitoring. These are specific competencies, different from pure microfinance or banking for formal enterprises. **One of the roles of BIO is to support the development of such expertise.**

(ii) In the form of equity

Investment in equity provides a stable form of financing for the development of enterprises. However, in the mainstream financial market third party investment in equity is only accessible to formal enterprises prepared to put adequate governance standards in place and with attractive growth prospects.

The largest enterprises can aspire to financing themselves through the equity capital market if it exists and is sophisticated enough. Still, in our intervention countries the development of capital markets is often weak and imperfect (lack of cash resources and activity, few specialized players, insufficient supervision, etc.).

[5] "Two trillion and counting. Assessing the credit gap for micro, small and medium-size enterprises in the developing world", 2010

B - Current BIO positioning on the financial sector

With 3.2% of the financial institutions portfolio of EDFIs, BIO is a small player compared to the leading institutions DEG, FMO and Proparco, which together represent 84% of the EDFI portfolio. BIO's positioning in this segment is atypical: although we collaborate with other DFIs on significant bank financing projects dedicated to SMEs, we are also active on small markets and/or with small institutions dedicated to a customer base of MSMEs, relatively neglected by the others. BIO thus represents 13% of the microfinance portfolio of EDFIs. These small institutions are also a passport to the future since certain of them could develop into the major players of tomorrow.

BIO is also one of the rare players who accept to provide financing in local currency, using hedging, enabling in particular financial institutions to make loans to SMEs in local currency and not transfer the exchange rate risk to these clients.

In the investment fund industry, BIO is a minor investor positioned in niche markets: equity financing of SMEs and renewable energy projects.

C - BIO strategy in the financial sector

a) For financial inclusion

We will **continue our interventions for improved financial inclusion** through:

- Due consideration of the role played by microfinance institution in financial inclusion in the local context
- an emphasis on Customer Protection Principles for all microfinance projects
- concerning our equity interventions and technical assistance programmes, an accent on (i) deployment of activities in under-banked areas, (ii) widening the range of basic financial products intended for people: savings, housing, insurance (health, home, agriculture) and loans appropriate to needs, (iii) development of financial access in rural zones and (iv) reduction in financial transaction costs to make them more accessible to as many people as possible, especially through mobile banking or banking agents[6].

In addition, BIO intends **to be at the forefront among EDFIs on the subject of financial inclusion in Africa and in Asian under-banked areas**. In certain countries BIO could differentiate itself by establishing new institutions enabling the creation of or increased financial services offers.

Furthermore, in line with the Special Evaluation Unit's recommendation, BIO will ensure that in all cases its investments in MFIs are additional in terms of financing available to private investors. This additionality comes in particular from the fact that we envisage long term investments with a vision that prioritizes development of the institution over production of short term capital gain; ensuring that we continue with the developmental mandate of our company and the provision of expert support in various fields.

[6] Banking agents: the subcontracting of certain banking services to agents (postal centres, retail outlets, etc.).

b) For the financing of eligible enterprises

(i) A focus on the small enterprise

We wish to position ourselves as a **reference for the financing of financial institutions that target small enterprises**. We will seek to stand out in this niche through investments with a higher risk profile and through support for new models and institutions. This is also a commitment to maintaining activity on small transactions that are high-risk but also with high added value. This strategy should be implemented hand-in-hand with the technical assistance unit to support the development of satisfactory operating modes for the financing of SMEs within credit establishments.

BIO is open-minded as to the best vehicles to achieve this goal: microfinance institutions moving up to small enterprises or universal banks moving down to the small enterprise market, leasing companies, factoring companies, insurance companies, etc.

Moreover, BIO will continue to have a proactive strategy on **equity investment in financial institutions active in the SME sector,** to increase its influence in terms of the balanced and responsible development of these companies. In this respect BIO will maintain a partnership strategy with key players (DID, AfricInvest, etc.) and develop its own expert network.

(ii) A new approach in the agricultural sector

This investment subject area was discussed above, in the section on the agricultural sector. The intention is to have a policy for the creation and development of financial institutions either dedicated to the agricultural sector, or with a clear strategic direction towards the agricultural sector (such as Banco Regional).

(iii) Development of a new financial sector: insurance

We will also explore the **insurance sector,** because it plays a key role in the economic development of countries:

- Insurance helps protect individuals and enterprises against certain risks, thus reducing their financial vulnerability. In developing countries individuals are more exposed to certain risks: flooding, loss of harvest, illness, early death.
- It contributes to the development of private savings (life insurance) which is fundamental in economies where social security is either non-existent or weak and where families have to rely on savings to meet emergency needs.
- Insurance is often a prerequisite for obtaining investment credit (personal insurance, assets insurance, etc.).
- Insurance companies invest their ample funds in local economies and are often the largest local investors.

Before making investment proposals in this sector, we will conduct an internal study on the sector's needs, the role that institutions such as BIO could play and the type of players that BIO could support. The objective is to seek a niche strategy with high added value.

(iv) Equity funding support for Eligible Enterprises

Through **investment funds**, BIO will provide **long-term equity capital support** to medium-size enterprises, the agricultural sector, basic infrastructure and in particular renewable energy.

We will select fund management teams who can play a vital role in formalizing medium-size enterprises, building up their managerial skills and expertise, creating an adequate governance structure to ensure that good decisions are taken and implemented, and in consolidating the financial structure of these enterprises. The supported enterprises often have a structuring role in the development of their market and serve as a role model for the entire private sector.

A key element when selecting our funds is the **principle of subsidiarity**: the selected funds must play a **spearheading** role for our action, and therefore explore investments that BIO teams cannot implement due to insufficient dedicated human resources.
Furthermore, it is expected that these funds offer us **co-investment opportunities** while also ensuring, through their presence in the governance structure, an adequate level of investment monitoring.

We will also look at the possibility of investing in **funds targeting small enterprises**. Given the lack of formalization of these enterprises, pure equity instruments cannot be envisaged (absence of audited accounts). Therefore, these will probably be hybrid funds using mezzanine debt tools and with the goal of improving the level of formality of their portfolio companies. These funds generally have lower expected returns than equity funds (around 5% return) but also a lower risk profile.

Lastly, in line with the recommendation made by the Special Evaluators to look for more **levers to ensure relevance on development of funds**, BIO will participate in a working group of DFIs within EMPEA[7] aiming to seek a common approach with our peers on this subject. BIO will also attempt to select management teams eager to establish a long-term relationship with DFIs and who are therefore especially sensitive to our concerns in terms of development and reputation.

D - Elements of analysis for our financing in the financial sector

BIO will assess its opportunities for financing in financial institutions based on the following criteria:

- Effects on local economic activity: number of SMEs financed, jobs indirectly created and mobilization of local deposits
- Structuring effects on the financial market: diversification of the financial sector, development of new products, diversification of granting of loans, transfers of expertise
- Financial inclusion: access to financial services by populations with low access
- Access to basic services and products (housing, education, etc.) through the provision of appropriate financial products
- Rural development: access to financial services by rural households and agricultural SMEs
- Social and environmental practices: Customer Protection Principles, management of social and environmental risks

BIO will assess its opportunities for financing in funds based on the following criteria which however still need to be refined in terms of looking at measuring impact on development:

- Effects on employment: number of jobs created

[7] EMPEA: Emerging Market Private Equity Association

- Effects on training and skills improvement: training budgets
- Structuring effects on the capital market: diversification of the financial offer, structuring of the private equity industry, innovative sectoral approach
- Contribution to institutionalization of enterprises: improved governance, long-term access to equity, provision of added value, support on environmental and social risks

V.2 The agricultural sector

BIO addresses this sector either directly by financing enterprises operating in the agricultural value chain, or indirectly by supporting financial institutions or funds operating in this sector. The Management Contract specifies that BIO will give **priority** financing to Enterprises developing agricultural activities which contribute, **directly or indirectly**, to strengthening **food security** in the countries in question.

A - Contextual elements in the agricultural sector

a) Priority given to food security

On average, growth in the agricultural sector reduces poverty three times more quickly than growth in any other economic sector. Agricultural development contributes directly to reducing hunger and malnutrition, and to increasing the ability of rural households to produce and buy nutritious food, while improving efficiency and increasing rural employment.

We wish to address the subject of food security from two perspectives from which the private sector can contribute:

- **access to the agricultural produce market**: development and improvement of agricultural chains are essential in order for production to meet market needs in terms of quality, quantity and diversity of foodstuffs. This takes place in particular through introduction of new technologies, investment in infrastructure, access to and more systematic use of fertilizers, development of distribution chains and support for players capable of playing a structuring role in agricultural segments.
- **inclusive rural development**: 85% of the African population lives off and depends on agriculture. A radical change in production methods would accelerate the rural exodus, To avoid this, it is appropriate to work towards developing employment and increased incomes in rural areas.

These intervention perspectives are subject to the necessity to **minimize the ecological impact** of agricultural development in terms of use of land and water, and so develop sustainable agriculture over the long term.

b) The constraints

There are a number of constraints to agricultural development in developing countries:

- Lack of public financing for agriculture
- Deterioration of climatic conditions (extreme temperature fluctuations, flooding, etc.)
- Inadequate securing of land-use rights and rights of access to natural resources,
- Lack of infrastructures suitable for increased agricultural productivity (cf. equipment operation, irrigation systems, processing, conservation, transport and storage of agricultural products, etc.)

- Scarcity of high quality agricultural inputs at competitive prices (fertilizers, seed, pesticides, etc.)
- Unmet needs for provision of public services (agronomic research, education, training, information, technical advice, etc.)
- Insufficient inclusion of family agriculture in value chains
- Exposure of producers to market risks (lack of protection against falling prices)

A number of responses to these constraints are to be found in **public action,** including improving land-use rights, agronomic research, access to credit, tariff protection and mechanisms to combat exchange rate volatility, risk management, strengthening of agricultural organizations, formation of regional markets, etc. This will also require the tackling of barriers linked to lack of infrastructure, logistics and regional integration.

c) Belgian Development Cooperation's strategic orientations

BIO's strategy must also form part of the broader strategy of the Belgian Development Cooperation for the agriculture sector and food security. The Cooperation's general goal is improved food security and contribution to sustainable economic growth generating decent jobs in rural areas. This goal breaks down into four priorities:

- Agricultural production: improving and securing agricultural production and productivity
- Marketing of production: improvement in agricultural optimization and access to markets
- Agricultural sector governance: strengthening of the State in its roles of coordination, facilitation and regulation and strengthening of civil society and farmers' organizations
- Rural women: individual and collective empowerment for rural women

Belgium's agricultural cooperation approach also encompasses support for family agriculture in view of contributing to food security for populations and sustainable economic growth, generating decent jobs.

Although the priorities on agricultural production, marketing of production and an accent on rural women may serve as a framework for our actions, BIO naturally has little influence over public governance of the agricultural sector other than ensuring that its own projects respect applicable regulations and integrate properly into local communities.

Moreover, BIO will not be able to work directly with family agriculture owing to the small size of these family operators and the high risk. On the other hand, this dimension can be taken into account indirectly thanks to collaboration between projects financed by BIO and farmers (in the form of jobs or supply contracts), and through financial institutions with an agricultural dimension that finance such family operators.

B - BIO strategy in the agricultural sector

To help respond to the challenges of food security and rural financial inclusion, BIO will centre its action on the following subject areas:

- Investment in improving productivity in the agricultural sector
- Support for agricultural operations that can play a structuring role in the agricultural chain
- Projects that can create local added value through processing of foodstuffs
- Development of rural activities through improved access to financing for small entrepreneurs in agricultural areas:

a) *Improving productivity in the sector* by investing in the entire agricultural chain, including upstream (infrastructure, irrigation, supply of equipment and agricultural inputs, technological improvements, etc.) and downstream (processing, storage, packaging, market access). Contributions in this sector may be made directly or indirectly through financial institutions in order to reach small and medium-size agricultural operations. Investment funds are also relevant players: due to their geographical proximity in terms of investments, their expertise and involvement in governance bodies of companies in the portfolio, they can be driving forces as regards strategic choices of agri-food companies and creation of added value for these companies.

b) *Financing of agricultural operators that can play a structuring role in the agricultural chain*. These operations should have a proactive and high quality approach in order to include rural communities in the project development:

   - Either through collaboration with smallholders (for instance through purchasing programmes from smallholders combined with technical assistance to improve their efficiency and competences).
   - Or by bringing decent jobs to surrounding villages in the context of existing plantations, which is also a contributing factor in acceptance of these projects.
   - Consideration of local communities in project definition, whether as regards access to water, to arable land or possible population resettlement.

We will work in priority **with agricultural operators that have reached a critical size and that combine the agricultural skills to** manage complex and variable production cycles (climate, illnesses, etc.) with project management competencies. Working with financially stable and well-managed agricultural operators should allow to have a long-term approach to support farmers, improved quality, transfer of expertise, development of certification, etc., which is not the case with more fragile institutions which tend to take short-cuts as regards treatment of suppliers and employees and as regards health and environmental standards.

Lastly, our objective is to contribute to the emergence of players that can have a demonstration role, setting the standards in terms of both their governance and respect for the environment. The success of such projects must contribute to building a climate of confidence in the private sector and serve as a catalyst for other investments in the agricultural sector.

In terms of the structure of the projects, we recommend that in the future we:

- avoid projects with too high agricultural complexity
- look for strong guarantees, which are often our last resort when disputes arise in projects
- develop an expert approach enabling us to focus on a few segments (for example, poultry farming, cocoa, cassava, palm oil) and develop other production segments in partnerships.

BIO will also continue to support agricultural **export projects**. Access to international agricultural product markets is fundamental to the development and enrichment of rural areas in developing countries and to safeguarding jobs there. This is especially true in the case of high value foodstuffs (vegetables, fish, flowers, coffee, cocoa, nuts and spices) which enable income diversification and greater sophistication in agricultural technology. Export development is also a vehicle for strengthening capacities (adoption of international standards, consolidating business lines) transferable to other cultures. BIO will naturally only consider such projects if they do not carry any risk in terms of food security.

Of course, **projects leading to greater food self-sufficiency** remain key. BIO has thus created real expertise in poultry farming (Senegal, Burkina Faso, Benin, Mongolia). It would be useful to identify promoters prepared to transfer their experience into least developed regions (Central Africa for example).

Another potential project axis involves projects **which increase internal demand for agricultural products** (where local production can replace imported agricultural foodstuffs). Thus certain beer brewers may be prepared to use locally grown cassava or maize instead of wheat imported from Europe.

We will also maintain **a moratorium** on **agricultural projects for biofuels**. However, projects in which crop residues (bagasse, rice husks, etc.) could be used as fuels are still entirely relevant for our activities.

c) *Investments in projects creating local added value through processing of agricultural products.* Development of processing projects in developing countries allows them firstly to access the link with the highest value in a product's value chain, and secondly to have better control over a product business line. Many countries have created tax-free export zones to encourage this development.

d) Development of rural activities through improved access to financing for small entrepreneurs in agricultural areas.

For our indirect investments in the agricultural sector, the challenge is to induce financial institutions to take an interest in the agricultural sector, given that the perceived risks are very high and that agricultural expertise needed to track these risks is inadequate. There now exist agricultural financial institutions in many countries in Latin America and Asia. In Sub-Saharan Africa however, financing of agriculture by the financial sector often remains rudimentary. The constraints are lack of a structured agricultural support policy, absence of adequate collateral, and fragmentation of players in the sector. Only a few structured players succeed in obtaining short and medium term financing. The export sector (cotton, coffee, etc.) also receives bank funding for financing inputs (seed, fertilizers, etc.) when public or private guarantee schemes exist (storage loans for example).

BIO's role in Latin America and in Asia would be to support development of agricultural portfolios by financial players present in the agriculture field. On the other hand, in Africa, our work would focus on the creation of such players, and on developing programmes dedicated to the agricultural sector within general banks.

Moreover, we will explore more fully working with agricultural cooperatives with the required financial strength and governance to receive financing.

C - Elements of assessment for our agricultural financing

BIO will assess its opportunities for financing operations in the agricultural sector based on the following criteria, the idea being that not all projects have to comply with all the criteria, but that they could be analysed pre- and post-transaction in the light of these criteria:

- Effects on agricultural production
- Effects on economic activity in rural areas: creation of formal jobs in rural areas, creation of economic opportunities for small agricultural operators
- Effects on the food supply in the local market
- Structuring effects on the agricultural and food sector: development of value chains, creation of local added value, transfers of technology and expertise
- Access to financial services (credit, savings, insurance) for rural households and agricultural SMEs
- Social and environmental practices: management of social and environmental risks, efficient use of natural resources

V.3 Energy

The development of energy projects plays a major role in the economic development of countries. Energy sector projects help increase production of electricity available to enterprises and households and diversify the energy mix. Some energy projects can have a positive impact on reducing the trade deficit and help limit rising prices.

Increasing available electric power improves the prospect of extending electricity distribution to peripheral districts inhabited by disadvantaged populations. These populations will thus reduce their use of biomass (wood charcoal) as a main source of energy. This in turn helps protect ecosystems, reduce time spent by women and children gathering wood or on other household tasks, and so free up time for school or income-generating activities. In the long term, an impact on health can even be demonstrated due to use of electrical appliances that are cleaner than open braziers for cooking, for example. For enterprises, secure access to electric power will mean they no longer have to use polluting and costly diesel generators and also give them improved competitiveness.

Projects in the energy sector also lead to job creation. In certain regions we also assist with the development of business lines supported by transfer of skills - this is sometimes the case with renewable energies for example.

Development of renewable energy or energy efficiency projects enables the reduction of greenhouse gas emissions and contributes to fighting climate change.

In the framework of the priority energy axis, while prioritizing renewable energy projects, we will remain open to all *energy generation sources except for biofuel and coal*, in other words:

- *renewable and sustainable sources:* hydroelectric, geothermal, wind and solar energies reduce greenhouse gas emissions and enable to manage without costly and polluting fossil-fuel based energy generation, thereby reducing dependency on imported energy.
- *conventional sources (gas, oil):* In countries with little or no potential for renewable energy, or in an effort to ensure a stable energy supply (renewable / conventional mix), financing these

types of projects makes perfect sense. Investments by development institutions ensure that these projects meet the most stringent environmental standards, and use the least polluting technologies.

- *hybrid sources (for example solar with diesel backup)* will also be considered eligible.
- *alternative sources (biomass):* Only when projects are based predominantly on agricultural crop residues (bagasse, etc.).

We will also remain open to all types of electricity production projects:

- independent projects producing for the local electricity distribution company (whether public or private) on the basis of a long-term purchase contract
- projects producing for the electricity wholesale market
- captive power projects producing exclusively for mines, cement works, factories, tourist centres, hospitals or industrial parks.

In addition, *energy efficiency* projects are also envisaged. These projects aim to rehabilitate existing plants in order to use less primary energy (fossil or other) but with the same energy efficiency, or the same quantity of primary energy with greater efficiency. The projects help reduce investment in infrastructure, and cut down on harmful pollutants. They also lead to lower energy costs, which benefits local enterprises and improves the lives of populations. These projects can be appropriate in all types of industry and particularly in energy-intensive industries.

Certain projects that have financing components for the *transmission of electricity* from power plant to network will also be considered by BIO.

Given the size of energy projects, we will **remain a follower** (particularly in partnership with FMO) **on large projects** but will endeavour to **develop our own expertise on small projects** (around €50 million) so that we can follow through more systematically with our leadership role for other investors (through ICCF for example). This expertise could in particular be developed in renewable energy and biomass projects.

In the context of our indirect interventions through investment funds in particular, our role will be to encourage the development of energy projects, and especially renewable energy in our priority markets.

BIO will assess its financing opportunities in the energy sector based on the following criteria:

- Effects on local energy production and the balance of trade
- Effects on energy cost and access to energy
- Effects on greenhouse gas emissions
- Effects on transfer of technology and expertise
- Adequate management of social and environmental risks.

V.4 Infrastructure of direct relevance to the development of MSMEs

BIO can invest in Enterprises involved in infrastructure of direct relevance to the development of MSMEs and social economy enterprises, such as ports, warehouses, transport infrastructure, storage sites, etc.

The main projects that would form part of BIO's scope will be:

- Irrigation projects, linked to our aim to support the agri-food sector in order to preserve local agricultural production and generate export potential.
- Telecommunications: The impact on local development lies in improving accessibility (especially in rural areas) and in achieving a decrease in the price of services offered to enterprises.
- Transport: The private projects considered, in particular in rail and port infrastructure, should help open up certain countries and so encourage regional trade and bring down the cost of transporting merchandise at country or regional level. BIO will also consider rehabilitation projects that enhance the safety and performance of transport systems for goods or.

BIO will also be interested in participating in financing projects involving Public Private Partnerships (PPPs), on condition that the project promoters are private.

Given the significant size of projects in these sectors and the small size of BIO's infrastructure investment team, we will remain a follower of lead investors in these projects.

V.5 Basic services to the local population

Our financing of basic services to the local population must complement public action, with the latter retaining the prerogative in terms of organization, regulation and supervision of these sectors. So in concrete terms, except for access to financial services, BIO will intervene in this sector when it can finance a private initiative that supports or complements the local government's policy and activities in this field (for example with financing by a private partner in PPPs). Regarding investments in the health, education, water and housing sectors, BIO will in particular analyse to what extent its interventions complement the Belgian Cooperation's strategy[8] regarding the public sector. This analysis will be undertaken in consultation with the services of DGD and the BTC responsible for these subject areas.

We will prioritize investments into improving the access to basic financial services: Naturally these include basic banking services (secure deposit systems, granting of loans, possibility of making money transfers at a decent price, monetization), but also insurance services (health, property & casualty, life). Microfinance projects also form part of these services.

Moreover, BIO will, as opportunities arise, consider projects in the following segments:

- Access to health care: BIO will intervene in this area in the context of creation or expansion of medical facilities (diagnostic centres, clinics, hospitals) intended for middle classes with facilities for the poorest people, or for financing the production of generic medicines in the developing countries, or for financing health services through development of health insurance. When

[8] Particular reference is made to the Basic Infrastructure Strategy Note of September 2002.

deciding on an investment, BIO will demonstrate that it will succeed in extending access to health care for the whole population.

- Water production and distribution, and waste water treatment: this is a field where development finance institutions have an additional and catalytic role to play, by mobilizing private financing. These projects were historically financed by states, and are still problematic in terms of financial viability and return in the eyes of the private sector.
- Access to education: BIO could for example finance vocational schools or universities, on condition that accessibility is quite broad.
- Access to housing: In the context of access to housing, BIO's interventions can cover refinancing credit lines in financial institutions for loans for housing purchase or improvement. Interventions could also support financing of projects indirectly enhancing the access to housing by enabling accessibility and reducing the price of basic products (cement or bricks for example).

Last but not least, BIO will obviously continue to abide by the so-called EDFI Exclusion List, which prohibits European DFIs from investing in certain sectors. The List is annexed to this Strategy.

VI. INTERVENTION CHANNELS

Channels

- *Direct interventions: BIO can intervene directly in Eligible Enterprises (…)*
- *Indirect interventions: BIO can also intervene indirectly, in particular:*
  - *(a) via financial institutions that provide financial services to Eligible Enterprises (…)*
  - *(b) via funds and investment companies targeting Eligible Enterprises (…)*
  - *(c) via infrastructure projects supporting Eligible Enterprises (…)*

BIO can hence intervene through different channels to realize its mandate.
In the specific case of direct investment in enterprises, we will focus on enterprises **that have the potential to become leaders and play a structuring role in their market.** These should be companies prepared to respect high quality standards and high environmental and social standards. These companies can generate ripple effects on large sections of a country's economy, upstream with their suppliers and their supervisory authorities, also with their peers and competitors, and downstream with their customers who benefit from a high quality product or service. In this respect we will naturally give precedence to projects with high local added value.

VII. PORTFOLIO BALANCE

From the effective date of this Management Contract, BIO's Board of Directors shall ensure it maintains a balance in its investment portfolio across its different categories (Eligible Enterprises).

When BIO assesses an investment proposal, it looks for a balance between the relevance of its intervention for development, taking account of the principles listed above, and the financial return.

Net Commitments at 31 December each year in the priority sectors (agri-food, energy and basic infrastructures, access to financial services) shall represent a minimum of 75% of BIO's total Net Commitments.

VII.1 Balance between Eligible Enterprises

As a reminder, Eligible Enterprises are

(i) MSMEs in developing countries (through our direct and indirect interventions and also infrastructure projects providing support for MSMEs);
(ii) Social economy enterprises,
(iii) Enterprises in the field of energy and combating climate change and
(iv) Enterprises offering basic services to people.

We will endeavour to keep a balance between the categories of Eligible Enterprises, and this will form part of our annual reporting to the Board of Directors.
For eligible enterprises in the social economy, we will, given the risks inherent in this sector and our lack of familiarity with this type of player, conduct a study of the sector in 2015 in consultation with sector players which will help define the framework of possible interventions.

VII.2 Sector balance

The Management Contract specifies that a minimum of 75% of net commitments should be made in the priority sectors. We will, as an illustration of sector priorities, also target 15% of net commitments in the agricultural and rural sector and 20% in the energy sector.

VII.3 Balance between BIO's relevance and efficiency

Within the community of development finance institutions BIO has defined, within its priority sectors and geographical areas, the niches in which it can play a pioneer or spearheading role, and the sectors in which our role will be to provide scarce funding but without any project management goal in terms of structuring projects and customer relationships. In the first case our investments will be more costly in terms of internal resources and expertise, in the second case we will be able to allocate our financial resources efficiently without this weighing too heavily on our human resources. This differentiation does not result in a difference in impact on development of the end projects supported, but does alter the extent of the role played by BIO.

Taking into account our operational history and priority sectors and regions, we will have the following main niches:

- ⇨ Improve financial inclusion and SME financing in underbanked regions in the form of equity funding (BIO / shareholder) or medium term financing
- ⇨ Play a structuring role for medium-size enterprises undergoing formalization
- ⇨ Support development of a number of agricultural subsectors (still to be determined)
- ⇨ Develop small / medium scale energy projects in regions with low access to energy
- ⇨ Develop a healthy private sector in Central Africa (DRC, Rwanda, Burundi)

VII.4 Balance among financing instruments

BIO currently has a portfolio oriented mainly towards debt instruments (72%), whereas 5 years ago there was a balance in the portfolio between debt and equity. This change is essentially due to creation of an infrastructure activity essentially oriented towards debt products and significant loans in both financial institutions and enterprises. This orientation has the advantage of providing BIO with regular and relatively stable revenue. It also has a lower risk profile than investments in equity.

With the aim of extending our role in certain niches and playing a more structural role in terms of our investments, **we will target a weighting of 60% debt and 40% equity in our portfolio** whether in indirect form (via funds) or direct form. Investments in equity however require more intensive monitoring and should lead us to extend BIO's investment and supervision teams, systematize certain partnerships and employ external expert resources.

VIII. ORGANIZATION / RESOURCES

Implementation of the Management Contract and of the strategy needs new thinking on organization, notably in terms of prospecting and supervision, expertise management, setting up partnerships and structuring investment documents.

VIII.1 Organization

In its intervention countries, BIO will focus on developing an understanding of (1) the structure of SME financing, (2) the key challenges and opportunities for agricultural development, (3) energy plans implemented and (4) the role of the private sector in development of basic services. Furthermore, the unit recently established on development economics and environmental and social aspects, and the regular internal training sessions and thematic seminars it organises, should provide an immediate boost with respect to the values, missions and principles of Belgian Development Cooperation.

As long as we do not have local presences, we will continue rely on prospection and supervision missions from Brussels, and on building partnerships with institutions that have local presence and the same intrinsic characteristics as BIO (operating in the private sector and investment, sensitivity to development issues, respect for high ethical, environmental and social standards).

We therefore envisage active prospecting in around twenty countries, prospecting that should include an in-depth visit to each country every two years with a review of the main SME financing players and visiting potential project referral agents (investment funds, banks, development finance institutions, embassies, auditing and legal firms, etc.).

In so far as local representatives of federal institutions (including the BTC) and federal entities can act as intermediaries for our activities through their interest in economic development via the private sector, BIO will explore integrating them into its prospecting networks.

Besides its staff and head office in Brussels, it could be desirable to establish a local presence in one form or another in its intervention countries. This presence could enhance project identification and investment monitoring. Still, such local presence, whether with BIO staff or in cooperation with other institutions already present in relevant countries, complicates management and is expensive. Therefore, BIO's Board of Directors will reflect on and decide whether and how BIO will develop a local presence.

VIII.2 Expertise management

Internal and external expertise management will become a central focus of BIO's organizational development in the coming years. Up until now, BIO has used the services of external experts on a case by case basis. Regarding key competencies, in a methodical and cross-functional way we will identify resource people for specific topics such as:

- being board members of companies in our portfolio
- developing particular areas of expertise within our investments: upgrading of accounting, financial, commercial, environmental and social aspects, etc.
- providing business line expertise in the framework of our due diligence and supervision work: agronomists, energy sector engineers, etc.

VIII.3 Partnerships for better efficiency

In the past, BIO has been able to develop successful partnerships on a formal basis (with FMO on infrastructure, with DEG on enterprises, with Incofin and DID on development of financial inclusion) or informal basis (with AfricInvest, with whom we have made a number of successful co-investments). The success of these partnerships is due in part to our common approaches on ethical and financial matters, but also to mutual respect based on long term established relationships. We will **consolidate these partnerships** which contribute to our mutual development while preserving the mandate of each party.

Moreover, **BIO and the BTC** have, as set out in the Management Contract, created a working group to develop collaboration opportunities for mutual training programmes, identification of areas of expertise where BIO could call on BTC, and the identification of other synergies and complementarities (the objective being to identify one or two pilot cooperation projects by the end of the year). In addition, BIO will strive towards better cooperation between Belgian development institutions in view of improving the regulatory environment in our intervention countries.

Other partnerships will be envisaged on a case by case basis, in particular with other players from the Belgian Cooperation, on condition that they contribute to the harmonious deployment of our activities in certain countries or sectors. Given the time and effort required to set them up and manage them, we will not have a proactive policy to increase the number of such partnerships,

VIII.4 Structuring of investment notes

Eligible Enterprises, the intervention principles and the priority strategic axes will serve as a framework for the Approval of Admissibility notes and the Investment Summary of proposed projects, so that follow-up can be performed in a consistent way. Each investment note will also explain, in the first-page table, how the investment forms part of this Strategy.

IX. STRATEGY IMPLEMENTATION

For the implementation of this strategy we will ensure a good understanding of the values, principles, strategic priorities and implementation choices in this Strategy by all the teams responsible for the investment cycle.

Concrete implementation steps are also presented below to serve as a roadmap:

Deadline	Objectives
31/01/2015	• Environmental and social procedure in place • New methodology to measure impact on development in place • Presentation of the strategy to the teams involved in the investment cycle • Setting up the working group and looking for complementarities with the BTC. • Start of the consultation process with Embassies
31/12/2015	• Revision of how prospecting is organized • Defining reporting tools • Systematization of the governance approach • Pricing policy • Putting in place complementarities with the BTC • Study on the social economy sector • Consolidation of successful partnerships • Improvement in expertise management
2016/2017	• Exit from jurisdictions excluded by Law

Evaluation
An annual evaluation of BIO’s implementation of this strategy will be done by the Board and will form the basis of the annual report to the Minister for Development Cooperation, as required by article 8.4 of the Management Contract.

In Annexe: EDFI Exclusion list

Annex: EDFI Exclusion List

1) Production or activities involving forced labor[9] or child labor[10]
2) Production or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements.
3) Any business relating to pornography or prostitution.
4) Trade in wildlife or wildlife products regulated under CITES[11]
5) Production or use of or trade in hazardous materials such as radioactive materials[12], unbounded asbestos fibers and products containing PCBs[13].
6) Cross-border trade in waste and waste products unless compliant to the Basel Convention and the underlying regulations.
7) Drift net fishing in the marine environment using nets in excess of 2.5 km in length
8) Production, use of or trade in pharmaceuticals, pesticides/herbicides, chemicals, ozone depleting substances[14] and other hazardous substances subject to international phase-outs or bans.
9) Destruction[15] of Critical Habitat[16]
10) Production and distribution of racist, anti-democratic and/or neo-nazi media.

In addition to the above, the financing of projects is excluded, when the following activities form a substantial[17] part of a project sponsor's primary operations or those of the project:

11) Production or trade in[18]
    a) weapons and munitions
    b) tobacco
    c) hard liquor
12) Gambling, casinos and equivalent enterprises[10]

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9 Forced labor means all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty as defined by ILO conventions.

10 Employees may only be taken if they are at least 14 years old, as defined in the ILO Fundamental Human Rights Conventions (Minimum Age Convention C138, Art. 2), unless local legislation specifies compulsory school attendance or the minimum age for working. In such cases the higher age shall apply.

11 CITES: Convention on International Trade in Endangered Species or Wild Fauna and Flora.

12 This does not apply to the purchase of medical equipment, quality control (measurement) equipment and any other equipment where EFP considers the radioactive source to be trivial and/or adequately shielded.

13 PCBs: Polychlorinated biphenyls, a group of highly toxic chemicals. PCBs are likely to be found in oil-filled electrical transformers, capacitors and switchgear dating from 1950-1985.

14 Ozone Depleting Substances: Chemical compounds, which react with and delete stratospheric ozone, resulting in "holes in the ozone layer". The Montreal Protocol lists ODs and their target reduction and phase-out dates.

15 Destruction means the (1) elimination or severe diminution of the integrity of a habitat caused by a major, long-term change in land or water use or (2) modification of a habitat in such a way that the habitat's ability to maintain its role (see footnote 10) is lost.

16 Critical habitat is a subset of both natural and modified habitat that deserves particular attention. Critical habitat includes areas with high biodiversity value that meet the criteria of the World Conservation Union (IUCN) classification, including habitat required for the survival of critically endangered or endangered species as defined by the IUCN Red List of Threatened Species or as defined in any national legislation; areas having special significance for endemic or restricted-range species; sites that are critical for the survival of migratory species; areas supporting globally significant concentrations or numbers of individuals of congregatory species; areas with unique assemblages of species or which are associated with key evolutionary processes or provide key ecosystem services; and areas having biodiversity of significant social, economic or cultural importance to local communities. Primary Forest or forests of High Conservation Value shall be considered Critical Habitats.

17 A benchmark for substantial is 5 – 10 % of the balance sheet or the financed volume.

18 In Financial Institutions this is calculated with regard to the portfolio volume financing such activities.