



House of Commons  
Public Accounts Committee

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**Investing for  
Development: the  
Department for  
International  
Development's  
oversight of CDC  
Group plc**

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**Eighteenth Report of Session  
2008–09**

*Report, together with formal minutes, oral and  
written evidence*

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## The Public Accounts Committee

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

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Mr Philip Dunne MP (*Conservative, Ludlow*)

### Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk).

### Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

### Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Lorna Horton (Senior Committee Assistant), Pam Morris (Committee Assistant), Jane Lauder (Committee Assistant) and Alex Paterson (Media Officer).

### Contacts

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## Summary

CDC Group Plc, formerly the Commonwealth Development Corporation, is the United Kingdom's Development Finance Institution. It is wholly owned by the Department for International Development (DFID), which views it as a means to help reduce poverty by supporting private sector development. CDC is self-financing, having received no Government funding since 1995. It does not donate aid. Rather, it invests equity in private enterprises in developing countries in order to demonstrate to other investors that it is possible to make money in such countries, while at the same time creating sustainable jobs, paying taxes and following good social and environmental policies. It now faces the new challenge of investing effectively during a global recession.

DFID restructured CDC in 2004 in order to invest indirectly, through private fund managers. CDC invests largely in sub-Saharan Africa and South Asian enterprises in sectors as diverse as retail, financial, agricultural and manufacturing. Since 2004, CDC has grown rapidly, more than doubling the value of its assets to £2.7 billion by mid-2008. DFID's oversight of certain elements of business efficiency needs to be improved. High profits have led to CDC accumulating some £1.4 billion of uninvested cash, far higher than expected. And management of rising levels of executive pay has been weakened by misunderstandings, particularly as to when CDC should have consulted DFID.

DFID does not interfere in individual investment decisions but sets the overall framework for CDC's investment policy, which targets poor countries. As a result, CDC invests over 70% of its resources in poor countries, a far higher proportion than for similar institutions in other donor nations. CDC has limited influence, however, where its fund managers invest within these broad criteria. Only 4% of its resources are invested in small and medium enterprises, which suffer a shortage of finance. And it has only recently reduced new investments in China, which has been relatively well served by other investors.

For DFID, financial performance is the principal indicator of CDC's development impact, but this information is not sufficient to assess CDC's effect on poverty reduction. In 2004, DFID and CDC set out plans to evaluate wider development results and to monitor compliance with ethical investment principles. But it is not doing enough to measure and report these aspects of performance, and work to remedy this situation is only now getting underway.

The level and nature of CDC executive remuneration are also relevant to business efficiency and management incentives. The Chief Executive's remuneration increased from £383,000 in 2003 to £970,000 in 2007, reflecting in part CDC's exceptional financial performance. Advisers concluded that CDC executives were paid below the median for this group. However, CDC does not compete for cash to invest, offers high job satisfaction, and has, since 2004, successfully recruited and retained talented staff.

On the basis of a report by the Comptroller and Auditor General,<sup>1</sup> we examined how effectively DFID has exercised its oversight of CDC to maximise its development impact.

## Conclusions and recommendations

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- 1. CDC has performed well since it was restructured by DFID in 2004, outperforming the market while investing in poor countries.** However, DFID has not been able to assess CDC's financial performance satisfactorily due to weak medium-term targets. The efficiency of CDC and its business model are questionable given that administrative costs have been rising as a proportion of portfolio value. DFID should set medium-term financial targets for CDC relative to relevant market indices, clarify its attitude to risk in investments, and define measures of efficiency which capture all the costs of the business model that CDC uses.
- 2. CDC accumulated £1.4 billion in cash by mid-2008 due to higher than expected profits and difficulty reinvesting the proceeds.** The cash is now committed to future investments but outside ranges agreed in CDC's 2004 Business Plan. DFID was not fully involved in the strategic choices being made. DFID should routinely be consulted on the nature and scale of major CDC commitments and on their effect on cash balances.
- 3. Steep increases in remuneration for CDC executives since 2004 reflected CDC's exceptional financial performance, but CDC did not properly consult DFID as required under the agreed remuneration policy.** DFID failed to ensure that the governance arrangements worked as intended. DFID and CDC must recognise that high levels of pay, however merited, must be subject to effective oversight, particularly if the organisation has not had significant problems in recruiting and retaining high calibre staff.
- 4. The remuneration arrangements led to extraordinary levels of pay in a small publicly-owned organisation charged with fighting poverty, with the Chief Executive receiving £970,000 in 2007.** Part of that pay reflects market-beating financial results, but it also reflects a dubious comparison with private sector 'fund of funds' businesses. Besides enjoying the security of working in a publicly owned body, CDC executives do not have to compete for money to invest. And the pay arrangements take too narrow a view of performance, with too much emphasis on financial performance and too little on poverty reduction.
- 5. Compliance by businesses and fund managers with CDC's ethical business principles is not independently verified.** Reporting on these principles represents a contractual obligation on fund managers, but CDC depends largely on their objectivity and honesty to assess and report compliance accurately. CDC staff earn bonuses if the assessment of compliance is favourable. DFID now accepts that it must work with CDC to strengthen the governance of business principles. It should ensure that assurance and assessment are independent of CDC and fund managers, and that the assessments cover the portfolio as a whole, with an agreed format for reports.

6. **Since 2004, CDC has increased the proportion of its portfolio in countries such as China and India which are already successful in attracting foreign investors.** A key DFID objective for CDC has been to demonstrate the possibility of good returns in less well-known and developed markets. New CDC commitments in China will now be limited to small and medium-sized companies. DFID should ensure that CDC concentrates its resources in deprived areas and markets. And it needs to improve the way that CDC measures and reports its effectiveness in mobilising additional investment in such markets in order to help guide future CDC Investment Policy.
7. **DFID has encouraged CDC to look for ways in which it can invest more in low income countries, which may require CDC to increase its use of financing instruments other than equity.** Instruments such as loan finance may imply different balances of risk, reward and administrative cost. DFID needs to make sure that CDC's financial targets, business model and incentives do not restrict such changes where they represent an appropriate response to the needs of poor countries. CDC's reporting should clearly distinguish results achieved from different types of business.
8. **Although CDC invests more of its resources in poor countries than any other Development Finance Institution, there is limited evidence of CDC's effects on poverty reduction.** CDC is working to collect improved information on the developmental effects of its investments, and DFID should require CDC to report the results systematically and in a way which fairly represents its portfolio. DFID should also commission an independent evaluation of CDC's impact, timed to inform the next five-yearly business review, and building on improved CDC fund evaluations.
9. **By investing through private sector fund managers CDC has found it more challenging to collect and report non-financial information such as its contribution to reducing poverty.** CDC and other investors look to moderate fund manager costs, and all parties have traditionally required that the performance and plans of the fund, and the companies in which it invests, remain confidential. These features have been built into the legal agreements surrounding the fund and its investments, and changes to practice require commitments from both fund managers and any other investors. CDC will, however, have unusually high influence with fund managers in the downturn. As one of the few entities with money to invest, CDC should use that influence to promote greater transparency and openness.

# 1 CDC's financial performance and efficiency of its business model

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1. CDC Group plc, formerly the Commonwealth Development Corporation, is the United Kingdom's Development Finance Institution. It is wholly owned by the Department for International Development (DFID), which views it as a means to help reduce poverty by supporting private sector development. CDC does not donate aid. Rather, it invests equity in private enterprises in developing countries in order to demonstrate to other investors that it is possible to make money in such countries, while at the same time creating sustainable jobs, paying taxes and following good social and environmental policies.

2. In 2004, DFID restructured CDC to change its business from making direct investments itself to placing investments through external fund managers. A large part of CDC was part-privatised as a fund management business called Actis. Initially, CDC invested largely through Actis and one other fund manager, Aureos, but over time it has come to work with more than 60 fund managers active in emerging markets. Under this new business model, CDC's tasks are to:

- select the right fund managers and funds to channel its money through;
- carry out due diligence investigations;
- negotiate the best terms and conditions, and
- oversee progress and plans for exits.

Each fund typically secures funding not only from CDC, but also from private investors and other Development Finance Institutions. It then provides equity finance to a number of enterprises. **Figure 1** shows CDC's investment model.

3. Since 1995, CDC has been financially self-sustaining. In recent years, its financial performance has been outstanding, with net assets more than doubling from £1.1 billion in 2004 to £2.7 billion by mid-2008, well above DFID and CDC's 2004 projections.<sup>2</sup> In contrast, CDC had been loss-making on average in the eight years before 2004.<sup>3</sup> Its strong performance broadly coincided with a period of rapid growth in emerging markets, but CDC also exceeded relevant market indices, despite investing in relatively poorer countries.<sup>4</sup> Because investment funds take up to ten years to produce profits, some 82% of CDC's profits since 2004 have come from investments made before then. The overall profitability of CDC's investments made from 2004 to 2008 will not be known for several years.<sup>5</sup>

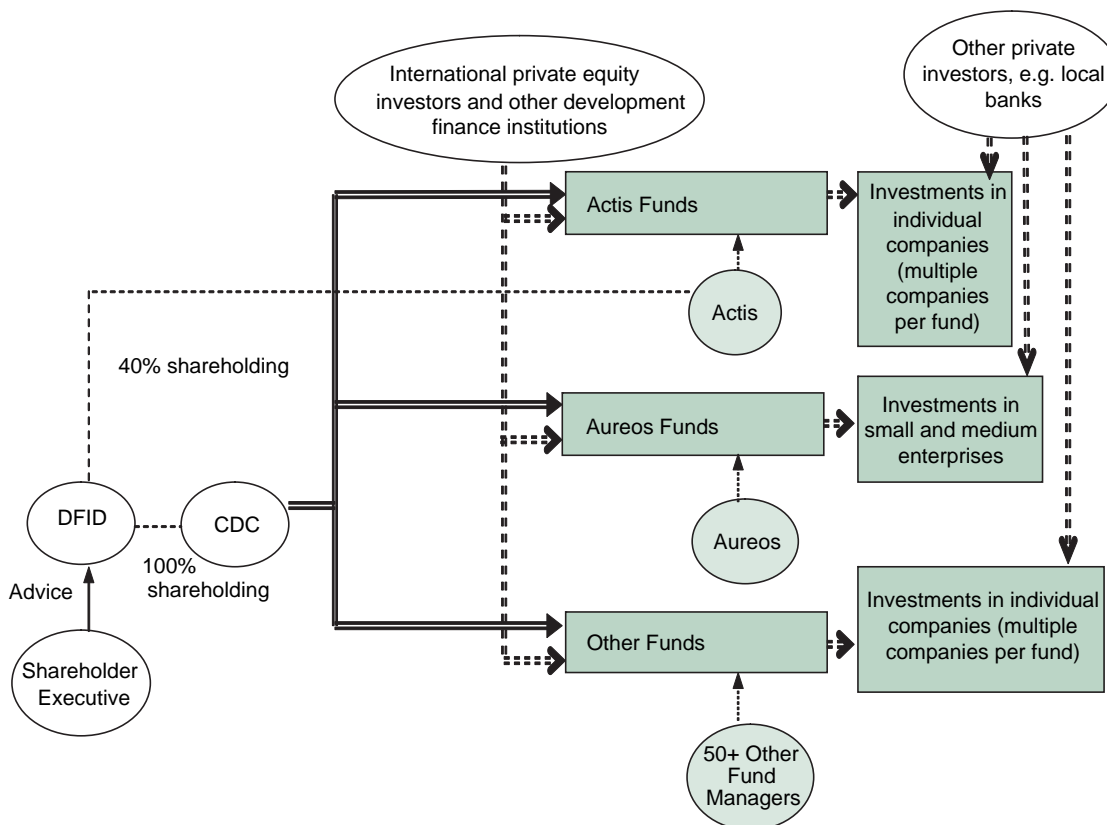
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2 Qq 24, 65; C&AG's Report, para 4

3 Q 18

4 Qq 69, 180; C&AG's Report; Figure 5

5 Q 18; C&AG's Report, para 2.4; Figure 4



4. With a growing recession affecting investment prospects across much of the world, CDC expects many of the 600 companies in its portfolio to be adversely affected and the next year or two to be difficult. Stock markets in emerging economies fell by around 60% in 2008.<sup>6</sup> In the current difficult investment climate, CDC's £1.4bn of uninvested cash is proving useful, enabling it to continue investing in poor countries and at lower prices. Fund managers may, however, experience short term difficulties in selling CDC's invested assets, reducing the flow of cash from its existing portfolio.<sup>7</sup>

5. Prior to the change in the global economic outlook during 2008, CDC's level of uninvested cash appeared extremely high and exceeded the amount held in investments. Since 2004, CDC had systematically underestimated its end-of-year cash balances, a result, in part, of higher than expected profits, and, in part, of fund managers drawing down committed funding more slowly than expected. CDC had no obligation to inform DFID when it held excess cash, taking into account its ability to convert proposed investments into actual ones. DFID intends to correct this situation by March 2009. DFID and CDC also point to the £1.8 billion that CDC has now committed to investment with fund managers over the next few years. Whether cash balances will in fact be substantially reduced over this period depends on the relative size of cash draw-down needed to finance actual investment, and the cash made available by any disposals.<sup>8</sup>

6 Qq 35, 70

7 Qq 16, 36

8 Q 16, 36, 43–50; C&AG's Report, paras 5, 2.10, 2.13; Appendix 2

6. In common with private sector fund management practice, CDC staff are incentivised for strong business performance, and 75% of the Chief Executive's remuneration has been through performance-related pay.<sup>9</sup> In addition, the fund managers that CDC uses receive both management fees and a share of realised profits above an agreed threshold. These arrangements have enabled DFID to ensure strong incentives for financial performance and have sent a signal to other potential investors that CDC's investments are commercially motivated.<sup>10</sup> However, the post-2004 business model also means that there is an additional tier of costs. Because it is typically 10 years before a fund's investments are wholly realised, the full extent of profits that will fall due to fund managers is not yet known. Currently 8.4% of profits associated with the sale of CDC-funded investment is taken by fund managers. And, whereas CDC's total operating costs represented 4.8% and 3.7% of its portfolio value in 2002 and 2003 respectively, the full costs of the new business model, including fees and profits due to fund managers, amounted to 5.5% of portfolio value in 2006 and 2007.<sup>11</sup>

7. CDC is exempt from tax in the UK and its profits are owned by the Government and intended to be reinvested in poor countries. CDC carries out its business through 72 subsidiaries, of which 40 are located in off-shore financial centres to make its investment tax efficient. CDC does not invest in tax structures listed as unco-operative or harmful by either the European Union or the Organisation for Economic Co-operation and Development. Its investee companies are required to pay taxes in accordance with local law, one of the ways in which profitable companies can contribute to wider development. CDC estimated that its investee companies are paying £250 million tax annually, based on information it had received from fund managers.<sup>12</sup>

8. The level and nature of CDC executive remuneration are also relevant to business efficiency and management incentives.<sup>13</sup> The Chief Executive's remuneration increased from £383,000 in 2003 to £970,000 in 2007, reflecting in part CDC's exceptional financial performance. DFID and CDC differed in their interpretation of the remuneration framework as to how far rewards could be increased to reflect exceptional performance.<sup>14</sup> Against explicit Treasury advice, DFID also allowed the CDC Board flexibility to alter the constituent weightings of the remuneration incentives. Finally, without consulting DFID, CDC changed the comparator group against which it benchmarked remuneration, permitting higher levels of executive pay. DFID has subsequently agreed this higher benchmark to be the right comparator, based on new advice from specialist remuneration consultants. The advisers concluded that CDC executives were paid below the median for this group. However, CDC does not compete for cash to invest, offers high job satisfaction, and has since 2004, successfully recruited and retained talented staff. In future, DFID will require a formal remuneration meeting with CDC before pay is set.<sup>15</sup>

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9 Q 17; C&AG's Report; Figure 18

10 Qq 21–22

11 Qq 110–116; C&AG's Report; Figure 6; Ev 28

12 Qq 83–93; Ev 24–25

13 C&AG's Report, para 12

14 Qq 117–119, 123; C&AG's Report; Figure 19

15 Qq 164–175; C&AG's Report, paras 5.14–5.16; Recommendation ix

9. DFID has refrained from interfering in CDC's investment decisions, a stance vital to demonstrating CDC's commercial discipline to other potential investors. To date, this is vindicated by CDC's performance as DFID's 2004 restructuring of CDC has been followed by exceptional financial performance in return for a relatively modest increase in business costs. However, there have been occasions when DFID's 1.5 person oversight team and their advisors have not seized, or been afforded by CDC, opportunities to exert an owner's proper oversight, as illustrated by the case of remuneration discussed above. DFID now recognises the need to be more active in its oversight of remuneration, and the need for a clear protocol and incentives for re-investment of cash generated by disposals. The period since 2004 also demonstrates the need for DFID to work with CDC to explore the significance of different scenarios for the future state of investment markets. DFID cannot be expected to predict the course of CDC's business, but it needs sufficient tools to evaluate and respond to a variety of risks and opportunities affecting business performance.<sup>16</sup>

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16 Qq 49–50, 120–123, 164–175; C&AG's Report, para 12

## 2 Whether CDC's investments are appropriately targeted to reduce poverty

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10. As a result of the current CDC Investment Policy, and previous investment policies in place prior to its restructuring in 2004, around 60% of CDC's investment portfolio has been directed to low income countries. This means its portfolio is much more focused on poor countries than are the investment portfolios of other Development Finance Institutions. For example, CDC is investing more in poor countries than the combination of the German, Dutch and French Development Finance Institutions. At DFID's request, it has largely withdrawn from Latin America where per capita incomes are higher, and has increased investments in Africa where incomes are much lower.<sup>17</sup>

11. Since 2004, a growing proportion of CDC's portfolio—up from around one quarter to nearly two thirds—has been deployed in Nigeria, South Africa, India and China. These countries contain some 62% of the world's poor and include some very poor districts, but they also contain well established locations for foreign private investment. Because CDC uses fund managers to invest on its behalf, it has less ability to direct its money to disadvantaged districts within a country than if it were a direct investor identifying its own opportunities using its own staff. When investing in a China fund, for example, it can try to use its influence so that the fund invests in the countryside as well as in cities. But when funds come up with first-class commercial propositions in urban areas, CDC is constrained as to how far it can direct the fund managers elsewhere.<sup>18</sup>

12. DFID has not set CDC targets to invest in particular districts or sectors within countries. Part of China's poverty reduction success has been the huge migration of people out of the poorest districts to the more dynamic coastal regions. DFID considers that if CDC is investing on the coast and creating sustainable jobs it is contributing to poverty reduction in China. DFID thinks it right for people to migrate from rural areas, where they were much less productive. DFID does not claim that without CDC investment this job creation in urban areas would not have happened; only that CDC is encouraging and facilitating greater job creation. Moreover, in China CDC has not only supported areas that are already well-invested. It has made some investments in Shandong Province and other quite poor provinces in an attempt to assist local economies.<sup>19</sup>

13. CDC and DFID acknowledge that the global investment climate is different now to what it was four or five years ago when DFID set CDC's first investment policy. DFID now considers that CDC can target its investments progressively on poorer countries, without excessive risk to the business. Accordingly, DFID and CDC have agreed a more stretching investment policy for the future. The new policy will permit some investments in middle income countries, but as a special arrangement, DFID has asked CDC to limit new

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17 Qq 18, 24, 29, 33; C&AG's Report, para 3.4

18 Qq 8–10, 160

19 Qq 9–12, 51–55, 72, 135

investments in China to small and medium enterprises. DFID thinks that other investors can meet the needs of these economies.<sup>20</sup>

14. CDC's accumulation of cash balances and high profits in excess of expected levels raise questions about whether it could do more in poor countries and difficult markets. Small and medium enterprises in many developing countries suffer from a continuing severe shortage of finance. Only some 4% of CDC's portfolio by value is currently invested in small and medium enterprises, even though 30% of its funds invest in this sector. Several of those funds specialise in microfinance institutions, which provide small amounts of finance to very small businesses, sometimes as little as several dollars each. Smaller businesses are important to development and have a huge benefit locally, but investing more than relatively small sums of money is difficult. The smaller deal size involved in this sector increases fund manager costs—in terms of selecting suitable investment proposals, carrying out due diligence work and monitoring investment proposals—relative to the value of an investment portfolio. In contrast, very large projects such as power stations take much more significant amounts of capital and yield economies of scale to fund managers. So CDC has invested relatively small sums in small businesses in total, even though it funds a considerable amount of activity in the sector.<sup>21</sup>

15. From 2009, DFID's new investment policy for CDC will require it to invest progressively in poorer countries, though not in specific sectors or sub-regions within countries. During lengthy debate with DFID about the new investment policy, the CDC Board expressed reservations that some countries are not as ready to absorb private equity investment as others. CDC's own projections indicate that high cash balances will last for several years, even if fund managers draw down cash from CDC for investment as quickly as currently forecast.<sup>22</sup> And in the short term, CDC's options to invest in poor countries might be limited during a global recession. Nevertheless, research commissioned by DFID in 2008 suggested that CDC could do more to grow demand for private equity in low income countries. CDC is also looking beyond private equity to see whether debt finance may be suitable for some of the least developed markets. The CDC Board has been hesitant, however, to move back into operating as an old style CDC with a large field staff and direct investments. It considers that the total focus on delivering equity finance through fund managers has been the root of CDC's success since 2004. If CDC is to diversify, for example, into debt products, it would prefer to use intermediaries as it has done for equity investment. Alternatively, if CDC is unable to invest its capital wisely through equity or new debt products, it will discuss with the government about whether DFID should withdraw some cash, so that the government can decide how to use the proceeds.<sup>23</sup>

16. The new Investment Policy shares with the previous policy a basis in permitting investment in a number of eligible countries. It is not surprising that within the parameters allowed by such a policy CDC investment has increased in the wealthier of the permitted countries and those with better developed financial markets. These are the markets which

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20 Qq 8, 24, 53, 56, 149

21 Qq 26–28; C&AG's Report, para 3.14

22 C&AG's Report, paras 5, 2.9–2.11

23 Qq 25–26, 157–159

offer the prospect of larger deals and manageable risks that commercial fund managers favour. In weaker markets in the poorest countries, a degree of market development may be needed to facilitate further investment in the future. CDC has now started to make investments which include a market development aspect, often accepting higher than usual risk, and lower than usual expected returns. In this type of investment, CDC's joint investors are usually Development Finance Institutions or philanthropic investors, rather than private investors seeking a commercial return. There are no criteria agreed with DFID by which CDC balances commercial with wider benefits, such as opening up and developing new markets.<sup>24</sup>

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24 Q 33; C&AG's Report, paras 3.14–3.18; Appendix 3

### 3 Whether CDC's investments are delivering the expected results

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17. DFID uses CDC's financial performance as its principal indicator of development benefit. Intuitively, firms that are profitable, pay taxes and create jobs are better for development purposes than firms that do not. DFID has concluded from research that exceptionally good financial performance is associated with improvements and development impact. The International Finance Corporation (a leading development finance organisation) looked at 469 of its own investments over a five year period and found a strong association between high levels of financial return and improvements in private sector development. However, the research also showed that profitability was not strongly correlated with environmental and social performance or wider economic benefits. So, while a critical factor, financial results are not enough to assess fully CDC's contribution to poverty reduction and other development benefits. CDC has begun to extend its information on development results beyond financial performance, but is constrained by its ability to obtain relevant data from more than 60 private sector fund managers.<sup>25</sup>

18. By mid-2008, CDC had completed only four evaluations of its development impact, against an expected 22. It had removed the target of 22 after the first four evaluations revealed consistent lessons. However, these assessments lacked depth, with little performance data apart from financial performance. CDC had established its own arrangements to evaluate development impact, based on information collected from fund managers, and there was no arrangement for DFID to receive or review these assessments. CDC has now produced a further eight evaluations, which, reflecting a change in oversight arrangements, DFID has now received. Because of this limited evaluation programme, it is hard to assess the contribution CDC's investments make to development, but DFID now accepts the need for more comprehensive evaluation in future.<sup>26</sup>

19. Exceptionally, in 2007, DFID asked CDC to report on the development benefits of its largest investment, Globeleq, managed on CDC's behalf by Actis. CDC and Actis commissioned consultants to assess Globeleq's achievements, rather than overall impact, and they reported in January 2008. A short version of the report was subsequently made available in July that year, but the full report has not been published. DFID has now released the non-commercially sensitive parts of the report.<sup>27</sup>

20. A central part of CDC's mission is to attract additional investment into poor countries, in addition to its own. Achieving a strong financial performance is integral to this mission, but CDC must also lead, rather than simply follow, other investors. CDC reports joint investments by other parties in the funds it invests in, and has significantly exceeded the relevant targets, reporting £1.5 billion in third-party capital invested with its two main fund managers, Actis and Aureos. Around 40% of this total, however, is from other

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25 Q 2; C&AG's Report, paras 4.1, 4.3

26 Qq 3-7, 11-12, 151; C&AG's Report, paras 4.10-4.12, 14

27 Qq 181-183; C&AG's Report, para 4.13

development finance institutions, which have mandates to invest in developing countries. Moreover, this simple measure of joint investment cannot reflect how far CDC's participation was instrumental in mobilising these other investments. Based on information received from fund managers, CDC believes just four of the 120 funds in which it invests were 'oversubscribed', attracting more finance than they set out to target, suggesting to CDC that it is not displacing private investors. However, DFID and CDC lack robust evidence on whether commercial investors would have invested in markets such as Nigeria, India, China and South Africa without CDC's presence.<sup>28</sup>

21. CDC requires all its fund managers to commit to a set of ethical business principles, in accordance with international best practice. These principles cover areas such as environmental protection, workers' rights, health and safety and compliance with local laws such as on tax, and are designed to ensure that good financial returns contribute to economic and social development without adverse effects. Fund managers are contractually obliged to report breaches of business principles, which, after having satisfied CDC's due diligence enquiries, CDC trusts them to provide. There is no system of independent verification, although CDC visits its fund managers at regular intervals and visits some investee companies. CDC cannot guarantee that all its investments meet its business principles, but emphasises the importance of continuous improvements in the governance of its investee companies. CDC has decided not to invest with fund managers which it felt did not take business principles sufficiently seriously, but has not had to take action against existing fund managers for failure to comply. CDC reporting to DFID on compliance with business principles is anecdotal. CDC and DFID now accept the need to report objectively on actual adherence to ethical business principles, and not simply the process of securing compliance.<sup>29</sup>

22. DFID has endorsed CDC remuneration packages which incentivise financial and non-financial aspects of fund performance. In practice, monetary incentives for staff to pursue non-financial development objectives have been weaker than incentives for financial performance. DFID was content to incentivise financial performance because of the history of CDC average annual losses of 4% for the eight years before 2004, and because it believes CDC must be seen to be commercially motivated in order to attract other investors. Development of credible non-financial measures, to achieve the originally intended balance, has proved difficult. With only limited information on CDC's development results and adherence to business principles, CDC's performance bonuses have continued to incentivise good CDC financial performance more than these non-financial aspects of poverty reduction.<sup>30</sup>

23. Better measurement systems will take time to implement, and require CDC to use its influence with fund managers to extract the essential information. DFID has agreed to independently audit the process with which CDC checks compliance with business principles, and to select a sample of firms, which CDC will verify for compliance.

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28 Qq 15, 23, 64–65, 81, 195–197; C&AG's Report, para 2.7; Ev 28–29

29 Qq 57–59, 91, 97–99; C&AG's Report, para 10

30 Qq 18, 31; C&AG's Report, para 5.11

Independent verification is particularly important given that reported performance in these areas contribute to CDC's staff remuneration.<sup>31</sup>

# Formal Minutes

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**Monday 30 March 2009**

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon  
Angela Browning

Rt Hon David Curry  
Rt Hon Alan Williams

Draft Report (*Investing for Development: The Department for International Development's oversight of CDC Group plc*), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 23 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Eighteenth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

[Adjourned till Monday 27 April at 4.30 pm]

## Witnesses

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**Monday 15 December 2008**

*Page*

**Ms Nemat (Minouche) Shafik**, Permanent Secretary, **Mr Mark Lowcock**, Director General Country Programmes, Department for International Development, **Sir Malcolm Williamson**, Chairman and **Mr Richard Laing**, Chief Executive, CDC Group plc

Ev 1

## List of written evidence

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# Oral evidence

## Taken before the Committee of Public Accounts

on Monday 15 December 2008

### Members present:

#### Mr Edward Leigh, in the Chair

Mr Richard Bacon  
Angela Browning  
Mr David Curry  
Nigel Griffiths  
Keith Hill

Mr Austin Mitchell  
Dr John Pugh  
Mr Don Touhig  
Mr Alan Williams

**Mr Tim Burr CB**, Comptroller and Auditor General, **Ms Caroline Mawhood**, Assistant Auditor General and **Mr Nick Sloan**, Director, National Audit Office, gave evidence.

**Mr Marius Gallaher**, Alternate Treasury Officer of Accounts, HM Treasury, gave evidence.

### REPORT BY THE COMPTROLLER AND AUDITOR GENERAL (HC18)

#### INVESTING FOR DEVELOPMENT: THE DEPARTMENT FOR INTERNATIONAL DEVELOPMENT'S OVERSIGHT OF CDC GROUP PLC

*Witnesses:* **Ms Nemat (Minouche) Shafik**, Permanent Secretary, **Mr Mark Lowcock**, Director General Country Programmes, Department for International Development, **Sir Malcolm Williamson**, Chairman and **Mr Richard Laing**, Chief Executive, CDC Group plc, gave evidence.

**Q1 Chairman:** Good afternoon. Welcome to the Committee of Public Accounts. Today we are considering the Comptroller and Auditor General's Report on the *Department for International Development's oversight of CDC Group plc*. We welcome back to our Committee Nemat Shafik who is the Permanent Secretary to the Department. Would you please introduce your colleagues?

**Ms Shafik:** I would be delighted to. On my left is Mark Lowcock, the Director General currently for Country Programmes but he has been overseeing CDC for much of this period; Sir Malcolm Williamson, Chair of CDC and Richard Laing the Chief Executive.

**Q2 Chairman:** Ms Shafik, I will start by addressing my questions to you but you can always pass them over if you wish. We know that CDC profitability has exceeded expectations but to what extent have CDC's profits led to poverty reduction?

**Ms Shafik:** We know quite clearly that exceptionally good financial performance is associated with improvements and development impact. Intuitively firms that are profitable, that pay taxes, that create jobs are better for development than firms that do not. If you look at recent research from the International Finance Corporation (which is the leading development finance organisation in the world) they have looked at 469 of their investments over a five year period and what they found is that 97% of projects that had high levels of financial return also had high levels of development.

**Q3 Chairman:** Obviously if you have high financial returns you must, to some extent, relieve poverty but why do we read in 4.10 that "CDC established its

own arrangements to evaluate development impact" (this is what we are talking about, this is an anti-poverty organisation) and "To date CDC has completed four evaluations". This does not strike me as an organisation which is committed as a core function to reducing poverty.

**Ms Shafik:** Part of the reason they have only done four reflects the fact the CDC was only restructured in 2004.

**Q4 Chairman:** Restructured when?

**Ms Shafik:** In 2004.

**Q5 Chairman:** Four evaluations in nearly five years.

**Ms Shafik:** Richard, would you like to say something about the evaluation process?

**Q6 Chairman:** You had been expected to complete some 22 evaluations, Mr Laing.

**Mr Laing:** Yes.

**Q7 Chairman:** What has gone wrong?

**Mr Laing:** Can I explain what we are doing on evaluation and the basis of doing it? We invest through funds as the Report says and the funds typically have a 10 year life. We set up in 2005, as the Report says, a process to assess development impact of those funds. The process that we set up to do requires us to assess the development impact at mid-life of the fund—that is five years—and at the end of the fund, so we would only expect, given that we started this business model in 2004, to have a handful done by the mid-life of the fund because most of these funds started in 2004. In fact, since this report was produced we have in fact done a further eight and that is line with our target.

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**Q8 Chairman:** Anyway, you were expected to do 22 and you are now on four. Let me look at where you are investing. We read in paragraph 3.9 that “A growing proportion, up from around one quarter to nearly two thirds” (of this investment) “has been deployed in Nigeria, South Africa, India and China”. Why have you allowed this organisation to invest so much in China where presumably its ability to actually lever significant investment, given the size of the economy, is really very limited? Why China? There is no real problem with developing a market in China; this is not one of the poorest of the poor nations. Why do we read that so much of this investment has gone to countries like Nigeria, South Africa, India and China which had very developed market places already?

**Ms Shafik:** In fact India, Nigeria, China and South Africa are 64% of CDC’s portfolio but they constitute 62% of the people who are living under a dollar a day. They are in fact where most of the world’s poor are.

**Q9 Chairman:** What evidence have you got that they are actually investing in the poorer parts of China and the poorest regions?

**Ms Shafik:** The issue is not whether they are investing in the poorest regions.

**Q10 Chairman:** Or indeed in the poorest people.

**Ms Shafik:** The issue is: are they creating jobs in China? As you know, part of China’s poverty reduction success has been the huge out-migration of people from the poorest regions to the more dynamic coastal regions. If CDC is investing in the coast and creating sustainable jobs it is contributing to poverty reduction in China.

**Q11 Chairman:** Why do we read in 4.12 that “The evaluations contain detailed financial performance data, but lack summarised quantitative data on other development effects”? This question I have asked you about China, surely this is something we would like to know. This is an organisation which we own, we want to relieve poverty and we would expect to see detailed evaluation on how we are relieving poverty.

**Ms Shafik:** We would and it is certainly the case that we have an extensive evaluation programme planned for the future.

**Q12 Chairman:** Why does it read here that DFID does not receive CDC’s evaluations?

**Ms Shafik:** We have now received all of them I think.

**Q13 Chairman:** How many people do you employ in DFID’s overseas organisation?

**Ms Shafik:** Our current staffing in the narrowest sense is one and a half full time staff.

**Q14 Chairman:** One and a half people.

**Ms Shafik:** We also rely extensively on the shareholder executive and external advisors when we need them. Over the last year when we have been enhancing and reviewing many aspects of CDC’s governance we have expanded our staff and we have

hired an additional person. We have relied heavily on legal advisors, remuneration advisors and consultants from a variety of areas when we have needed them.

**Q15 Chairman:** What is to stop CDC investing in businesses that would have attracted support from other investors?

**Ms Shafik:** In fact I believe none of CDC’s funds that it has invested in have been oversubscribed<sup>1</sup> which is a very good indicator that they are not crowding out or substituting for other investors. The majority of funds that it is supporting are first time groups coming together to invest in emerging markets.

**Q16 Chairman:** You are sitting on £1.4 billion. How much cash do you need to run an efficient organisation?

**Ms Shafik:** We actually do not think that the amount of cash that CDC has is a problem because most of that cash is already committed. Of the £1.4 billion that exists, £1.8 billion is already in pre-existing commitments. That cash is not sitting idly in a CDC bank account; it is sitting in the government’s debt management office and is reducing the amount the government itself has to borrow. Most funds are quite envious of CDC’s cash at the moment because it can play a counter-cyclical role as it should.

**Q17 Chairman:** Let us look at remuneration now; this is page 31, figure 19. This is a very profitable organisation—we do not deny that—and I am sure it is very well run, but it is an anti-poverty organisation and you are paying the chief executive £970,000 a year (the best part of a million pounds a year). Have you really kept control of this remuneration package, Ms Shafik?

**Ms Shafik:** It is important to remember that three-quarters of this remuneration package is driven by performance and the fact that the salary is what it is reflects the outstanding financial performance that CDC has achieved.

**Q18 Chairman:** I suspect that the reason why the chief executive is getting a salary which is extraordinary for an anti-poverty organisation is precisely because of these performance bonuses and that is why you are investing so much in China, Nigeria and South Africa but you are not investing in the Congo and the world’s poor. That is why Mr Laing—he can answer himself in a moment—is earning £970,000. I put it to you, Ms Shafik, that as the department responsible you wholly own this, you should have got a grip on this much earlier and you should have ensured that his performance bonuses were related to his efforts to relieve poverty for the world’s poorest people. You only have one and a half people employed in your department overseas organisation; I think that frankly you have not kept proper control of it.

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<sup>1</sup> *Note by witness:* The actual number of oversubscribed funds is only four (out of a total of over 120 funds).

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**Ms Shafik:** CDC is more focussed on the poorest countries than any development finance organisation in the world; 60% of its investments are in low income countries. Its competitors or its equivalents are no more than 20% or 30% investing in low income countries. They are investing more in poorer markets than anybody out there. Secondly, on remuneration, it is very important to understand the context in which the remuneration framework was agreed for CDC. When we restructured CDC it had, for the previous eight years, lost on average 4% a year, so that is minus 4% rate of return for eight years running. We made losses. When CDC was restructured it has been returning rates of return of 24% over the last four years and it is precisely that success that we wanted to incentivise through the remuneration framework.

**Q19 Chairman:** So we are going to carry on with this kind of remuneration package in the future, are we?

**Ms Shafik:** We are currently reviewing the remuneration framework.

**Q20 Chairman:** What is likely to happen next year, for instance?

**Ms Shafik:** I think it is quite clear that next year will be a much tougher year given what has happened in world markets and I expect that the remuneration will be lower.

**Q21 Chairman:** Will there be any change of policy? You can always take the argument that if you were running a private hedge fund in the private sector then obviously the sky is the limit, we know that. However, this is a wholly owned public company. Do you have no point of view about what should be the upper limit in a wholly owned company, owned by the public? Obviously there has to be proper remuneration, we all accept that, but do you think that £970,000 a year is about right?

**Ms Shafik:** I think the issue is: have we incentivised strong financial performance?

**Q22 Chairman:** You have to do that; we all accept you have to do that, but do you think it is about right?

**Ms Shafik:** Is the framework right? I think the answer to that is yes. Perhaps I will ask Mark Lowcock to answer on this.

**Mr Lowcock:** One thing we have done in the light of the success of the company developmentally and financially over the last five years is to set a new investment framework for the next five years which asks CDC to invest increasingly in even poorer markets. We do think that it is important that the people who work for CDC are incentivised to invest profitably. Moreover we think it is very important that those we are trying to attract to co-invest with CDC believe that CDC is motivated commercially. One of the successes of the last four years has been that the company has raised something like £1.5 billion in extra investment from third parties whom we believe would not have come into these relatively poor markets unless they thought CDC were operating in what they saw as a commercial way.

**Q23 Chairman:** Mr Laing, you are sitting here, you have to be allowed to defend yourself. Here you are, sitting in front of a group of MPs earning this salary, defend it.

**Mr Laing:** I defend it because the results have been very good. CDC has generated £1.7 billion over the last four years. As the Permanent Secretary said, over 75% of my pay was performance related. We have invested over a billion pounds into the poorest countries in the world and we have attracted alongside our capital \$2.6 billion of third party capital alongside us in our main fund managers, Actis and Aureos. The structure of pay is performance related; the mechanics were set up; the company delivered and therefore the pay was made accordingly. CDC as a team is investing in the toughest markets in the world. We recruit from the fund of funds industry which is the comparative group which the government's own advisors have said is an appropriate group to recruit from. That same advisor has pointed out that CDC is paid below the medium. We need to attract good people to do what we do and that is why people are paid well.

**Chairman:** Thank you. Keith Hill?

**Q24 Keith Hill:** I would like to begin by congratulating CDC on its outstanding performance. You have more than doubled your net assets in a period of four years. As we see from figure 27 in appendix four of the Report, CDC has a far better record of deploying these very large assets into investment in poor countries than any other European development finance institution. As paragraph 3.13 demonstrates you invest more in low income countries than in upper middle countries by quite a considerable extent and more in low income countries than in low middle income countries particularly where there are the opportunities for quality investment. This seems to me an outstanding record of achievements on the part of CDC and I really cannot understand why the organisation has been the target of this media campaign against it in recent times. I want to ask some questions about investments in low income countries and also in small to medium enterprises, but can I first ask you whether you accept the charge in the NAO Report that you invested disproportionately in the poor countries of which the Chairman has spoken while increasingly neglecting smaller economies?

**Sir Malcolm Williamson:** First of all thank you for your kind comments; I think we are all very proud of the performance. There are several issues I would like to make, particularly in the context of the Chairman's opening remarks when he questioned the investments we have in China, Nigeria and so on. I think the world is different now from the way it was when we first started this mission four or five years ago. We have had a lot of success in emerging markets and there has been a kind of rising tide, so a lot of countries that were designated poor four or five years ago no longer are in that definition which is why we have gone for new investment policies described by Mr Lowcock earlier. When you look at the countries in which we invest we are a fund of

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funds so we can only invest where there are fund managers. Just because Nigeria is a big country and it has the biggest population in Africa, it has more opportunities, there are more opportunities to invest in a place like Nigeria than there are in the Republic of Congo but that does not mean that we do not invest in the Republic of Congo. I visited a mine there about three weeks ago in which we have an investment and it is quite a surprising sight to see. I think that we are constantly trying to see what we can do to get into the poorest countries but unfortunately some are not as ready for private equity as other countries are. In terms of the new investment policy we are looking beyond private equity in fact to see what we can do to help some of the poorest countries by doing other products, debt for instance, because it seems important to keep the mission focussed.

**Q25 Keith Hill:** Could I ask you about the Lisa Curtis report which I think was done for DFID in August of this year and is referred to in the footnote to paragraph 3.12. You received advice in September that “CDC could do more to grow demand for private equity in low income countries, by developing more intermediaries and by actively supporting the development of potential investments”. Can I ask you what your reaction to that has been?

**Sir Malcolm Williamson:** We wanted to take a considered view of that report and take into account all other sorts of options so we had a strategic piece of work done recently (which the board has discussed but which we have not exposed yet to our department) which tries to look at the future and the best way of dealing with some of these problems. I think it is interesting that the first question is: should we have more of a field force that can do that handholding that is suggested in that report? I suppose as Chairman of the Board I have been a little bit hesitant about that because I think it might take us back into an old style CDC. What we have done over the last four or five years has been a very focussed piece of business which has resulted in the success it has because we have had a total focus on it. If we are going to diversify, for example into debt products, I would rather we did it in a disintermediative way, in the way that will have equity, so that we do not need a massive staff and we do not need a massive field force. I think the Lisa Curtis report was helpful and promoted a lot of thought and discussion, but I think at the stage we are at we would probably be recommending, when we come forward on this, that we have a very much more focussed approach to what we do and we do not go back into having a big field force.

**Q26 Keith Hill:** Before I move onto the question of small and medium enterprises, let me again put to you an observation made by the NAO which is that there have been opportunities for investment in low income countries. Why did DFID and CDC not seize these during the period 2004–07 given the massive scale of your uninvested cash?

**Sir Malcolm Williamson:** I think the answer to that is that we have taken those opportunities. I visit a lot of countries and I see CDC in quite a big way in a lot of places—the Zambias, the Congos—and a lot of countries benefit from our being there in terms of their development. We have been going through an investment cycle and when you go through this sort of cycle you put money out in the bad times and you often harvest them in the good times and then you put money out again in the poorer times. At the moment we have gone through that cycle where we have done a lot of harvesting which is why we have cash in the bank but we have also been sowing a lot of seeds so, as was said earlier, that £1.4 billion in the bank is actually spoken for and over-committed in terms of the investment promises that we have made. Those promises reflect the nature of the business that we have, which is hugely towards developmental targets in the poorest countries in the world, it is just that some of the smaller countries do not have the absorptive capacity that some of the bigger countries do.

**Q27 Keith Hill:** You spoke of seeds and absorptive capacities, let me ask about finance for small and medium enterprises which the NAO Report, I am sure absolutely accurately, describes as experiencing a severe shortage of finance. Why is only 4% of CDC’s portfolio invested in such funds?

**Mr Laing:** It is right that the percentage of the total portfolio is relatively small. One factor is that the amount of capital you can get to work in SMEs is very difficult but also because we are also investing in very large projects such as power stations and so forth which take up significant amounts of capital. I would point out that in paragraph 3.14 that the NAO rightly point out that 30% of our funds by number are invested in micro-finance and small and medium enterprises. Since 2004 we have actually significantly increased our focus on micro-finance and SMEs which was not happening before 2004 and it is something that certainly I am very proud of that we are investing in SMEs. This is real life stuff. Just the week before last I was in northern Zambia talking to a table egg producer, a business completely refurbished, employing 119 people up from about 70, each of those the local management reckon have eight dependents each. So it is a small investment doing a lot of good in a remote part of northern Zambia. Interestingly, they do more than just the commercial side. That is an area where there is 43% HIV/AIDS and they have been asked by the EIB (the European Investment Bank) to set up a clinic which they will manage and that will benefit 18,000 people. These SMEs are very important; they have a huge impact locally but it is relatively small sums of money.

**Keith Hill:** Thank you.

**Q28 Nigel Griffiths:** I am very keen to explore some more of your micro-financing examples. That was a good one. How small do you go down in terms of your financing of micro-projects?

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**Mr Laing:** That 37 specialist funds—the 30% I was talking about—will range from the very large scale investments of up to about \$7 or \$8 million but then in micro-finance we have about half a dozen funds. There, of course, the individual amounts could be as low as \$3 or \$4 per person on occasion. It is an enormous range.

**Q29 Nigel Griffiths:** You are demonstrating that it is truly micro-finance. I am very keen to return to table 27 on page 46, firstly just to check the facts. Is it right that the richest country in Europe at the moment—the biggest economy—is Germany which was actually investing last year less not per head but in absolute terms than us?

**Mr Laing:** If you take Germany, FMO (the Dutch) and PROPARCO (the French) their investment in poor countries in fact in aggregate is less than us so the British Development Finance Institution is doing more in poor countries than the combination of the Germans, the Dutch and the French.

**Q30 Nigel Griffiths:** Are any of the three of these on the sort of incentive programme that you are on?

**Mr Laing:** They have some incentive arrangements but not similar to ours, no.

**Q31 Nigel Griffiths:** Do you think the incentive arrangements have been helpful in motivating not just you but your staff to ensure that money is actually reaching 66% in this case of poor countries?

**Mr Laing:** One of the targets we are set is about getting our capital to work in the poorest countries of the world and if we fail to meet that target then our incentive arrangements are penalised.

**Q32 Nigel Griffiths:** How come relatively rich countries like Spain have only a 1% investment?

**Ms Shafik:** The Spaniards tend to focus a huge proportion of their finance in Latin America which is mainly in middle income regions, so very little of it is going to low income, poor countries.

**Q33 Nigel Griffiths:** Have we overtaken any of these countries in the past decade or so since the Commonwealth Development Corporation became CDC? In other words, where have we gone in these league tables in that time?

**Mr Lowcock:** When we have overtaken I am not sure, but we have certainly moved more into the poorest countries. For example, the company, at our request, has come largely come out of Latin America where per capita incomes are much higher and heavily into Africa where they are much lower.

**Ms Shafik:** It is important to note that our new investment policy which was announced in a written ministerial statement last month will take this even further with requiring 75% to go into low income countries and 50% of new investments to go into Africa.

**Q34 Nigel Griffiths:** I notice that the NAO say in one of their paragraphs that it takes up to 10 years for these projects to mature. Is that perhaps part of your answer to the Chairman's question about

evaluations? How do you evaluate projects one, two or three years in? How do you evaluate them in credit crunch and uncertain times like now?

**Ms Shafik:** That is exactly right, that it takes time. You can only look at these projects five or 10 years out and hence the delay in evaluation. Going forward we have quite a detailed evaluation programme planned which will produce a dozen evaluations next year and 20 thereafter. We will begin to start getting real data on the new investment portfolio and its impact.

**Q35 Nigel Griffiths:** I know it is not the subject of this Report but obviously we and the public will be concerned to know what the impact of the credit crunch is. Have you got a preliminary assessment of that which you could share with us?

**Ms Shafik:** I think Richard should speak to that.

**Mr Laing:** There is no hiding from it; it is not going to be good. Our portfolio consists ultimately of 600 investee companies; those 600 companies are working in the global world and they are being affected by the recession. Some of them are struggling and some of them are doing better but it would be foolish of me to say that it would be anything other than difficult for the next year or two.

**Q36 Nigel Griffiths:** Are you expecting a decline in the amount of money that you will be able to invest in the poorest communities and countries?

**Mr Laing:** That is something we are assessing at the moment. It will depend on the ability of our fund managers who manage the portfolio on our behalf to sell businesses in order to return cash to us. I would expect that certainly in the short term that their ability to sell is going to be reduced and that will result in less cash coming to us. The fact that we have a cash deposit at the moment—that the Permanent Secretary was referring to—is so useful because that means we can continue to put money to work even though we are getting less back from our portfolio in these difficult times.

**Q37 Nigel Griffiths:** How are you estimating we will be at the end of this financial year in terms of investing in poor countries both in absolute terms and in percentage terms? Will we be able to maintain the 66%?

**Mr Laing:** I think percentage-wise we will. We have been given a new policy by DFID which will require further new commitments going forward, in fact to go to 75% of low income countries; that is something we will do.

**Q38 Nigel Griffiths:** Looking again at table 27 does that mean we will go from top spot to a kind of mega top spot?

**Mr Laing:** Yes, it will.

**Q39 Nigel Griffiths:** Table 28 is the changing deployment of CDC's investment portfolio, what does that tell me in column two about Botswana, Nigeria, Columbia, Mozambique and countries like that.

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**Ms Shafik:** What this table tells you is that CDC is not investing in those countries which already get a lot of investment, the grey first column. CDC is not doing much investment in those countries which have the worst possible investment climate for business. Where you do see CDC is in those countries—in the blue boxes—which either do not get much investment or have marginal investment climates but not dreadful ones and that is as you would expect.

**Q40 Nigel Griffiths:** Column one, the grey area for the first quartile, is that where we are investing or not?

**Ms Shafik:** No, we are not. Those are countries that already get quite a bit of investment; they are high investment countries.

**Q41 Nigel Griffiths:** So when constituents write to us and ask why we are not in the Congo or Sudan, we are not in with these programmes because there is heavy interest by other countries, is there? Are we still the biggest bilateral aid donor to Sudan?

**Ms Shafik:** In Sudan's case of course they get a lot of investment in the oil sector.

**Q42 Nigel Griffiths:** So they are getting it directly.

**Ms Shafik:** Yes.

**Q43 Angela Browning:** Could I come back to the question of the cash balances which the Chairman asked about and you told us that you were in an enviable position with these cash balances which, at the time of the NAO Report, exceeded the value of investment. What is the position with regards to the recommendations specifically made about these cash balances by the NAO Report on page eight, small three? They make some positive requests here, that there should be a protocol. Is there a protocol?

**Ms Shafik:** We will be developing a protocol in the future.

**Q44 Angela Browning:** You do not have one at the moment.

**Ms Shafik:** It is linked with the new investment policy and the new remuneration framework so we will alter the remuneration framework in a way that will make it clearer as to how CDC should handle cash balances. Having said that, we do not see the current cash balance as a serious problem; in fact it is quite an advantage in the current economy.

**Q45 Angela Browning:** We have also heard in another answer that actually although you have these cash balances a significant amount of that balance has already been committed for future use. One of the recommendations at small three was that "The protocol should require consultation with DFID over the use of any excess cash". Were you consulted, Ms Shafik, about the way in which this money has been allocated for future use?

**Mr Lowcock:** The company can only commit to funds which keep it compliant with its investment policy. We have tightened the investment policy to the extent that if the company has cash which is not

currently invested in its investment companies it has to keep it on deposit at the Office for Debt Management. It being on deposit there has the effect of reducing what the government would otherwise have to pay.

**Q46 Angela Browning:** I fully understand that but one of the recommendations which has been made to you by the National Audit Office in its Report says that the protocol which you have yet to establish "should require consultation with DFID over the use of any excess cash". We have heard that the excess cash has already been allocated for future use; I am asking you if you were consulted about that future use.

**Ms Shafik:** The cash that is there now is not excess cash as would be defined by the NAO because it is committed to legitimate sources, but in the future we will have a policy on cash management which will be part of the remuneration framework that we are agreeing.

**Q47 Angela Browning:** What I want to ask you now is that if you put this protocol in place as suggested and if it is the future practice that DFID would then be consulted about the use of any excess cash, have you got the ability to make a risk analysis and a judgment about that or is it going to be the case that when CDC say to you, "This is what we think should happen to this" have you got people who are able to make a judgment on that or will you need to recruit them?

**Ms Shafik:** We do have people who can make a judgment on it. We have quarterly meetings with CDC reviewing the business on a regular basis. When we need additional support we get it but we have a very strong and able team who, I think, by the evidence here, have done a very good job.

**Q48 Angela Browning:** At the end of the day they have not actually been consulted to date as outlined in this protocol.

**Ms Shafik:** As we say, we do not see this cash balance as excess; it is pre-committed and we do not see it as a problem.

**Q49 Angela Browning:** I know you do not see it as a problem but you have actually got a specific recommendation by the National Audit Office. Why do you think they made this recommendation if you do not see it as a problem?

**Mr Lowcock:** One possibility would be for the company to get to a point where it has more cash than it can wisely invest in the markets we have instructed it to work in. At that moment the government could take a view about whether it wanted, for example, to broaden the markets or to withdraw cash from the business and put it to some other use. One of the points of the protocol would be to make sure that such a moment was identified and there was a proper discussion of what to do were it to be identified.

**Q50 Angela Browning:** Do you have a timetable for establishing this protocol?

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*Ms Shafik:* We will agree the remuneration policy probably in the next month and we will have a new business plan for CDC by March so it will be within the next one to three months.

**Q51 Angela Browning:** Could I ask you about China because that was also touched on by the Chairman? On page 11 we can see an example of a specific investment in China which is CDC's investment in De Quing Yuan, the poultry company managed by Capital Today. You mentioned, I think, in response to the Chairman that one of the main purposes of investing in China was that the populations in the rural areas are gravitating towards the urban areas. Is this specific project in a rural area?

*Mr Laing:* It is on the east coast region I understand. I have not visited it.

**Q52 Angela Browning:** I just wondered if this is an example of a business or a company operating in a rural area in order to retain people working in a rural area or is this something which goes on in an urban area.

*Ms Shafik:* Most of the job creation in China has been on the coast and people have legitimately migrated because that is where the jobs are. The fact that it is on the coast is probably a sensible thing. I should also clarify that only 6% of CDC's portfolio is in China.

**Q53 Angela Browning:** I understand that.

*Ms Shafik:* Going forward there will be no investments in China except for in small and medium enterprises.

**Q54 Angela Browning:** It is just that it is rather strange, given the background to China and its economy, to see that money was being put there. I was trying to work out what sort of analysis you would do in a project like this in China in terms of deadweight costs. You gave us the impression that the investment, apart from making a return, would be helping to produce jobs in rural areas where people were migrating to urban areas and I am just asking whether this project is actually fulfilling that or whether that would have happened anyway.

*Ms Shafik:* I think what I intended to say was that the job creation is in the urban areas and it is probably the right thing for people to migrate from rural areas where they are much less productive.

**Q55 Angela Browning:** Are you saying that without these investments it would not have happened?

*Ms Shafik:* No. These are just encouraging and facilitating greater job creation in urban areas.

**Q56 Angela Browning:** There will not be any more investment in China apart from small businesses.

*Ms Shafik:* That is right.

**Q57 Angela Browning:** Could I just finish on the question of governance? Quite a lot is said in the NAO Report about governance and we are told that DFID has requested and received from CDC only periodic good practice examples and again there are

some recommendations here. I just wondered, Ms Shafik, why you tolerated CDC reporting only anecdotally about compliance with business principles.

*Ms Shafik:* I will say something first about governance and then about the business principles. There are five aspects to DFID's governance of CDC. There is our investment policy, there are the business principles, there is the remuneration framework which sets the pay, there are the overarching responsibilities for the chair which we agree with the chair every year and there is a signed MOU with CDC about how we are going to operate. Over the last nine months we have been systematically strengthening every one of those aspects of our governance framework. In March of this year we agreed new arrangements for reporting on pay; in October we agreed a new letter with the chair; in November we agreed a new investment policy which we lay before the House; in December/January we will be agreeing a new remuneration framework. On the business principles the issue has been that it is not practical for CDC to get independent audits of compliance with business principles for 600 companies. What we have agreed with CDC going forward is that we will independently audit the process by which CDC checks compliance with principles and we will select a representative sample of firms which they will independently verify are complying with business principles.

**Q58 Angela Browning:** CDC has over 60 fund managers; let us talk about them and their understanding of what you are requiring of them in terms of meeting their obligations. How many of those 60 CDC fund managers now fully meet their obligations to report compliance to you?

*Ms Shafik:* All of them report to CDC once a year about their compliance. The issue is additional verification beyond that. Richard, would you like to say something about that?

*Mr Laing:* Every fund manager to whom we commit capital to their funds are required to sign up to our investment code which sets out the business principles and they are required to report back to us in the event of there being a breach of those business principles and also to confirm to us once a year that they are being honest. That is a strong obligation and we will not go into a fund where the fund manager is not prepared to do that. There have been examples where we have turned down a fund manager because we felt they were not taking our business principles seriously.

**Q59 Angela Browning:** Will you accept the recommendation of the NAO to report objectively on actual adherence to ethical business principles and not simply the processes of secure and compliance? Have you accepted that recommendation?

*Mr Laing:* Yes but what we need to do primarily is to make sure that our investment fund managers are doing what they are meant to do and so check them. In order to do that, as Ms Shafik said, we will be

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looking at a sample of investee companies—the underlying companies—to make sure that business principles are being followed.

**Q60 Angela Browning:** I always find this one of the most important parts of any NAO Report and that is when you look at page eight and you see the range of recommendations made by the NAO, can we take it then that you, having already read this report and studied it for some time now, are satisfied that you can accept and meet these recommendations so that if you were to come back before us this time next year you would be able to say you had put all of that into your practice?

**Ms Shafik:** Broadly speaking we agree with all the recommendations.

**Q61 Angela Browning:** I am asking if you are going to do it.

**Ms Shafik:** Yes, in fact we have already, as I have said, moved on many of these things in terms of the new investment policy, the new remuneration framework, putting in place this new procedure for business principles. So yes, we are almost there in terms of responding to these recommendations and we will do that within months.

**Q62 Mr Touhig:** Ms Shafik, your department is responsible for Britain's international aid programme with the ultimate objective of poverty reduction. The CDC Group is supposed to support that.

**Ms Shafik:** That is correct.

**Q63 Mr Touhig:** How does it do that? What are the specific targets and objectives that you set it?

**Ms Shafik:** CDC is one very important instrument in our arsenal for fighting poverty. DFID does many other things.

**Q64 Mr Touhig:** Yes, but what specifically have you asked them to do?

**Ms Shafik:** We have asked them to demonstrate and to bring others with them to show that you can make money and create sustainable jobs in the poorest countries in the world, and do that in a way that creates sustainable jobs, pays taxes and has good social and environmental policies.

**Q65 Mr Touhig:** That is a broad mission statement; what specifically have you asked them to do?

**Ms Shafik:** We have asked them to do that in the context of the investment policy, to invest the majority of their assets in the poorest countries in the world. It is important to note that we have not put any public money into CDC since 1995 so it is a self-sustaining vehicle. We are continuing to push the frontier to create sustainable private sector development in the poorest countries.

**Q66 Mr Touhig:** A little while ago Mr Laing said that you put a billion pounds into the poorest countries in the world. That is not true though, is it? You put that money into China, India, South Africa and Nigeria where you might have the largest

number of poor people but not necessarily the poorest countries. They are quite different things, are they not?

**Ms Shafik:** Yes but CDC can invest in those economies where we no longer give a lot of aid, to be honest. We are investing in the more public sector side of development in those countries because there is not as much of an opportunity for business.

**Q67 Mr Touhig:** Investing in the poorest countries is not the same as investing in the key areas like India, China, South Africa and Nigeria which might have the largest number of poor people taken across the world but are not necessarily the poorest countries.

**Ms Shafik:** They have the largest number of poor people but CDC is not giving aid to them; CDC is investing and getting a return.

**Q68 Mr Touhig:** How often do you and your ministers meet with the chairman and the chief executive to review their objectives?

**Ms Shafik:** We have a quarterly meeting with CDC to review performance and additional meetings as needed. In the recent period we have met quite a lot.

**Q69 Mr Touhig:** The Comptroller and Auditor General's Report does point out that you have substantially exceed growth expectations. The annual rate of growth in assets has averaged 24% and the Report also tells us that over-performance reflects the strong market upturn in the economies you have invested in. Should you be surprised at this? You are investing in India and China, two economies that will overtake Europe and the United States and be world leaders economically.

**Ms Shafik:** Again context is important. In 2004 CDC was restructured. The internet bubble had burst; the East Asian crisis had occurred; the Russian crisis had occurred; Argentina had defaulted. Investors were fleeing from emerging markets so when we restructured CDC and gave it this investment policy and mission it was not obvious that investors would go heavily into emerging markets. That context is important. Having said that, CDC has outperformed its benchmark so they have not just been going with the trend with emerging markets, they have done better than the trend. I should note that the index that we have available to us—which is the Morgan Stanley Emerging Markets Index—is actually heavily weighted with middle income countries which are much easier markets to make money in than the ones CDC is in.

**Sir Malcolm Williamson:** I would emphasise that we do benchmark ourselves against an index; it is not just looking at what we do in absolute terms. Therefore we have, over the last few years, exceeded the benchmark. What we would hope over the next few years if we are going to see difficult times is that we still out perform the benchmark, but it is not going to be easy. We know this next year or two could be very rough. I suppose my big fear is that some of the countries that have become richer will become poorer to the point where they are back in the bracket we would have looked at back in 2004.

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**Q70 Mr Touhig:** Ms Shafik just said that you do not just invest in markets that are going to produce a strong return, it has to be a solid investment and poverty reduction, but we are not suggesting, are we, that China and India, even with the global crisis we have now, are really going to start to retreat in terms of economic growth. These are two powerful economies.

**Sir Malcolm Williamson:** If you look at the Stock Market indices for these emerging markets they have all fallen by about 60% in the last few months.

**Q71 Mr Touhig:** Yes but their growth is still far in excess of most of Europe.

**Sir Malcolm Williamson:** It will be, yes.

**Q72 Mr Touhig:** So these are going to be pretty strong economies even with the world downturn.

**Sir Malcolm Williamson:** I do not want to give an economic forecast here, it is not my job, but I think the important thing to say is what Mark Lowcock has said which is that we have a new investment policy which is designed to make us focus on the poorest countries in the world, that some countries that were in our nets before, like China, will no longer be in the future. I would stress in answer to the question from Angela Browning earlier that when we have been in China we have not actually always been exclusively in those areas which are getting help, we have made investments in Shandong Province and other quite poor provinces actually in an attempt to do something for the local economy. I think the answer to your question is that we have a very clear development mission; nobody can tell us what it is and we are doing our best to execute it in the most sensible way.

**Q73 Mr Touhig:** How often do you review your investment portfolios in the developing countries other than China and India?

**Sir Malcolm Williamson:** The board of CDC acts as an investment committee so we do not make any investments that do not go to the full board and the full board reviews progress on all those investments on a very regular basis. That is part of the management information that flows to us.

**Q74 Mr Touhig:** So you have a board that actually takes its responsibility pretty seriously.

**Sir Malcolm Williamson:** It takes them very seriously, I can assure you.

**Q75 Mr Touhig:** You have a history of banking, of course, Sir Malcolm.

**Sir Malcolm Williamson:** Yes. We are not very popular people these days, are we?

**Q76 Mr Touhig:** Do you believe in risk as a banker?

**Sir Malcolm Williamson:** I take risk very seriously, absolutely.

**Q77 Mr Touhig:** Most of your colleagues seem to think they can sell us products that they do not understand and they have managed to take away

something called risk. When I crossed the road today from the Abbey to the St Stephen's entrance of the Commons I took a risk.

**Sir Malcolm Williamson:** I cannot speak for other banks but I can speak for the one that I chair and I chair the risk committee there and they regard me in good times as a pretty miserable old git and in the bad times people thank me for being a miserable old git.

**Q78 Mr Touhig:** So you are a pretty old fashioned banker.

**Sir Malcolm Williamson:** Absolutely.

**Q79 Mr Touhig:** You recognise that in any investment there is risk.

**Sir Malcolm Williamson:** Yes.

**Q80 Mr Touhig:** Do you think therefore that in terms of your board taking its decisions it weighs that risk up much more greatly in the sense—again coming back to the point the Chairman made and I made about investment—that China and India are somewhat safer investments?

**Sir Malcolm Williamson:** No, not necessarily. In fact I would say that when the board looks at investment policies it is desperately interested in development impact and it is interesting that it is development impact first and return second. In actual fact when I think of the investment decisions we have made, as a miserable old git I would not put my money into half of them but we have done it because we believe it is going to make a big development impact.

**Q81 Mr Touhig:** The Report suggests perhaps that you may not be taking sufficient consideration of the investments you make where you are really just displacing other investment that was there, you are not really helping economies.

**Mr Laing:** The greatest test of whether we are displacing capital (and by the way I do not believe we are displacing capital) is when we go into funds to see whether the fund managers are reaching the maximum that they want to have per fund. In virtually all our funds—I can think of just a couple in over 120 funds that have not—they have reached their maximum. That is in itself evidence that we are not displacing anybody, indeed that our capital is additional. Most of our fund managers want more capital.

**Q82 Mr Touhig:** I am just following on from my colleague Angela Browning's point right at the end. Of course you have got the recommendations, you will consider the recommendations, you will be implementing them and you will doubtless be reporting back at some stage on what progress is being made.

**Ms Shafik:** That is correct. We will obviously give a formal response to the NAO Report but we are in broad agreement in our proceeding on virtually all the recommendations.

**Sir Malcolm Williamson:** Let me emphasise that the board has no problem with these recommendations either.

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**Mr Touhig:** Thank you.

**Q83 Dr Pugh:** Do you agree with the National Audit Office when they claim that one of the ways in which businesses help the developing world is through paying tax in the country concerned and obviously giving that country a social infrastructure and so on? Do you agree with that as a wholesale benefit?

**Sir Malcolm Williamson:** Yes

**Q84 Dr Pugh:** Can you tell me how many subsidiaries of CDC are in tax havens?

**Sir Malcolm Williamson:** Let me make a distinction first and I will let Richard answer the detail of the question. There is a distinction I would make between the way that we make the investments and the way that tax gets paid by the companies in which we invest. The companies in which we invest pay about £250 million in tax. The fact that we actually have funds which are supported by us which are domiciled in so-called tax havens is a different issue and Richard might like to explain why we do that.

**Mr Laing:** I prefer to call them off shore centres because tax havens gives the impression that there is some sort of illegality going on. We are required to seek to avoid uncooperative tax structures listed by the OACD and tax regimes listed as harmful under the EU Code of Conduct and we follow that. However, we also have an obligation to be efficient. We are investing the tax payers' money ultimately and it means that we must not be profligate in that and must have efficient tax structures. It means that by being efficient we can do more. The investors who invest alongside us will also require us to use best practice and to be efficient; they will not want us to use inefficient structures. Our investee companies at the bottom of this structure that we have where funds are invested are paying tax and that is the £250 million.

**Q85 Dr Pugh:** We will come to that but I want to talk about off shore centres for the moment if we can. It is quite easy, obviously, to make more profit and do an awful better if you pay an awful lot less tax. We all accept that scenario and are fully familiar with it, but I did ask how many of the 78 subsidiaries of CDC are in tax havens and nobody has answered that question. Could you answer my question?

**Mr Laing:** I would need to come back to you by way of a note with a very precise number but it will be a few; it will be 12 to 20, that sort of number.<sup>2</sup>

**Q86 Dr Pugh:** Could you give us a note on that then? I will come back to the £250 million in a minute to see where that fits in. Do you agree with the overall assessment offered by Richard Murphy of Tax Research UK who said that if you look at the whole current tax rates for CDC for 2006 and for 2005 they would turn out to be negative?

**Mr Laing:** I would need to understand the numbers behind that but it is true that we pay very little tax and the main reason is that we are tax exempt by the

UK Government, so the profits we make here we do not pay tax on because our shareholder does not want us to pay tax to itself.

**Q87 Dr Pugh:** How much tax do you pay overseas?

**Mr Laing:** The investee companies pay the £250 million.

**Q88 Dr Pugh:** Would you explain how you get to that figure of £250 million?

**Mr Laing:** That was done by a sample of our investee companies. We asked a range of our fund managers, particularly the larger ones, and that gave that figure.

**Q89 Dr Pugh:** Have you accessed their accounts?

**Mr Laing:** The fund managers certainly will have.

**Q90 Dr Pugh:** The fund managers have, but you cannot yourselves look at their accounts.

**Mr Laing:** This is where the National Audit Office was helpful in saying that we need to have a more precise number on that and we are now doing exactly that. For each of those 600 companies we will have a precise number.

**Q91 Dr Pugh:** So you took the fund managers' word really that they were all paying tax.

**Mr Laing:** I did not say that they were all paying tax. For example, if a company is loss making it will not be paying tax, but we did take their word for it. These are people we trust.

**Q92 Dr Pugh:** If you take, for example, something like the Diamond Bank in Nigeria where £88 million went in, you are confident they pay a good chunk of tax in Nigeria, are you?

**Mr Laing:** I would need to look at that particular example.

**Q93 Dr Pugh:** So you are not confident.

**Mr Laing:** I do not know the details of every single one of our 600 companies. That company will apply the laws of Nigeria and when it makes profits it will pay tax. I can certainly give you that assurance.

**Q94 Dr Pugh:** If we take the huge transaction of Celtel which was eventually sold to Kuwaiti Telecommunications you are fairly confident that both Celtel and Kuwaiti Telecommunications paid a good deal of tax.

**Mr Laing:** Celtel, which was run by Actis, one of our main fund managers, where it is due to pay tax it will pay tax. I cannot comment on the purchaser.

**Q95 Dr Pugh:** It all sounds a bit vague, does it not? Clearly one would like to think that money was being invested in companies and paying tax preferably in the countries we are trying to benefit through the funds in the first place and you cannot give me that sort of assurance.

**Mr Laing:** What I am saying is that I do not have in my memory whether each of those 600 companies—

<sup>2</sup> Ev 24

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**Q96 Dr Pugh:** Do you have the information?

**Mr Laing:** We could find that information and indeed we are now asking our fund managers as a matter of process to inform us of the tax being paid by the underlying companies. I referred earlier to our business principles; within that is a commitment that companies must follow the law and that includes paying tax.

**Q97 Dr Pugh:** I did look very carefully at the businesses principles and they are entirely laudable; they do say they should not employ children under 14, they should provide safe, healthy working conditions for employees and so on, but you are very much dependent in this on assurances given from fund managers who would not generally be prone to own up to this sort of thing, would they?

**Mr Laing:** They are required to own up and they are contractually obliged to own up. One of the reasons why we get them to report to us is to verify that and to check that. In addition we will visit our fund managers regularly and we will visit investee companies.

**Q98 Dr Pugh:** Have you removed any fund managers as a result of your enquiries?

**Mr Laing:** No, but as I said earlier we have certainly not invested with fund managers who we felt would not take this seriously. We have actively taken a decision to not invest.

**Q99 Dr Pugh:** You cannot guarantee that you are not actually putting money into a company that say, for example, is providing extraordinary unsafe working conditions or employing children of a very young age. You cannot guarantee that, can you?

**Mr Laing:** I cannot guarantee it and nor would I want to guarantee it in a sense. The key thing is that we see improvement. There are examples where a fund manager has gone into a company and has identified issues. I can think, for example, of a company called Top Security in India where our fund manager realised that the guards employed by that company were not being paid a minimum wage and they put it right. That is good news; we want to see improvement. They would have a programme to correct things that are wrong whether it be health and safety or environmental issues. That improvement in the business principles is so important in these parts of the world.

**Q100 Dr Pugh:** Going back to this £250 million figure that you have put on the record, could you send us a note showing how you have arrived at that figure of £250 million, what it is based on and who are the fund managers who particularly enabled you to construct that figure?

**Mr Laing:** Yes, I will do that.<sup>3</sup>

**Q101 Dr Pugh:** I have one final question to the Permanent Secretary. It does say in the NAO Report—which slightly astonished me with these

huge, huge sums of money being dispersed—that there is only 1.5 persons working in the department overseeing this. Why?

**Ms Shafik:** The 1.5 is parts of many people's time. It is a team of many people with different skill sets but we also rely quite heavily on a shareholder executive.

**Q102 Dr Pugh:** So this 1.5 is made up of several bits of people, is it?

**Ms Shafik:** It is part of Mark's time; it is part of other people's time. In addition to that—we have increased it recently because we have been reviewing the government's framework—we also rely very heavily on the Shareholder Executive who have extensive experience of people's work on corporate governance in many companies for the government. When we have needed it we have got in external advisors. In the Civil Service we do not have a lot of people who know about remuneration in the private equity fund of funds industry; it is not a skill that you keep on the payroll and when you need it you get specialist helpers.

**Dr Pugh:** So it is 1.5 plus a lot of helpers. Thank you.

**Q103 Mr Bacon:** Mr Laing, you mentioned that there were 600 companies paying some £250 million in tax. Is that across the portfolio, the 250 companies are all over the world.

**Mr Laing:** That is correct.

**Q104 Mr Bacon:** Could you send us a list of them showing how much tax each has paid?

**Mr Laing:** What we agreed to do was to send a note of how we derived that £250 million.

**Q105 Mr Bacon:** I would like to see a list of all 600 companies.

**Mr Laing:** The reason I am hesitating is that some of our fund managers were contractually bound not to disclose the names of every company.

**Q106 Mr Bacon:** They are contractually bound not to disclose the names of the firms they have invested in.

**Mr Laing:** Yes, for commercial reasons. We can send you a list of some them.

**Q107 Mr Bacon:** Perhaps you can send us what you can.<sup>4</sup>

**Sir Malcolm Williamson:** There are some companies in our portfolio that do not pay tax.

**Q108 Mr Bacon:** I am interested in the ones that pay tax so perhaps you can send us what you can. Can I ask you about the fee structure? On page 13 at figure six it talks about this element of carry which it describes as a “pre-agreed percentage of all profits above a fixed threshold. Total profits taken by Fund Managers in 2005–07 equated to 9% of the total profits realised over the period.” What happened in the earlier years prior to 2005?

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<sup>3</sup> Ev 24

<sup>4</sup> Ev 24

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**Mr Laing:** Carry is a profit share of a fund.

**Q109 Mr Bacon:** I understand what it says; I am just asking what happened prior to 2005.

**Mr Laing:** Up until that time the fund had not returned all its capital to us so therefore the fund manager was not due any carry.

**Q110 Mr Bacon:** Could you tell us—if not now then perhaps in a note—what were the total profits taken by fund managers in the period 2005–07?

**Mr Laing:** The three numbers in figure six add up to £57.2 million.

**Q111 Mr Bacon:** What do I add together to get that?

**Mr Laing:** Table six, line five the 9.1, the 23.2 and the 24.9.

**Q112 Mr Bacon:** Those three come to 57.2. That is the total profit taken by fund managers in the period.

**Mr Laing:** In cash for that time, yes.

**Q113 Mr Bacon:** That number, 57.2, equates to 9% of the profits, is that correct?

**Mr Laing:** Yes.

**Q114 Mr Bacon:** So the fund management fees in line two which were 34.1 million last year, that is separate, is that right?

**Mr Laing:** That is correct.

**Q115 Mr Bacon:** So the fund managers get this 57 million, as you have just described it, but they also get the 34 plus the 26 plus the 25 as well.

**Mr Laing:** They get their fee and then they get their profit share.

**Q116 Mr Bacon:** Thank you, I just wanted to understand that. Is it possible that you can send us a schedule that reproduces this showing the total profits? Rather than having to calculate what 9% must have been 9% of, you can see the profit and then see the 9%.

**Mr Laing:** We can send you a schedule which explains that, yes.<sup>5</sup>

**Q117 Mr Bacon:** Thank you. I would like to ask about pay. This is on page 31. Ms Shafik, it describes in paragraphs 5.14 and 5.15 the process of contact between DFID and CDC. At 5.15 it says, “CDC advised DFID in writing each year about its Remuneration Committee’s proposals, but this document did not detail the basis for those proposals”. It goes on, “CDC informed DFID that remuneration proposals complied with the 2004 Framework: CDC interpreted the Framework as having evolved under discussions each year; DFID believed CDC was confirming compliance with the three-way comparator group.” At the bottom it says, “The National Audit Office concludes” (this, I think, is a rather damning sentence) “that CDC should have sought formal approval to depart from the tripartite comparator group; while DFID should

have drafted a more precise remuneration policy”. The reason this is relevant, of course, is because, as we see on the right hand side there, Mr Laing’s total remuneration during this programme went from £383,000 up to £970,000. Essentially they were able to rewrite their own ticket and you at DFID were asleep on the job I think.

**Ms Shafik:** No, I do not think that is the case. We acknowledged that the original remuneration framework that DFID agreed with CDC was ambiguous about what would happen if performance was exceptional. There were no caps beyond a certain level. In fact the context again is relevant, it was a context in which emerging markets were collapsing.

**Q118 Mr Bacon:** Which year are you talking about?

**Ms Shafik:** On remuneration.

**Q119 Mr Bacon:** When you said that emerging markets were collapsing which year were you talking about?

**Ms Shafik:** This was in the period just prior to the restructuring so it was in 2001–03 when East Asia had collapsed, Russia had collapsed, Argentina had defaulted, the internet bubble had burst and after 9/11 every investor was running away from risk. We did not think that we would have the problem that performance would be exceptional and we did not anticipate an exceptional performance situation.

**Q120 Mr Bacon:** Surely part of risk management in your job is to think of every possibility, including the fact that, as they generally do, markets might recover. In fact, if you look at 2003 which is on page 12, CDC’s annual financial performance, you will see that the benchmark which you referred to earlier—the Morgan Stanley Capital International benchmark—grew by 51%, so the emerging markets were not collapsing at all then, they were recovering. Funnily enough the financial performance return on the portfolio for CDC grew by only 20. This is page 12, figure five, second column where it says 2003. The first numeral is four and below that there is 20 and then 51. The 20 refers to the return on the investment portfolio for CDC; the one below is the index that you referred to earlier.

**Ms Shafik:** That is right.

**Q121 Mr Bacon:** That shows that they massively underperformed the index. Emerging markets were not collapsing at that point; they were growing by 51%.

**Ms Shafik:** That was the beginning of the recovery.

**Q122 Mr Bacon:** It was more than the beginning of a recovery; they grew by 51% and CDC massively underperformed at that point. The difference between those two is so striking that it kind of makes you wonder whether the performance was not finessed to be under the market. When the market is growing that strongly to underperform by that much—by 30 percentage points—it is quite striking. It makes you wonder almost if it was not kind of dampened down or suppressed so that once a new

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incentive structure came in you would have growth from a lower base because these things have to start from a base, do they not.

*Ms Shafik:* They do.

**Q123 Mr Bacon:** How do you account for that enormous underperformance? How do you account for the fact that as a risk manager you did not think about the possibility that markets might recover and how do you account for the fact that, as it says in paragraph 5.12 on page 29 that “DFID allowed CDC’s Board the flexibility to adjust the weightings without reference to Government, against explicit advice from the Treasury”. That is your job.

*Ms Shafik:* The original remuneration framework did have ambiguities about what would happen under exceptional performance and we acknowledge that. The issue then occurred that after 2005 CDC changed the benchmarks—the comparator group—against which they were assessing pay. When DFID found out we then had a discussion and reviewed whether they were using the correct benchmarks. When we got independent remuneration advice the advice was in fact that we had the wrong benchmarks to start with and the one that CDC was using (which was the private equity fund of funds benchmark) was the correct one. We made that change formally thereafter.

**Q124 Mr Bacon:** I find it incredible that you were allowing CDC to invest in China. £2.7 billion is substantial funds; 6% is still quite a lot of money from a fund of that size. I find it difficult to believe that China could not have coped quite well without that investment. I am running out of time, but could I just ask Mr Laing a question about your public profile. Is it correct that you have been running a public relations campaign?

*Mr Laing:* I have not been running a public relations campaign.

**Q125 Mr Bacon:** No, not you personally but CDC have been implementing a public relations campaign.

*Mr Laing:* One of the things we do is make sure that we tell the story of development and the importance of economic growth to our stakeholders and we use external advisors to help us with that.

**Q126 Mr Bacon:** This is Quiller Consultants.

*Mr Laing:* Yes.

**Q127 Mr Bacon:** How much have you paid them?

*Mr Laing:* We agreed a market rate for their advice.

**Q128 Mr Bacon:** How much?

*Mr Laing:* I would need to check the exact amount; we pay them a monthly amount and I would need to check what that is and let you know.

**Q129 Chairman:** Can you give us a rough estimate. You are the Chief Executive, what do you pay them roughly?

*Mr Laing:* It is somewhere between £10,000 and £20,000 a month but I would need to check that.

**Q130 Mr Bacon:** Have you had any advice for which someone was paid prior to appearing in front of this Committee?

*Mr Laing:* Yes, I have.

**Q131 Mr Bacon:** Who was that?

*Mr Laing:* That was Quiller.

**Q132 Mr Bacon:** Did you pay them separately for that advice or is just part of their monthly fee?

*Mr Laing:* It is part of their advice. I do not attend these very often.<sup>6</sup>

**Q133 Mr Bacon:** We used to have a member here called Mr Steinberg who offered cut price advice but no-one ever took him up; I have never understood why. Do you think that DFID might be uncomfortable with the level of profits you are making?

*Mr Laing:* I think they should be very pleased with the amount of profit we are making. It is evidence that the companies in which we are investing are sustainable.

**Q134 Mr Bacon:** If you think they would be very pleased, why did you say in a meeting on 9 September that you thought DFID might be uncomfortable with the level of CDC’s profits?

*Mr Laing:* The fact that the numbers that were spoken about earlier—24% per annum growth—clearly that is high and it is an issue that needs to be explained.

*Mr Bacon:* I have run out of time. Thank you.

**Q135 Mr Mitchell:** We have a letter from Roy Darkin<sup>7</sup> who has had various positions in DFID in the past (you have probably had a copy of the letter) and he makes a couple of interesting points but the central one is that development capital is being withdrawn from agriculture where it could presumably have a big effect on improving the standard of living and the economic strength of developing countries. Why is that?

*Ms Shafik:* I do not think we can prejudge which sectors are going to be the ones that are developmentally beneficial. There is no evidence that investing more in agriculture versus industry is going to be better for development. I think the key determinant of development impact is whether firms are performing well financially. Profitability is 97% correlated with development impact and if those profits are to be had in industry or in finance then that is more likely to result in sustainable growth.

**Q136 Mr Mitchell:** Mr Laing, if you are withdrawing investment from agriculture and if you are paying people by incentives and bonuses they are going to withdraw from agriculture because it is unprofitable, it is not particularly nice, it is messy, returns are low and slow. You might better put your money in some

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<sup>6</sup> Ev 28

<sup>7</sup> Ev 29

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kind of glamorous small or medium enterprise with a big return. In other words, the bonus system encourages a move away from basics.

**Mr Laing:** We are not withdrawing from agriculture. We have a \$100 million fund which we set up a couple of years ago which is specifically for agriculture in Sub-Saharan Africa. Just last year I visited Juba in the south of Sudan; it operates in a post-conflict area and investing in a company called Equatorial Teak, a sustainable hard wood forest. It is going to employ approximately 250 people permanently. It is the first employer of any scale in Western Equatoria. Agri-business is still very much part of what we do.

**Q137 Mr Mitchell:** It is not as big as it was.

**Mr Laing:** No, it is not as big as it was but it still is very much part of what we do.

**Q138 Mr Mitchell:** It is actually able to make a bigger contribution to improving the standard of living of these poorer countries than anything else, is it not?

**Ms Shafik:** When CDC was investing more heavily in agriculture it was making losses of negative 4% a year. The international evidence is that only 5% of firms who have unsatisfactory financial performance make any possible development impact. Bankrupt firms and firms that are not profitable do not have a development impact. They do not create jobs, they do not pay their taxes and they do not create sustainable markets so it is an illusion to think that low profitability is associated with high development impact, in fact it is quite the opposite.

**Q139 Mr Mitchell:** If the principle is additionality it is not going to be attracted to the unglamorous investment in agriculture.

**Ms Shafik:** I think the question is which investments create sustainable jobs and livelihoods for their people rather than which ones are glamorous or not. To be honest, we are agnostic about glamour in our investment policies.

**Q140 Mr Mitchell:** I put it to the two of you that really you want to invest more in small and medium enterprises because they are more glamorous, more exciting and produce a bigger reward and your obsession now is return.

**Mr Laing:** You are speaking to someone who actually spent a part of his career in agri-business and I found it very glamorous, but it is one sector alone.

**Q141 Mr Mitchell:** It is an important sector.

**Mr Laing:** It is a very important sector but so are financial services, so is manufacturing, so are SMEs.

**Q142 Mr Mitchell:** The financial services are, as here, the froth; the basic is agriculture and the thing that is going to do most to improve the standard of living and the trade returns for these countries is agricultural performance.

**Mr Laing:** You need a breadth of investment across the breadth of sectors. Infrastructure, for example, Africa will not work without good roads, without power stations so we have put a significant amount of our capital into that. We have a breadth across the portfolio of different sectors.

**Q143 Mr Mitchell:** You are saying that financial services, which I described as the froth on the economy and which have brought such benefits here to this country in our present situation, are going to be more important for these countries and certainly it is an area which both your background and your Chair's background predisposes you to because you are both coming from a financial background.

**Mr Laing:** I come from industry, but let me tell you about one financial services investment because it is a very powerful story. There is a business called Equity Bank which one of our fund managers in Kenya invested in. This is a bank which focuses on micro-finance to poor Kenyans down to £4 a head; 600,000 borrowers now have access to capital through that bank and it works with Care International for community projects and so forth. I think financial services do have a very strong role to play in the economy.

**Sir Malcolm Williamson:** By contrast, going back to your question on agriculture, we visited tea plantations. If you can get people to actually put the tea into a teabag and export the teabags to Tetley's it is far better than going down to Mombassa trying to sell your tea on the exchange. We are trying to get businesses that have a sustainable future in that way and we are very happy to back those.

**Q144 Mr Mitchell:** So Mr Darkin's criticisms are unjustified.

**Mr Laing:** As I said, I think you need to have a balanced portfolio.

**Q145 Mr Mitchell:** Let us move on because 3.9 tells us about the concentration of investment policy on India, Nigeria, South Africa and China. Mr Bacon's point was that that was £160 million. I would not have thought that China was dying for want of foreign investment at the moment. Why are you putting so much into China?

**Mr Laing:** Those four countries you mentioned, as I said earlier, 62% of the world's poor live there. So China, India, South Africa and Nigeria is where the poor are.

**Q146 Mr Mitchell:** That is where poor people are but it is also where you can make the maximum returns on your investment. The poor people are concentrated in poor countries.

**Mr Laing:** And these are poor countries. In India 80% of the population live on less than \$2 a day. In India their foreign direct investment per person was \$20 last year, that is about 1% of what it is in the UK.

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**Q147 Mr Mitchell:** Let me name three other countries: Bangladesh, Pakistan and Sri Lanka which are mentioned in 3.9. As a percentage of your portfolio they are down from 15% to 2% and they have similar problems and the same poverty.

**Mr Laing:** The main reason why that reduction was because we were very heavily invested into the Bangladesh power industry—we produced over one-third of the power for Bangladesh—that company was sold in 2007 to a consortium who were going to build up and run the business going forward and that resulted in a very significant reduction in our portfolio in Bangladesh. In Pakistan we have recently committed to a new fund in Pakistan so we would expect to see that number go up.

**Q148 Mr Mitchell:** Why, when DFID itself is reducing its efforts in China, are you accepting that they should increase their efforts in China?

**Ms Shafik:** Going forward we have asked CDC not to invest at all in China because we think at the margin their resources are best used elsewhere. So there will be no more investment in China.

**Q149 Mr Mitchell:** You are quite happy with this development.

**Ms Shafik:** Going forward we have asked CDC to stop investing in China with the exception of small and medium enterprises because we think that other investors can take up.

**Q150 Mr Mitchell:** Does the fact that you are now working through fund managers (the number of fund managers is up substantially) mean that you are going to be paying out much more in fees and bonuses and other things which do not contribute to local development but put money in private pockets?

**Mr Laing:** Almost all the fund managers that we select are based locally so the fees that we pay the fund managers are going to those local employees. There are some who may have head offices in this country; there is one that I can think of who has their head office in Washington. We deliberately choose people on the ground.

**Q151 Mr Mitchell:** They are not talking very well, are they? It is not possible for DFID to evaluate their value and contribution.

**Mr Laing:** You are referring to fees; the fees are going to the people on the ground, the fund managers that are doing the job of investing.

**Mr Mitchell:** Thank you.

**Q152 Mr Curry:** I think remuneration is an absolute red herring. I am delighted that DFID has only got components of people that add up to one and a half; the last thing we want is vast numbers of civil servants riding shot gun over people. Can we establish at the beginning that you are not in the business of aid?

**Ms Shafik:** We are in the business of development.

**Q153 Mr Curry:** A lot of the questions we have had up to now pre-suppose that you should be in the business of direct aid but that is not your business, is it?

**Ms Shafik:** Are you referring to CDC, not DFID.

**Q154 Mr Curry:** Yes, I should have addressed my question to Sir Malcolm.

**Sir Malcolm Williamson:** We are trying to help with the development of the poorest countries in the world through private equity. We have that as our central task and we are just one arm of what DFID is generally throughout the world to help the poorest people. We do make development a central point in what we do and if you think about the board's responsibilities I have already said that we act as an investment committee, we are also a business principles committee and we take that very seriously. We are trying to make sure that we are doing responsible investments.

**Q155 Mr Curry:** Since we have talked about agriculture, if you had a programme of developing small scale wells so that people had access to water, that would actually be less of a development than an aid project.

**Sir Malcolm Williamson:** That sometimes comes as a by-product of what we do. When I visited Songas which an off-shore power supply from gas outside Tanzania it was very interesting that they produced water supplies to the locals from desalination processes which has given them a reliable clean water supply. That is a by-product of what we are trying to do, not the central purpose.

**Q156 Mr Curry:** It seems to me that you are in a catch-22 in a way. You have huge amounts of cash balances deposited in a place which is giving you a solid rate of interest. What rate does the government pay you on this cash balance?

**Ms Shafik:** It actually sits in the Office of Debt Management and reduces the government's need to borrow from the markets.

**Mr Lowcock:** It pays a little bit above the Libor I think.

**Q157 Mr Curry:** So you in a better position than most pensioners at the moment. You are not looking forward to a zero rate of interest. You have the cash balance. We are moving into a recession and you want to find investment opportunities for where that money works. You are likely to find your range of options narrowing rather than increasing during a recession, are you not?

**Sir Malcolm Williamson:** That is possible.

**Q158 Mr Curry:** Therefore, even though you might wish to refocus and enlarge your investment arena, in practice the opportunities may go in the opposite direction so the logic of the situation might push you to invest more in China and India. Is that not the dilemma that you face?

**Ms Shafik:** It is but—

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**Q159 Mr Curry:** Somebody has just nodded and somebody has just said yes.

**Sir Malcolm Williamson:** We had a long, long debate about the investment policy going forward and I think the board have some reservations about trying to get a quart in a pint pot because a year ago that is the way it looked when we were talking about the poorest countries in the world where there was enough demand to make the supply that we had and get third party capital at the same time. The world is a different place today and you may be right in your prognosis for all I know. The conclusion that we came to was that if we are going to have a mission to focus on the poorest countries in the world let us not throw away what we have created which is a very valuable business in my opinion which is doing fund of funds work, but let us add to it and do some other products like debt if we think that will help and if it will move the cash mountain. The cash mountain is spoken for—it has all been committed—but in the event that funds cannot put that money to good work and there are not enough opportunities then we will have to rethink how we use the cash for debt products.

**Mr Lowcock:** What the government has said is that essentially, if the company is unable to invest its capital wisely, the company will have a discussion with the government about whether we should withdraw some cash and then the government will decide how it wants to use it.

**Ms Shafik:** Can I also thank you for making the comment about our staff because this is a very small and very productive team who have taken a billion pounds of public money overseen creating it into £2.7 billion and created a million jobs in the process.

**Q160 Mr Curry:** Please do not let the thanks eat too much into my time! Having pleased you, let me just tell you something which rather concerned me. You were talking about China, you were talking about investing on the coast because people were migrating. That migration panics me because we know that because of climate change we are going to see significant migration; we know the movements of people spill over into asylum seekers and people seeking refuge. Surely if we are trying to do something in our interests as well as in the interests of development what we would need to do is to try to contain some of that migration. Let us think about Istanbul; it is a horrendous megalopolis which is a breeding place for all sorts of poverty and extremism which one fears very much. Is this a consideration? Have you got geo-political ideas in your mind when you are making this investment or is it much more on a small scale? This is a mission statement question really.

**Ms Shafik:** The primary objective of our policy in the CDC is to reduce poverty and clearly the more jobs we create in poor countries the fewer people want to migrate but that is a by-product of our strategy rather than the purpose of it, I have to say.

**Sir Malcolm Williamson:** I think the difficulty with your question is that because we are a funder of funds we invest in funds. If we invest in a China fund, for example, we can try to use our influence to make

sure that that fund makes investment in the countryside rather than the cities but if they come up as they did with a first-class proposition on solar power in a factory that happened to be based in Wuxi (a few hours away from Shanghai) that in itself seemed to be an extremely good, sensible investment to make and one that would actually help with global warming. You are caught in a bit of a bind with this as to how you direct the fund managers.

**Q161 Mr Curry:** What political changes might assist in allowing you to do what you want to do? Let us take the Doha Round. Whilst the leaders were busy saving the world in Washington a short time ago they all said they was going to be a new impetus from the Doha Round and we are all waiting for somebody to do something about that. If you look back a couple of years one of the causes of the failure to make progress was that some countries, led by India and others, were resistant to the idea of getting investment guarantees and improving the climate for investment in some of the poorest countries. Presumably that is something which would benefit you very much. If you got better investment guarantees and a better investment climate then there would be more funds into which you could contribute and you could then focus your activities more on the least developed countries. Is that fair?

**Ms Shafik:** That is something that DFID does as part of its role. It advises countries on how to improve their investment climate. The more work we do on that the more there are opportunities for investors like the CDC to take advantage of it.

**Q162 Mr Curry:** The irony is that the countries where you most want to invest are the countries least capable of receiving the investment.

**Ms Shafik:** That is correct. That is why DFID has invested in something called the African Investment Climate Facility which is an organisation that actually advises countries in Africa, for example, on how to make their investment climates more attractive.

**Q163 Mr Curry:** How do you react to the sort of new ethics in the way people look at things like food? We have had a debate about airmiles. It is barmy in my view but it is there. You invest in a company in Kenya making cut flowers which then uses airmiles to get to the United Kingdom, and yet you get the *Guardian* readers who say this is all terrible, we should not be doing this because it is destroying the planet. How do you cope with a climate of opinion in the West against the most efficient needs of development in the developing countries?

**Sir Malcolm Williamson:** In my case the debate about the cut flowers is a debate we have had. We were trying to help people in the Rift Valley in Kenya and we were able to justify that on the basis that we were creating a lot of jobs, improving the local environment considerably with schooling and all sorts of things. Yes, you have the problem of a flight a night to get the flowers into Marks and Spencer the

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next morning but if you look at the internal flights in China it is a drop in the ocean. It is all relative, is it not?

**Mr Lowcock:** You also have a saving because sunlight grows crops and flowers in Kenya.

**Mr Curry:** I am on your side on this one and I am on the side of the cut flowers, but there are quite a lot of people who get very twitch about this sort of thing, the silly idea about food miles in the United Kingdom. I think my time has run out. Thank you.

**Q164 Mr Williams:** Mr Laing, when you doubled the pay of your executives were you aware that this was ignoring explicit Treasury advice?

**Mr Laing:** First of all I did not double the pay of executives; it is the remuneration committee who set the pay.

**Q165 Mr Williams:** If there are Treasury rules operating we would expect you to be aware of Treasury rules. I will ask Treasury for guidance. Treasury, would you expect someone in Mr Laing's position to be aware of explicit Treasury guidance?

**Mr Gallaher:** We would give advice to the department exactly as it says in the Report, advice. The decision would be made by the department at the end judging all the facts they have in front of them.

**Q166 Mr Williams:** It says in the NAO guidance to us that it ignored explicit Treasury advice. Is that not so? Which is right and which is wrong?

**Sir Malcolm Williamson:** None of us dispute the facts in this Report. It is true that there were some ambiguities in the letters that we had from DFID; it is also true that we did not go and consult as we probably should have done to change it. What has happened, in the aftermath of picking that up, is that we have devised a new remuneration policy. It would not have changed the numbers that are in this Report; the Report does not suggest that the numbers are wrong.

**Q167 Mr Williams:** You were required to consult; why did you not do that?

**Sir Malcolm Williamson:** We were in error in not doing that.

**Q168 Mr Williams:** Why did you not consult?

**Sir Malcolm Williamson:** I thought we had.

**Q169 Mr Williams:** Who did you think had done it? You did not do it; who did you think had done it? Did you think that Mr Laing had done it?

**Sir Malcolm Williamson:** No, it has nothing to do with Mr Laing; you can blame me and the remuneration committee for this.

**Q170 Mr Williams:** Can the committee act without either of you having any oversight?

**Sir Malcolm Williamson:** I am a member of the remuneration committee so I freely accept responsibility. I think that the moral of this story is that we put right what was wrong in the structure but actually it has not changed the numbers that would

have been paid. It is not that there would have been a magical different set of numbers than those that are set out in this table. We have not done anything out of malice in the CDC I can assure you. I think there is a difference between procedures which we put right and actually the amounts that have been paid which of course relate to 2007 which was a sterling year and which, with all likelihood, will not be repeated this year because we are not going to have such a sterling year.

**Q171 Mr Williams:** Was the department mildly surprised when it discovered this change?

**Ms Shafik:** Yes.

**Q172 Mr Williams:** Mildly or seriously surprised?

**Ms Shafik:** Seriously. I think we should have been more intrusive in our oversight but because we had been getting reassurances about compliance we assumed that it was fine.

**Q173 Mr Williams:** In fairness you are being overgenerous in accepting the blame and saying you should have been more industrious in your oversight. The fact of the matter is that they were expected to consult you, not you consult them. They were supposed to consult you; is that not the way it works?

**Ms Shafik:** That is correct.

**Q174 Mr Williams:** They did not, did they?

**Ms Shafik:** That is correct but we have now put in place—

**Q175 Mr Williams:** You were not pleased, were you?

**Ms Shafik:** No, but we have now put in place a mechanism to ensure that there is a formal meeting on remuneration between the relevant director general in DFID, the remuneration committee of the CDC before pay is set.

**Q176 Mr Williams:** Let us just follow up what happened. When you discovered this had happened what did you then say to Mr Laing? Were you angry about it?

**Ms Shafik:** Mr Laing was not involved.

**Sir Malcolm Williamson:** Mr Laing is outside the argument.

**Ms Shafik:** It is with the chair and the remuneration committee; they were the ones who set the pay.

**Q177 Mr Williams:** Now we have established who it was with, did you make it clear that you were not best pleased?

**Mr Lowcock:** Yes we did and we then commissioned some work (which again the NAO have commented on in a fair way in their Report) about what to do to rectify the situation that had arisen.

**Q178 Mr Williams:** So it was sufficiently wrong to need rectifying. In that case, when did you tell Treasury? Treasury gives explicit guidance in a stronger term than our Treasury colleague has said. You, I assume, immediately informed the Treasury.

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**Mr Lowcock:** There are two points about the Treasury here. One is about the percentage applied to total development impact which we changed, as you say, against Treasury advice. Had we taken Treasury advice some of the payouts would have been higher than they turned out to be. The second point about Treasury is what did we do when we found out that the comparators had been changed without our knowledge? After discussion with Treasury and others we asked the question: what are the right comparators? As the Report says we concluded that the right comparators actually were the ones that the company picked without telling us. The main issue that we had a problem with and were, as you say, not very happy about, was the process.

**Q179 Mr Williams:** That is what I am saying, the process. They let you down; they failed in their obligation to you. That is the reality, is it not?

**Sir Malcolm Williamson:** Yes, and we have apologised for that.

**Q180 Mr Williams:** Did you apologise to the department?

**Sir Malcolm Williamson:** Yes and we have apologised to you as well.

**Mr Williams:** You do not need to apologise to me but the Committee as a whole I am sure you would need to. I just wanted to clarify that situation which seemed to be one of bemusement all round. Thank you.

**Chairman:** I think Mr Griffiths has a supplementary question.

**Nigel Griffiths:** It is supplementary to a point because we spend our time focussing on billions of pounds of overspend on gross financial mismanagement and on poor service and materials delivery. The people who come before us generally keep their very large salaries. Paragraph four says that “CDC’s investment performance also exceeded relevant market indices” and 13 says “By achieving the strong performance with a portfolio weighted towards poor countries, CDC will have made a credible contribution to economic development in those countries. In these respects and in securing a good return on the public funds invested CDC will have achieved good value for money.” I hope that our Report reflects that.

**Chairman:** I am sure it will.

**Q181 Mr Mitchell:** Under CDC’s ownership an organisation called Globeleq has been criticised by actuaries for overcharging customers in countries such as Tanzania and Uganda. Actis commissioned a report for DFID which stated that the department only produces an edited version of the report and you have refused to publish the full report. Can we ask you for the full report?

**Ms Shafik:** One of the things we have to balance is our interest in being as transparent as we can while at the same time protecting commercial confidentiality and so the reason we had to edit the report was to make sure that we were consistent with commercial confidentiality. Obviously if we do not respect that we cannot persuade other investors to come in—

**Q182 Mr Mitchell:** The report was commissioned by Actis; can we have it?

**Ms Shafik:** We cannot release the commercially sensitive information but we can certainly release all the rest.

**Q183 Mr Mitchell:** Can we see the report therefore without the commercially sensitive parts?

**Ms Shafik:** Yes, of course.

**Q184 Mr Bacon:** Can I first of all ask the National Audit Office, this figure on page 12 concerns me greatly. Figure five, second column shows that in 2003 the emerging market benchmark index grew by 51% and CDC was significantly behind that in a way that could not but have had an impact on the base line for the calculation of bonuses in the subsequent four years, in the period 2004–08, which is the period we are talking about; the restructuring started immediately afterwards. Did you examine that particular issue of the underperformance in 2003?

**Mr Sloan:** It was not a major part of the study, no. What I would say is that I think we have to look at these indexes over a period because there is not a precise match between the way the MSCI index is constructed and the portfolio that CDC will have had at any particular point in time. If you do that I think you see there is something of an averaging effect going on.

**Q185 Mr Bacon:** These are startling differences.

**Mr Sloan:** Indeed, and that will come about because of the precise constituents of the index and the precise constituents of CDC’s programme in that period. The point on the evaluation, to the best of my knowledge all these investments were valued according to standard private equity practices and the sums audited both by CDC’s auditors and presumably by the constituent firms’ auditors.

**Q186 Mr Bacon:** Mr Laing, when managers bought out the fund management side of CDC I think they bought 60% and it became Actis. Is that right?

**Mr Laing:** That is correct.

**Q187 Mr Bacon:** Can you just remind us what was paid for that 60% stake?

**Mr Laing:** It was over £300,000.

**Q188 Mr Bacon:** £373,000.

**Mr Laing:** That is right.

**Q189 Mr Bacon:** What were the profits in the first year?

**Mr Laing:** Of Actis?

**Q190 Mr Bacon:** Yes.

**Mr Laing:** I believe—I would need to check this—that Actis makes very little profit after all its costs.

**Q191 Mr Bacon:** Was it not £8 million in the first year?

**Mr Laing:** Not after all its costs, no.

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**Q192 Mr Bacon:** Perhaps the NAO could arrange to send us a note on this because it strikes me that DFID sold off the fund management arm too cheaply. How you come up with a valuation of £370,000 for 60% of a business that is generating a significant profit not long after strikes me as rather strange.

**Ms Shafik:** The valuation of Actis was done by KPMG.

**Q193 Mr Bacon:** Do you think you send us a note on that?

**Mr Burr:** Of course we could.<sup>8</sup>

**Q194 Keith Hill:** I just want to draw out from the Report the note on the sale of Celtel—CDC's stake in Celtel—which seems to me to highlight exactly the distinction that David Curry was making between aid and development because I think I would be right in saying that the absence of a telephone landline infrastructure in Sub-Saharan Africa was probably amongst the single largest impediment to development on the Continent and probably the single largest contribution to economic development in Sub-Saharan Africa in the last 25 years has been the development of a mobile phone infrastructure. Let us remember that CDC made that investment in Celtel, subsequently sold its share at a 500% profit which went overwhelmingly to be reinvested into development around the world. It seems to me that this is the big picture that we ought to keep in our minds when we think about the work of CDC.

**Ms Shafik:** Celtel alone provides 30% of the mobile phone coverage in Sub-Saharan Africa today. When Celtel started only two million Africans had access to mobile phones; today it is a hundred million. That is a massive growth. The development impacts of that in terms of farmers being able to call the markets to find out who has got the best price for their produce, in terms of health workers being able

to call doctors to find out how to treat patients when they are in distant, isolated rural areas are phenomenal and almost impossible to quantify.

**Sir Malcolm Williamson:** We are still investing in companies that are putting up extra masts to make the coverage even better.

**Q195 Chairman:** I have one last question from our members' brief, a point that is worrying me. It tells us here that DFID lacks evidence on whether commercial investors might provide the finance without CDC in countries such as Nigeria, India, South Africa and China. Do you have any reason to believe that commercial investors would have put significantly less money into China but for the efforts of CDC?

**Ms Shafik:** In terms of how much leverage has CDC created?

**Q196 Chairman:** Yes. If you had not been there would commercial investors still have stepped into the breach?

**Ms Shafik:** Directly we know that CDC has achieved 1.5 billion of additional leverage from the investments it has made. We also know that when CDC started there were just a handful of fund managers who invested in Africa.

**Q197 Chairman:** I am talking about China now. Do you have any reason to believe that commercial investors would have invested significantly less in China if CDC had not done so?

**Mr Laing:** What I can say is that of the funds we have invested in China I can only think of one that fully reached its target,<sup>9</sup> all the others were not in that position and needed our capital to set up that fund. That fact is evidence that other people were not stepping in.

**Q198 Chairman:** Perhaps we could have a note on that; that would be interesting.<sup>10</sup>

**Mr Laing:** Yes, of course.

**Chairman:** Thank you very much; that concludes our hearing.

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<sup>9</sup> *Note by witness:* There are actually two oversubscribed funds for China.

<sup>10</sup> Ev 28

<sup>8</sup> Ev 19

## 1. Supplementary memorandum from the National Audit Office

Questions 186 to 193 (Mr Richard Bacon): *Valuation of Actis LLP*

1. At its hearing on 15 December 2008, the Committee of Public Accounts asked the Department for International Development (the Department) about the price paid by incumbent management for Actis, a fund manager previously wholly owned by CDC Group plc. The Committee also asked about the relationship between the amount paid by management (£373,000) and the first year's reported operating profit for the partnership (the US dollar equivalent of £4.6 million).

2. The Committee asked the National Audit Office to provide a note on the valuation of Actis when it was part-sold to its management in 2004, and the profits generated subsequently.

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## BACKGROUND

3. In 1997, the Department for International Development (the Department) converted the Commonwealth Development CDC into a public limited company—CDC Group plc (CDC)—in anticipation of the sale of substantial stake to private investors. There was, however, little interest from potential investors<sup>1</sup>, and the Department instead decided in 2003 to restructure CDC. As part of this restructuring the Department established a separate fund management arm, known as Actis LLP (Actis).

4. The Department sold a controlling stake in Actis to its managers in July 2004. Thirteen individual partners and twelve overseas corporate partners, together with an Employee Trustee, subscribed £373,040 for 60% of the voting rights in the business, subject also to various governance conditions. The Department holds 40% of the voting rights in Actis. The sale terms provided for the management initially to receive only 20% of any residual profits, or any proceeds from an onward sale of the business. This would increase to a 60% share after 10 years.

5. Actis's main role is to promote and manage funds invested in emerging markets on behalf of investors. Its single biggest investor is CDC itself, which is wholly owned by DfID. In the new structure established in July 2004, CDC retained ownership of its existing investment portfolio, built up over several decades, known as the "legacy portfolio". DfID agreed that Actis should manage this legacy portfolio on CDC's behalf for five years extendable to ten years at CDC's option. The legacy portfolio was valued at £805 million at 1 January 2003.

## THE SALE PROCESS

6. CDC was responsible for implementing the sale of Actis. To oversee the conduct of the sale, CDC's Board formed an Independent Committee (the Committee) in early 2003, comprising board members who had no direct interest in Actis. The Committee took advice from KPMG and from McKinsey. The Board was separately advised on remuneration matters by Towers Perrin. DfID was advised by Treasury Solicitors in relation to public law, Campbell Lutyens & Co Ltd on corporate structuring and finance, Field Fisher Waterhouse on commercial law, PricewaterhouseCoopers on tax matters and the newly formed Shareholder Executive, then part of Cabinet Office, in relation to corporate structuring and finance.

7. KPMG, in accordance with terms of engagement agreed with the Committee on 31 July 2003, undertook an initial non-binding valuation of Actis on behalf of the Committee. The valuation was not commissioned to set the price at which someone would invest but helped guide discussions with Actis's management over the appropriate price they should pay to purchase Actis.

## THE PRINCIPLES USED TO VALUE ACTIS

8. Valuing Actis was not straightforward. In valuing any entity, the valuer must identify the residual earnings that accrue to the business owners. The valuer must then estimate how much potential new owners would be willing to pay for the right to these residual earnings.

9. These calculations were complicated in the case of Actis because the entity was purchased by its employees. These owner-employees have access to two streams of income:

- a. The amounts they earn from their labour as fund managers. These amounts should closely reflect the market rate for similar fund managers elsewhere. The fund managers would in principle enjoy these amounts whatever ownership structure they worked under and whoever owned Actis. The rewards for their labour are not relevant to the valuation of Actis.
- b. Their rights to enjoy the residual earnings achieved by Actis. These amounts represent the dividends the owner-employees would be entitled to as a result of taking the risk of investing capital in Actis and so form the basis of the valuation of Actis.

10. The valuation was also complicated because there were few obvious comparators to Actis. In advance of the sale, CDC had negotiated fund management fee levels with Actis that were only expected to cover operating costs and allow Actis to break even.

11. There are two common methods used to value businesses for sale:

- a. a discounted cash flow approach; or
- b. a market-based approach, which multiplies expected post tax earnings by a multiplier based on the way investors value other comparable companies.

12. As discussed with the Committee, KPMG utilised a discounted cash flow basis and also took into account the level of net assets held by Actis. A market approach to valuation as a cross-check was not required of KPMG because Actis had not been structured to generate significant profits. The few traded funds management businesses identified as possible comparators were generating profits from assets under management and other activities.

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<sup>1</sup> Ev Q69

13. KPMG based its discounted cash flow valuation on agreed forecasts of the residual cashflows that would accrue to the new owners of Actis from each part of the business. It then applied a discount rate to these cashflows to calculate a capital value. KPMG used discount rates considered suitable for the area of business, taking into account its riskiness. For management fees from existing funds, KPMG adopted a discount rate of 13.2%. For new funds, KPMG used a higher rate of 18.6% to reflect greater risk of uncontracted potential future funds. This took into account the difficulty and uncertainty in raising and investing new funds.

14. In September 2003, KPMG's initial non-binding valuation of Actis on behalf of the Committee concluded that the whole business could be valued at between US\$3–4 million, equivalent at that time to £1.8 million to £2.4 million.

#### ADJUSTMENTS TO THE INITIAL VALUATION

15. In November 2003 KPMG were requested by the Committee to reconsider the valuation of Actis because the employees were not purchasing the whole company. Instead employees were purchasing 60% of the voting interest and 20% of the rights to residual profits (for the first 10 years) and were subject to various governance conditions (paragraph 16). Furthermore, KPMG were informed that there was no basis for expecting any cash distributions of residual profits in the first five years. And there was no public market in which managers would be able to dispose of their shares.

16. The Department holds veto rights over the appointment of the chair of Actis LLP and two non-executives, the three of whom together make up the Business Principles Committee. The Department has the voting and consent rights common to all Actis members and, in addition, the ability to block decisions in certain areas ("special decisions") and enforce business objectives.

17. Taking into account these factors, KPMG valued the interest in Actis to be sold to employees ("interest valuation") at between US\$580,000–\$700,000, a 70% discount on the whole business valuation of US\$3–4 million in September 2003. In March 2004, at the request of the Committee, KPMG provided an interest valuation revised to take account of prevailing exchange rates—which resulted in an interest valuation of between £320,000 and £387,000.

18. The Committee agreed that the amount to be paid by employees on 7 July 2004 for their interest in Actis should be £373,040. A Trustee on behalf of employees provided 15% of this amount, with 25 partners providing the balance.

**Figure 1**

#### PAID UP OWNERSHIP INTERESTS IN ACTIS LLP

	£
Trustee for Actis employees	55,950
Actis partners	317,090
Secretary of State for International Development	427,000

19. The National Audit Office has concluded that assumptions about revenue and expenses underpinning the valuation were reasonable, and that the discount rates used in the calculation were also reasonable. The sale price was not, however, tested through a competition because, after option appraisal and advice, the Department and CDC's Board considered that such an approach would have significantly damaged CDC's management capacity, and risked damaging the £805 million portfolio value (as at January 2003).

20. A competitive process is usually the best way of getting best value in a sale. Had management been made to compete against external bidders, and had external bidders shown an interest, management might have attributed more value to the operational independence that owning their own business gave them. There might also have been a strategic value to other bidders from CDC's existing strong investment presence in emerging markets. In particular there is value in having CDC as a "cornerstone" investor—an investor whose £805 million of funds under management demonstrated investor confidence in providing the Actis team with funds to manage and who provided fees that would cover most of the running costs thereby reducing the business risk.

21. The Department, however, considers that a number of factors meant that this approach was not practicable in this case. It is not clear that any potential investor would have had a better track record of managing funds in emerging markets than Actis' existing management team. The lack of such a record could have put CDC's existing investment portfolio at risk, particularly in light of the detailed knowledge that Actis management had of this portfolio. Any such theoretical buyer would also have had to take into account that whilst they were buying a 60% voting interest, they would only be entitled to a 20% interest with regard to their share in residual earnings. Nevertheless, it is the National Audit Office's judgement that, wherever feasible, it is better to test a sale price through a competitive process.

## THE 2007 VALUATION OF THE SHAREHOLDER EXECUTIVE PORTFOLIO

22. The Shareholder Executive is responsible for managing and/or advising on the Government's ownership interest in 27 publicly owned businesses, including Actis. As part of a value for money study the NAO commissioned an attempt to value the Shareholder Executive's business portfolio, comprising some 18 businesses for which similar private sector firms could be identified. This exercise, subject to a number of caveats set out in the Comptroller & Auditor General's report<sup>2</sup>, estimated the enterprise value of the portfolio to be between £17.1 billion and £20.8 billion as of 30 June 2006. The report published broad valuations for sectors and none for individual companies.

23. At its hearing on 27 June 2007, the Committee of Public Accounts requested the subtotals that made up the estimated enterprise value of the Shareholder Executive's portfolio<sup>3</sup>. Each sub-total was a high level valuation of an individual business in the portfolio, conducted on the basis of a multiple of reported earnings or contemporary forecasts. The portfolio valuation exercise did not further investigate circumstances specific to the individual businesses. At that time the stock market multiples for broadly similar businesses were high, ranging from 30 times earnings to 48 times earnings. The valuation used a lower earning figure of £6 million<sup>4</sup> and a higher earnings figure of £11 million. As a result a valuation range of £182 million to £535 million was attributed to Actis LLP. This valuation range suggested that Actis represented between 1% and 2.5% of the enterprise value of the portfolio.

24. The earnings figures used, although based on the partnership accounts of Actis for the year ended December 2005, and a forecast for the year ended December 2006, did not take into account the salary and bonuses of working partners that come out of reported profits. Subsequently, the National Audit Office commissioned a separate assessment to understand Actis' earnings figures better, taking into account working partners' prior claims. This showed, for the reasons set out in paragraphs 35 and 36, that there were no distributable earnings in 2005. As a result the valuation using a multiple of reported profits was too high, and a different approach needs to be taken to any future valuation.

25. There have been no other valuations of Actis since the sale in 2004.

## ACTIS PERFORMANCE SINCE THE SALE

26. The essence of Actis's business model is simple. Its employees manage investments on behalf of investor clients, who include both CDC itself (through both legacy investments and its commitments to new funds) and new investors. The investors benefit when the value of these investments increases. Actis can dispose of these investments on the investors' behalf, and any resulting profits providing a defined minimum or "hurdle" rate is achieved are then shared between Actis and the investor.

27. Actis receives fees from its investors for managing investments. It passes a proportion of these fees on to the individual employees responsible for managing investments. Where it disposes of investments, and providing the "hurdle" rate has been achieved, it will again pass a proportion of profits to the individual fund managers. Individual employees are therefore incentivised to act in the investors' interests because they benefit directly from increases in the value of investments when they make profitable disposals. The hurdle rates of return, and the level of carried interest applicable for Actis's management of CDC's legacy investments, were negotiated at discounts to market rates.

28. Since the sale Actis has generally performed in line with the 2004 Business Plan. In two years out of four, both total income and operating profit exceeded forecasts. Actis has achieved this outcome largely because of some £12 million of additional fees generated by investment from third parties. On an aggregate basis between 2004 and 2007, operating profit was 7.5% higher than plans. Overall revenue increased by some 4% compared to a smaller 3% increase in costs.

Figure 2

## FIRST YEAR AND AGGREGATE ANNUALISED PROFIT &amp; LOSS FOR ACTIS LLP

<i>Profit &amp; Loss</i>	<i>P&amp;L in US dollars</i>		<i>P&amp;L converted to sterling</i>		
	<i>2004–07</i>	<i>2004–07</i>	<b>First year actual</b>	<i>2004–07</i>	<i>2004–07</i>
	<i>Plan</i>	<i>Actual</i>		<i>Plan</i>	<i>Actual</i>
	<i>\$m</i>	<i>\$m</i>	<b>£m</b>	<i>£m</i>	<i>£m</i>
CDC Legacy	98	76.3	<b>12</b>	52	41
CDC New Funds	97	90.2	<b>8.5</b>	51	48
Third party fees	39	61.7	<b>6.5</b>	21	33
Other	0	15.4	<b>3</b>	0	8
<b>Total</b>	<b>234</b>	<b>243.6</b>	<b>30</b>	<b>124</b>	<b>129</b>

<sup>2</sup> *The Shareholder Executive and Public Sector Businesses* HC 255, 28 February 2007—Appendix 3 describes the portfolio valuation commissioned from Accenture by the National Audit Office

<sup>3</sup> House of Commons Committee of Public Accounts *The Shareholder Executive and Public Sector Businesses* 42nd Report of Session 2006–07, HC 409

<sup>4</sup> Actis financials are reported in US dollars and have been converted at £0.5507 = \$1 (rate at 30 June 2006)

<i>Profit &amp; Loss</i>	<i>P&amp;L in US dollars</i>		<i>P&amp;L converted to sterling</i>		
	<i>2004–07</i>	<i>2004–07</i>	<b>First year</b>	<i>2004–07</i>	<i>2004–07</i>
	<i>Plan</i>	<i>Actual</i>	<b>actual</b>	<i>Plan</i>	<i>Actual</i>
	<i>\$m</i>	<i>\$m</i>	<b>£m</b>	<i>£m</i>	<i>£m</i>
Total Costs	193	199.5	<b>25</b>	101	104
Operating Profit	41	44.1	<b>5</b>	23	25

Note: Operating profit is subject to employee claims (paragraph 27 above and 35 and 36 below)

Source: Actis—summary extracted from partnership accounts in US dollars, sterling values converted by the National Audit Office at December year end values each year and rounded

29. While fees from third parties grew significantly, fees paid by CDC for managing CDC’s legacy funds were £11 million less than projected in the 2004 Business Plan. Fees fell as legacy portfolios were reduced in size by earlier than planned sale of investments and the return to the CDC of £876 million of cash out of investment proceeds.

30. The total legacy portfolio gain realised, as at October 2008 and as calculated under the partnership agreement, has been £959 million out of which the carried interest payable to Actis has been £83 million—an average profit share of 8.65%<sup>5</sup>. Actis calculate that, had the same portfolio entirely consisted of third party funds, then full market rates—although not appropriate in the case of CDC—would have generated a much larger carried interest payment of up to £193 million.

#### REMUNERATION PAID TO EMPLOYEES

31. Actis reports annually a range of financial results, including operating profits. Operating profits are calculated by deducting relevant expenses from annual turnover. Relevant expenses include administrative costs and the remuneration of non UK partners.

32. Operating profit is subject to a series of deductions to remunerate UK based partners, as follows:

- a. Profit share on disposals of the legacy portfolio and new investments (paragraphs 5 and 26).
- b. A fixed profit share, representing the “salary” and benefits of the working partners.
- c. Short Term Incentive Plan payments.
- d. Notional interest on capital contributions.
- e. Lastly, and only if any earnings remain unallocated, amongst the working partners and the employee trustee<sup>6</sup> (together, initially 20%) and DfID (initially 80%). DfID’s share of these net profits reduces to 40% at the end of 2013.

33. This order of priority reflects the incentive-based remuneration structure put in place to reward Actis employees. The Department placed limits upon carried interest payments to individuals both within one year and in aggregate limits on carried interest payments, in respect of the legacy portfolio, as set out below:

- no individual should receive carried interest payments in an aggregate amount that exceeds £3,000,000; and
- no individual should receive an amount in excess of £500,000<sup>7</sup> in any one accounting year, save that the excess may be carried forward.

34. PricewaterhouseCoopers, on behalf of the National Audit Office, examined documentation provided by the Remuneration Committee of Actis for the period from 2003 to 2007. This documentation covered the entitlement of the working partners to a fixed profit share (“salary” and benefits) and bonus under the Short Term Incentive Plan against a target of matching the 60th percentile of market rates for comparable employment positions. Benchmarked against market data, the Remuneration Committee found that Actis was below the target level allowed and the documentation made available to PricewaterhouseCoopers supported this conclusion.

#### RESIDUAL PROFITS AVAILABLE FOR DISTRIBUTION

35. To date, the remuneration of Actis working partners through the incentive payment structure has fully absorbed the reported operating profits. In particular, after the deductions set out in paragraph 32 there were no residual profits available for the Department (who have a right to 80% of the residual profits) or the other owners of Actis, including staff represented by the Employee Trustee, (who have a right to 20% of the residual profit).

<sup>5</sup> The CDC base case in 2003 envisaged a total gain of about £250 million (US\$450 million) generating carry of about £16 million (US\$28 million). The gain has been about four times greater and the carry five times greater.

<sup>6</sup> The Employee Benefit Trust holds a nine per cent ownership interest in Actis on behalf of members of staff who are not partners and who do not benefit under the partners’ profit share and incentive plan provisions.

<sup>7</sup> The stated limits are adjusted each year in accordance with the retail prices index.

36. In 2005, for example, Actis statutory accounts reported in US dollars operating profits equivalent to £7.2 million after administrative expenses and taxes. The administrative expenses already included about £5.5 million of payments for overseas partners but no payments for UK partners. Under the partnership agreement, all operating profits had to be applied to the working partners first according to the agreed priorities. In total, £12.7 million was paid to the UK and overseas partners, with about 40% relating to their profit share arising from sale of the investments held in the legacy portfolio, and the balance fully absorbed by their fixed profit share (or “salary” and benefits) and amounts earned under Short Term Incentive Plans.

#### CONCLUSION

37. This note has explained the background to the sale of Actis and set out the relationship between operating profits and residual profits.

It shows that:

- a. Valuing Actis is not straightforward. It has few comparators and was not expected to make significant profits. In addition, because it has been purchased in part by its employees, any valuation needs to distinguish between the amounts managers receive as workers, and their residual rights to profits.
- b. The valuation approach adopted in 2003 was reasonable, although it may not have taken into account elements of value that could only be tested through a competitive process which the Department did not consider feasible in this case.
- c. Since the sale, Actis has performed well. It has increased both its funds under management and its operating profits.
- d. In consequence, the employees have received remuneration in line with the incentive-based remuneration approach adopted by Actis.
- e. In practice, the remuneration paid to employees has absorbed all operating profits, meaning that there is no residual profit to distribute, either to the Department (who have a right to 80% of any residual profit) or the employees-as-partners and staff (with a right to 20% of any residual profit).
- f. As a result, the reported operating profit of \$8 million in 2004 (equivalent to £4.6 million) is not a meaningful guide to the reasonableness of the £381,610 paid for a stake in the business. Operating profits are all absorbed by incentive-based remuneration, which would accrue to the employees regardless of the ownership structure for Actis.

23 February 2009

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## 2. Supplementary memorandum from the Department for International Development

Questions 84–85 (Dr Pugh): *asked how many subsidiaries of CDC are in tax havens?*

As at 31 December 2008, CDC had investments in 72 subsidiaries. Many of these are investment holding companies that are located as follows:

Barbados—	4
Bermuda—	9
BVI—	1
Guernsey—	1
Jersey—	1
Malta—	1
Mauritius—	18
Netherlands Antilles—	1
Singapore—	4
Total for offshore financial centres (OFCs)—	40

The companies CDC invests in currently pay annually in the region of £250 million of tax and other charges to their governments—this figure is completely unaffected by CDC’s use of offshore financial centres. The reason that CDC makes use of OFCs is that, in order to attract other private sector investors to invest in Funds, it is important that the latter do not end up paying tax twice. It is therefore sensible to register the Funds in a tax-neutral environment.

The use of offshore financial centres is a legitimate and widely-used practice undertaken by other Development Finance Institutions, which, like CDC, are committed to supporting economic growth in developing countries in the most effective and efficient way. Using OFCs actually means CDC delivers more

money to the economies of poor countries by mobilizing extra investment. CDC seeks to avoid use of jurisdictions listed as uncooperative tax havens by the OECD or tax regimes listed as harmful under the EU Code of Conduct for Business Taxation.

Questions 88–100 (Dr Pugh) and Questions 103–107 (Mr Bacon): *wanted to know (i) how did CDC arrive at the £250 million tax figure; (ii) what calculations were used to come to this figure; (iii) which fund managers provide CDC with tax information and (iv) Can you list each investee company?*

At CDC's request, fund managers collected information on taxes from the most recent sets of accounts of underlying portfolio companies. (i) This data was provided to CDC in local currency and converted by CDC into GBP at recent exchange rates before being aggregated. (ii) The £250 million tax figure was based on data received from 215 investee companies within 44 funds managed by 32 different fund managers (out of a total of 56 fund managers). This represents about a third of CDC's portfolio, based on the number of investee companies and number of funds. (iii) More than half of fund managers currently provide CDC with tax and employment information. CDC are working with the others to ensure in the future that it receives this important data from all fund managers.

(iv) List of investee companies (January 2009).

A Little World Private Limited  
 AB Microfinance Bank Nigeria  
 AccessBank Azerbaijan  
 AccessBank Tanzania  
 Ad2pro media Solutions  
 Advans SA  
 African Energy Resources  
 Africatel Holdings BV  
 Ala TV  
 Alexander Forbes  
 Alstom Electrical Industries Plc  
 Alvac Company Limited  
 American Home Assurance Co (Gold Ridge Mining)  
 Amoun Pharmaceutical Company SAE  
 Analistas de Recursos Globales S. A. P. I. de C. V.  
 Andromeda  
 Anqiu Ocean Machineries  
 Apex Partners Limited (Oriental Cambridge)  
 Arabian Yemen Cement Company, Limited  
 Argwings Twin Services Ltd  
 Artumas Group Incorporated  
 ASA Afghanistan  
 ASA Consultancy Ltd  
 ASA Lanka Pvt. Ltd  
 ASA Posters Corporation  
 Ashoka Buildcon Ltd  
 Asiasoft Corporation PCL  
 Aster Teleservices Private Ltd  
 Atria Convergence Technologies Pvt Ltd  
 Augere Holdings (Netherlands) B V  
 Autofine Limited  
 Aviance Ghana Ltd  
 Azito Energie SA  
 Banco Davivienda S.A.  
 Bangkok Ranch  
 Bank of Africa Uganda Ltd  
 Banque Commerciale du Rwanda S.A.  
 Baobab Investments S.A.  
 Batim Africa  
 Beijing Deqingyuan Agricultural Technology Co Ltd  
 Belmont Hotel Investments (Laos) Ltd  
 Bharat Box Factory Limited  
 Bhartiya Samrudhhi Finance Ltd  
 Bioplus Life Sciences Private Ltd  
 Blue Sky International  
 BRAC Afghanistan Bank  
 Brandcorp Holdings (Pty) Ltd  
 Bunnings Hardware Ltd  
 C&I Leasing Plc  
 Cable Holdings Limited  
 CAPIC Hexagon Limited  
 Capsea Marine  
 Catholic Syrian Bank Ltd  
 Celebrity Fitness  
 Celtel Congo (RDC) S.a.r.l.  
 Celtel Madagascar S.A.  
 Celtel Uganda Limited  
 Central African Gold  
 Ceylon Oxygen Limited  
 Charm Communications  
 Chemica  
 China Shanshui Cement Group Ltd  
 Chongqing Real Estate Development Co Ltd  
 Clininvest Holdings Pvt.Ltd  
 Comat Technologies Pvt Limited  
 Compagnie Sahelienne d'Industries S.A.  
 Companias Asociadas Petroleras S.A.  
 Confianza  
 Continental Carbon India Limited  
 Copper Tubing Africa Ltd

A1 Consultancy Company  
 AccèsBanque Madagascar  
 AccessBank Liberia  
 Accutest Research Lab  
 Advanced Solar Power Cayman Ltd  
 Aeroflex Industries Limited  
 African Financial Holdings Ltd  
 Agencia de Viajes Horizontes de Costa Rica S.A.  
 Albidon Limited  
 Allied Catering Equipment (Pty) Ltd  
 Altea Packaging (formerly Intaj Packaging)  
 Ambow  
 AMH Media Holdings Ltd  
 Ampella Mining  
 Andchristie Company Limited  
 Annapura Financial Services Private Limited  
 Anvil Mining Ltd  
 Aqua Packaging Ltd  
 Arch Pharmalabs Ltd  
 Arohan Financial Services Ltd  
 AS Ali Petroleum  
 ASA Beijing Consultancy  
 ASA Ghana NGO  
 ASA Pakistan  
 ASHA Cambodia  
 Asia Pacific Exploration Consolidated  
 Aster Infrastructure Private Ltd  
 Athi River Steel Plant Ltd  
 Atyati Technologies Pvt  
 Auro Mira Energy Company Pvt Ltd  
 Avance Ingenieros Holding Inc.  
 Avtec Limited  
 Bajaj Hindusthan Sugar and Industries Limited  
 Banco Pine S.A.  
 Bank of Africa (Kenya) Ltd  
 Bank Respublika  
 Banro Corporation  
 Barone, Budge & Dominick (Pty) Ltd  
 Beijing Bai Ying Tong  
 Belarusian Bank for Small Businesses  
 Belvedere  
 Bharti Infratel Ltd  
 Biofilm SA  
 Blue Financial Services  
 BOA Bank Tanzania Ltd  
 BRAC Bank Limited  
 Bright Star Foods Ltd  
 Butal General Traders  
 C&O Pharmaceutical Technology  
 Candax Energy Inc  
 Capital Properties Holdings Ltd  
 CareWorks Africa Ltd  
 CDC-PTL Holdings Ltd  
 Cellcom Telecommunications Ltd  
 Celtel Gabon S.A  
 Celtel Malawi Limited  
 Centaurus Company  
 Centrale Laitiere de Mahdia (Vitalait)  
 Charleston Travel Ltd  
 CHC Limited  
 China Gtel Ltd  
 China Wolfberry Holding Co Ltd  
 Cirtex Electronics Ltd  
 CN Innovations Holdings  
 Compagnie General de banque SA  
 Compagnie Tunisienne de Grains (Cotugrain Group)  
 Concern Galnaftogaz  
 Constructora e Inmobiliaria Centroamericana S.A. de C.V.  
 Continental Reinsurance Plc  
 Copperbelt Energy Corporation Plc

Copperbelt Minerals	Cornerstone Insurance plc
Corporacion InterAmericana para el Financiamiento de Infraestructura S.A.	CPK Consultores Intercontinental, S. A. de C.V
Credito Real, S.A. de C.V.	Crystal Parlour
Dalmia Cement (Bharat) Ltd	Data Nets Ltd
Dawnay Day AV	Deacons Ltd
Delhi Assam Roadways Corporation Ltd	Dequingyuan Agricultural Technology co Ltd
Dewan Petroleum (PVT.) Ltd.	DFCU Limited
Diamond Bank	Digicel International Finance Ltd
Dilkusha NBFC	Dipped Products Ltd
Distri-Thai Holdings (Mauritius) Limited	DM Healthcare Pvt Ltd
Docuformas S. A. P. I. de C. V.	Dongguan City Your Moon Home Textile Co. Ltd
Donghaian Warehouse Logistic Centre	Dorman Long Engineering Ltd
Doshion Ltd	Dunhuang Jindi Vanadium Company
Dunkin Donuts (Golden Donuts & ABP Café)	Duoyuan Global Water Inc
Dutch Lanka	DWC Drilling
Dynamic Fibre Moulding (Pty) Ltd	E- Tranzact
e-Channeling PLC	Educational Services Private Ltd
Edyficar	Ekim Turizm Ticaret ve Sanayi Limited Sirketi
Electrotherm (India) Ltd	Elite Truck Hire
EM Communications	Emergent Ventures India Pvt. Ltd.
Empower	Energia Mayakan, S. de R.L. de C.V.
Engro Asahi Polymer & Chemicals	Environmental Care Management Company Ltd
Equatoria Teak Company	Equitas Micro Finance India Private Limited
Equity Bank Ltd (Uganda)	Equity Bank Ltd (Nigeria)
Equity Bank Limited (Kenya)	Esanna Holdings
Eskhata Bank OJSC	Europlan
Eurotech Engineering International Limited	Evan Corporation (dba VANCL)
Excelcheer Investment Limited	E-Yantra Industries
Favorita Fruit Co Ltd	Fengrun new Energy Equipment Co. Ltd
Ferrochina Ltd	Fibrex Angola
Finagestion	Financial BC SA
First City Monument Bank Plc	Forus Bank
Fountain Springville Estate Limited	Franconomic Enterprises Ltd
Fruitpack Industries Ltd	Fuel Logistics
Fujian Haikui Aquatic Products Group	Fushun Excavator Corporation Ltd
Gala Precision Technologies Pvt Ltd	Gathee Enterprises
Gayatri Jhansi Roadways Limited	Gayatri-Lalitpur Roadways Limited
General Motors Auto	Generale Assurance Mediterranee
Geometric Software Solutions Company Ltd	GET Power Pvt Limited
GI Terminal Technology India Pvt Ltd	Glencar Mining Inc
Global Energy	Golden Lay Ltd
Goodearth Maritime Ltd.	GPT Steel Industries Ltd
Grain Bulk Handlers Ltd	Green Infra Ltd
Groupe des Assurances de Tunisie	Grupo Panalum & Subsidiaria
Gruppo Limited	Guandong Mingyang Wind Power Technology Co. Ltd
Guaranty Trust Bank	Gujarat Pipavav Port Ltd
Gujarat Venture Capital Fund 1995	Gujarat Venture Finance Ltd
Gulf of Guinea Energy Limited	H & Q Philippine Holdings (BVI) Inc
Hailing Pharmaceutical Group	Harbin Pharmaceutical Group Company Ltd.
Harmon Hall Holding, S. de R.L. de C.V.	HDFC Bank
Hebei Meihua Group Co Ltd	Helios Towers Nigeria Ltd
Heritage Foods Ltd	Highland Petroleum Holding
Hill & Associates Ltd	Hill Packaging
Himin Solar Energy Group Co. Ltd	Hind High Vacuum Company
Holdsport (Pty) Ltd	Home Solutions Retail India (Pvt) Ltd
Homeway Investment Ltd	Hot Pot Ltd
House of Busby (Pty) Ltd	Hui Lau Shan
Hydrotech Tanzania Ltd	ICH Properties Holdings Ltd
Icosnet	“Impulse Talent Sdn Bhd”
Indepth Water Services	India Hospitality Corporation
Indorama Petrol Limited	Infratel Indus
Inpac	Integra Software Services
Interchick Company Ltd	Intercontinental Bank
Intrasoft Technologies	Invescom Limite / Orange Madagascar
INX Media Private Ltd	Inyoni Yami Swaziland Irrigation Scheme
Ithambeka Trading Enterprise	Iven Medicare India Private Limited
IVR Hotels and Resorts Limited	Jagannatha Financial Services Ltd
Janalakshmi Financial Services	Jas Toll Road Company Limited
Jinan Yellow Cat Wood Industry Company Limited	JK Investec
JMC Projects LTD	Joan Traders Ltd
Johnnic Communications West Africa Ltd	Join Hands Enterprise
Joruth Enterprise Ltd	JRG Fincorp
JRG Securities Ltd	Kalpataru Power Transmission Limited
Kamro Agrovet Retail Ltd	Karvy Stock Broking Ltd
Kasbah Resources	Kashf Microfinance Bank
Kenya Safari Lodges and Hotels Ltd	Kianjamba Transporters
Kijja Enterprises	Kilombero Valley Teak Co Ltd
Kimemiah Engineering Construction Ltd	KMB Bank
KML Company Limited	Koelfontein Investments (Pty) Ltd
Kosan Crisplant Cameroon	K-Rep Bank Ltd
Krishna Godavari Gas Network Ltd	Krizm Hotels Private Limited (brand name—Lemon Tree Hotels)
Kronospan / Kronohim	Krunghthep Land PCL
KungFu Fast Food	Lak Jaya Microfinance Ltd
Landmont Limited	Lat Sa Ta Multimedia
Lattice Bridge Info Tech	Leasafric Ghana Limited
Leasing Group	Liberty Club Ltd
Lima Feeds	Linatex Asia Sdn Bhd
Linya Distributors	LMKR Holdings Limited
Lodox Systems (Pty) Ltd	Lutsk Motor Vehicle Plant
Mahindra Castings Pvt Ltd	Mahindra Retail Private Limited
Malaysian Ventures (Two) Sdn Bhd	Manipal Health Systems Pvt. Ltd
Manipal Universal Learning Pvt. Ltd	Manorbois
Mantri Metallics Private Limited	Maples ESM Technologies
Marketpro Investments 100 (Pty) Ltd	Marsun Company Ltd
Match Electrical	Medikredit Integrated Healthcare Solutions

Mentor Media  
 MFBC  
 MIC Microfinance Bank Ltd  
 Micro Africa Ltd  
 Millennium Information Technologies  
 Mivan Far East Limited  
 Moga Holding Ltd  
 Mo'men Foods Ltd  
 Mouka Limited  
 MRS Rhino Investment  
 MTN Nigeria Communications Limited  
 Music Broadcast Private Ltd  
 Nairobi Business Park Ltd  
 Nana Hostel  
 Nanjing Aotecar Refrigerating Company Ltd.  
 National Stock Exchange of India  
 Newpack SA  
 Nilgiri's  
 Nirula s  
 Norman Batuma Mutekanga  
 Notore Chemical Industries  
 Oakland Media Services Ltd  
 Oceanic Bank International plc  
 Okapi Hotel  
 Orascom Telecom Algeria  
 Orezone Resources Inc  
 Ortel Communications Limited  
 Orzunil 1 Societe Anonima  
 Outsourcing Services Limited  
 Pacific Aviation Partners  
 Pacific Green Industries (Fiji) Ltd  
 Padma Textile Mills Ltd/Bextex Ltd  
 Pagasa Philippines  
 Pancake House Inc.  
 Parabolic Drugs Ltd  
 Peresys (Pty) Limited  
 "Petro Group Holdings Pte Ltd"  
 PharmARC Analytic Solutions Pvt  
 Phoenix Petroleum  
 Planor Capital International  
 Plumblink SA (Pty) Ltd  
 Polimet Pte Ltd  
 Poulina  
 Prime Fuels  
 Primo Oleochemicals Inc  
 Privi Organics Limited  
 ProCredit Bank Serbia  
 Professional Services, Inc.  
 Prudent Choice International Limite (eHi)  
 PT ASA Indonesia  
 PT CDC Land  
 PT Global Kalimantan Makmur  
 PT Semai Lestari  
 PT Tri Daya Esta  
 PV Technologies India Ltd  
 PVR Pictures  
 Qingdao Guodian Lande Environmental Engineering Company  
 Ragia Communications Ltd  
 Rainbow Printing  
 Rawford International  
 Real People Investment Holdings (Pty) Ltd  
 Reclamation Holdings (Pty) Limited  
 Regimanuel Gray Ltd  
 Reliance Financial Services Co., Ltd  
 Resourcery Limited  
 Richmore Life Sciences  
 R.M Group  
 Rolex Rings Private Limited  
 S Bacher & Company (Proprietary) Limited  
 Sachal Radio Group  
 Safripol (Pty) Limited  
 Sainik Mining & Allied Services Ltd  
 Salt Investment SAZF Ltd  
 Sandhar Technologies Ltd  
 Sathapana Ltd (formerly known as Cambodian Entrepreneur Building Ltd)  
 Savcio Holdings (Pty) Ltd  
 Scaw Holdings  
 Secova eServices  
 Semme Mineral Water PLC  
 SFO Technologies Pvt Ltd  
 Shandong Dougongfang Group  
 Shandong Sanrong Group Co Ltd  
 Shanghai Sinoway Herbage Cosmetics Co Ltd  
 Sheng Shi International (HK) Development Ltd  
 Shing Cheong Holdings Limited  
 Shri Hari Fintrade Private Ltd  
 Sical Logistics Ltd  
 Sign Source Ltd  
 SIRO Clinpharm Pvt Ltd  
 SMMS Investments Pvt Ltd  
 Snax  
 Societe d'Articles Hygieniques  
 Socremo  
 Songas Limited  
 Spencon  
 Metha Collections  
 Mibanco  
 MIC Tanzania Limited  
 Microqual Techno Private Limited  
 Mineral Deposits Limited  
 Moepi Platinum Ltd  
 Molecular Connections Pvt Ltd  
 Moser Baer Solar Plc  
 Mozal SARL  
 MTN Cote d'Ivoire  
 Muhangi Enterprises  
 Myfuel Ltd  
 Nairobi Imaging Solutions  
 Nandi Investments Ltd  
 Nanjing Xiezhong Auto-Airconditioner (Group) Co., Ltd.  
 NDO WMN  
 Nextel Telecomunicações Ltda.,  
 Nimir Chemicals Pakistan Ltd  
 Nitrex Chemicals India Ltd  
 Northpole Ltd  
 Nusantara Investment Fund Ltd  
 Ocean & Oil Investments Ltd  
 Oceanic Oil Ltd  
 Optimus Ltd  
 Ordyn Technologies (Pvt) Ltd  
 Oriental Containers Limited  
 Orwell (Oil & Gas) Nig Ltd  
 Oteko/ Sfat  
 Ovidian Design & Marketing Ltd  
 Pacific Communication Solutions Ltd  
 Pacific Retail Ltd  
 Pagasa Consultancy Ltd  
 Pan American Energy LLC (Argentine branch)  
 Panda Flowers Limited  
 Paras Pharmaceuticals Ltd  
 Peters Papers Ltd  
 Petstar, S.A. de C.V.  
 Phoenix Lamps Limited  
 Pinoy Consultancy Ltd  
 Platmin Ltd  
 PMI Theodore Alexander  
 Porini Ltd  
 Power Link Electro House  
 Primedia (Pty) Ltd  
 Private Networks Nigeria Ltd  
 ProCredit Bank  
 Profab  
 Progressive Base Holdings Limited (LP Amina)  
 PT Adaro Energy  
 PT Buana Finance Tbk  
 PT Finansia Multi Finance  
 PT Pamindo Tiga T  
 PT Tirta Marta  
 PT Yupi Indo Jelly Gum  
 PVR Ltd  
 QAI India Ltd  
 Rabai Power Limited  
 Rainbow Development Ltd (Portland Paints)  
 Rams Square Pharmacy cc  
 RDC Concrete India Pvt Ltd  
 ReaMetrix Inc  
 Regal Forest Holding Co Ltd  
 Reliable Autotech Private Limited  
 Reliance Infratel Limited  
 Revolution Stores Co. Ltd  
 Rinac India Limited  
 Robo Silicon Pvt Ltd  
 Rubamin Ltd  
 SA Block (Pty) Ltd  
 Safepak Ltd  
 Sai Sudhir Infrstructure Pvt Ltd  
 Saiss Holding  
 Sandbox Holdings Company Ltd  
 Sani Kleen Hygiene Services (Pty) Ltd and Yvonne Smith  
 Satin Creditcare Network Limited  
 Save on Surplus Inc  
 Seaways Shipping Ltd  
 Seilanithih  
 SEP Pharma Ltd  
 Shaanxi Tony Heavy Industries Co. Ltd  
 Shandong Rongqing Logistics co Ltd  
 Shanghai Krupp Stainless Co. Ltd  
 Shanghai Tongyue Leasing Co. Ltd  
 Shield Mining  
 Shiriam City Union Finance  
 Shuanghui International Holdings Ltd  
 Sicopa  
 Sinai Marble  
 Skye APIC Limited  
 SMS Shivnath Infrstructure Limited  
 SNC Former Public PCL  
 Société Maghrébine de Monétique (S2M)  
 Somkan Marine Foods Ltd  
 Spandana Sphoorty Financial Limited  
 Sphere Investments Limited

Spykar Lifestyles Private Limited	Srei Infrastructure Finance Limited
Ssebagala & Sons Electro Centre	Star Wave Investment Holdings Ltd
Starcloud Media Co Ltd	Sterling Add-Life India Ltd
STI (India) Ltd	STS Holdings Ltd
Sunac International Investment Holdings Ltd	Sunshine Holdings PLC
Swala Leasing and Finance Limited	Swaraj Mazda Ltd
Swift Networks Ltd	T4 Corp
Tai-I International Holdings Ltd	Taizina Biotechnology
Tanzania Breeders and Feedmills Ltd	Tanzania Tea Packers Ltd
Target Cranes (Pty) Ltd	Tausi Freight Logistics Company Ltd
Tebma Shipyards Ltd	Technovator International
Techochem SA (holding company for Nycil Ltd)	Tecpro Asstech Limited
Tecpro Power Systems Limited	Tecpro Systems Limited
Teknicast Sdn Bhd	Tema India Limited
TEMSO Engineering	TenGer Financial Group LLC
The Junction Ltd	The York Timber Organisation Limited
TIAuto (Pty) Ltd	Tintoria Ltd
Tofo Public Cellular Payphones (Pty) Ltd	Tops Security Ltd
Trans Highway Trucking	Transaction Capital (Pty) Ltd
True Vine Academy	Truong Thanh Furniture Company Ltd
Tsavo Power Company Ltd	Tsebo Holdings and Operations (Pty) Limited
Tunisian Health Care Centers	Turk Ekonomi Bankasi A.S.
Umeme	Unigestion Holding S.A.
Uni-Resources Investment	V Link Travel Solutions Pvt Ltd
Vaishnavi Associates (Bagalore) Pvt.Ltd	Veeda Clinical Research
Vicentin S.A.I.C.	Vijaywada Tollway Private Limited
Vinta Systems Inc	Virgin Nigeria Airways
Volta Resources (previously known as Birim Goldfields)	Voltic International Incorporated
Vysr Inc.	Wall Street Institute
Wargen Services Ltd	Watawala Plantations PLC
Weifang Modern Science & Technology Development Co Ltd	Weifang Shengrui Parts & Machinery
Well Sea Investments Ltd	WinInChina Inc
Wisdom Alliance Ltd	WSP Holdings Ltd
Xiabu Xiabu	Xinjiang Dingxin Special Materials Co
XYZ Limited	YiFeng Pharmacy Chain Store
Zara Furniture	Zatix Participações S.A (previously Omnilink Tecnologia SA)
Zenith Bank PLC	Zhejiang Jindun Pressure Vessel Co. Ltd
Zhong An Credit	Zhong Nan Holdings Ltd
Zingo Investments Ltd	

Questions 108–116 (Mr Bacon): *In note 2 of figure 6 (page 13) of the report there is a reference to “carry” paid equating to 9% of total profits. Richard Bacon MP asked to see CDC’s total profits in the years 2005–07 in order to be able to identify more easily the proportion represented by carry*

The actual figure in the NAO report for carry should be 8.4% of realised profits, not total profits. This was rounded up to 9% for the NAO to avoid any allegation of under-declaring, although it should more appropriately be rounded down to 8%. A full explanation of the figures appears in the table below.

	2005 £m	2006 £m	2007 £m	Total £m
Realised Return (this relates to profits on realised investments, ie companies that have been sold)	208.5	67.4	406.2	682.1
Unrealised Return (this relates to valuation increases in existing investments)	178.6	270.0	223.0	
Portfolio return	387.1	337.4	629.2	
Other Income and expenses	38.7	37.6	42.8	
Total Return	425.8	375.0	672.0	
Amount of profits to Fund managers as “carry”	9.1	23.2	24.9	57.2
	57.2			
	682.1	=	8.4%	

Questions 126–132 (Mr Bacon): *asked for the monthly rate paid to the consultant firm Quiller*

The rate is £17,500 per month (plus VAT).

Questions 195–198 (Chairman): *asked what evidence we had to show that commercial investors would have invested less in China without CDC’s investment. Richard Laing offered to show which funds had been oversubscribed*

CDC has only invested in two over-subscribed China funds; CDH China Fund and Legend Capital Fund (China).

However, two factors should be borne in mind regarding over-subscription. First, fund managers regularly claim to have been oversubscribed (when it is doubtful they were) as a way of talking-up their next fund raising round. Second, if CDC is an early subscriber to a fund and the presence of CDC has a good demonstration affect, which we firmly believe it does, then the presence of CDC may encourage a full or even over-subscription.

(Chairman): Following the Hearing, the Committee asked a further question:

*If the aim of CDC is to demonstrate profitability in underserved markets, why were investments made in high-profit areas like eastern China? Should not CDC be identifying new opportunities for other investors to follow, rather than following private investors into well developed markets?*

China's poverty reduction success has been as a result of the huge out-migration of people from the poorest regions to the more dynamic coastal regions. When CDC invested in the coast, creating sustainable jobs, it contributed to poverty reduction in China. It is important to note that investments in eastern China are not necessarily high-profit and low-risk.

When the investment policy was set in 2004 China was not the automatic success story that it is now seen as—companies in China and Latin America needed foreign investment and the Investment Policy at the time reflected this. Times have changed and finance is now more readily available in China. CDC's new investment policy reflects the need to focus the company even more on the economies that have the greatest need for private sector money.

9 and 28 January 2009

### 3. Memorandum from Mr Roy Darkin

Dear Mr Leigh

I listened to your radio 4 interview on 5 Dec 08 regarding CDC with interest and total agreement. I would point out that it is not only the smaller poorer countries that CDC public development capital has withdrawn from but also the more marginal, but equally important, sectors such as agriculture. These issues revolve around CDC's investment policies which at present appear to have been held to ransom by over paid executives from an incentive scheme mainly based on financial performance. Nobody seems to have found a solution to highly paid and average paid staff working in the same organisation. Nevertheless I agree that there is no justification for the remuneration currently enjoyed but that it should not detract from what should be a debate on CDC's investment policies and their effectiveness at reducing poverty.

I attach my last letter to the Secretary of State for International Development and his subsequent reply in 2004.<sup>8</sup> The "Additionality" required from the use of public capital has yet to be debated instead having been circumvented by the nebulous arguments of the "trickle-down" theory from the Thatcher era to justify high return investments in a few concentrated territories. In CDC's case Additionality means doing something which the private sector would not do of its own accord. CDC has withdrawn from perhaps the most important sector of all namely renewable natural resources where most people in developing countries live and which everyone recognises is fundamental to development. CDC should allocate a significant fund to agriculture and should also re-open CDC offices in those countries where Actis has withdrawn.

DFID should also be held to account. In the Secretary of State's reply, reproduced below, he promised that DFID would be closely monitoring the development impact of CDC's investments and work with CDC to increase them. It is clear from the NAO report on CDC that this has not happened and DFID should be held to account.

"I am sure that we share a common objective for CDC—to reduce poverty especially in sin-Saharan Africa and southern Asia. I believe that CDC can and will make a real contribution to this. We will be monitoring the developmental impact of CDC's investments closely in the future and will work with CDC to seek ways to increase this. The agricultural fund that you have suggested is the sort of proposal that we might well look at in the future, although we would have to consider whether CDC was the most suitable organisation to take this forward."

DFID have continued to maintain an arms length relationship with CDC. The following extract of a statement made by Dr Julian Lewis from the April 2002 Westminster Hall debate on CDC may explain part of the reason.

"themselves. However, Bowen Wells, the distinguished former Chairman of the Select Committee on International Development, expressed the view that one purpose of the part-privatisation of the CDC was to reduce competition with the Department for International Development for Treasury funds. The 1999 legislation made it possible to borrow funds from the private sector as well. Unfortunately, the price of doing that seems to be an unacceptable sacrifice of the Department's developmental aid."

This view is reinforced by the following statement made in a letter to me by the Secretary of State in February 2004 in which any support for CDC would have to be at the expense of DFID.

"You comment that CDC was excluded from the aid budget and had more investment proposals that funds available. In development, as elsewhere in life, resources almost invariably fall short of ideal levels. However, CDC deploys well over £1 billion of public funds, a very substantial commitment. If DFID were to invest more money in CDC, it would have to be at the expense of other DFID activities."

<sup>8</sup> Not printed.

There appears to be a conflict of interest with the management of CDC and its current profits based incentive system and with DFID who do not want any competition for funds. The result is CDC's current investment policies rather than what is actually required as should be reflected in the additionality of its investments representing Britain's public development capital and host country requirements. I believe that there should be a review of CDC's investment policies by the International Development Select Committee as was intimated by the Chairman of that committee back in September 2003 in a letter to me.

"Clearly in considering our future work programme between now and the end of this Parliament, one of the many competing issues that the Committee will want to consider for further enquiry will be CDC. I obviously can't prejudge what the decision the Committee will come to, but I suspect that colleagues might feel that it would be sensible to wait a little longer to enable the Committee to see clear evidence of the progress or otherwise of CDC's investments, and as importantly, what evidence or otherwise that can adduce as to the effect their work has had in helping countries meet the Millennium Targets before we undertook a comprehensive enquiry into their work and finances."

I am a former employee / public servant of CDC who has campaigned against the changes that have taken place and have in the past received the following from Jenny Tonge, former Lib Dem shadow in 2002. This evidence essentially revolved around an early fund management company and financial incentives. There is undoubtedly a later trail from others who witnessed subsequent events. Certainly I am not aware of any debate on the Additionality of CDC's investment policies which were instead circumvented in the pursuit of profit.

"If such an enquiry were to take place, the Select Committee would call expert witnesses to give evidence on the CDC. From your letters it seems clear that you have evidence of decisions made by CDC's management that may have had an ill adverse effect on CDC's investment policies. You also mention the fact that you would like a 'review' of the CDC. It would seem to me that the best forum for such a 'review' would be through a Select Committee investigation."

Without a fundamental change to the existing incentive policies it is unlikely that any changes will happen.

I believe a significant proportion of the portfolio should be allocated to renewable natural resources which does have a higher development impact than an office block or shopping mall. For instance CDC investment, expertise and management models in the biofuels sector would have resulted in the whole industry being far more developed than is currently the case. The tragedy of laying off more than 2000 man years of tropical agricultural experience and expertise along with associated long term development capital is summarised in the attached CDC agricultural fund. My last letter to the then Secretary of State in April 2004 outlining the case for additionality and a substantial Agricultural fund along with his reply is attached.<sup>9</sup> CDC summary is a small selection of replies over the years along with a summary of my own career in CDC.

I hope the above may be helpful in arriving at a more favourable outcome for Development and for The CDC, Britain's Development Finance Institution.

12 December 2008

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#### Further memorandum from Mr Roy Darkin

Thank you for circulating my letter and attachments and to Austin Mitchell MP for raising the subjects of agriculture and additionality. My response to the answers or conclusions drawn in the debate are:

- Agriculture is loss making by the Permanent Secretary: Not true. Commodity prices have been much higher over the last decade making many of those previously marginal agricultural investments profitable. Agriculture is generally dependent on commodity prices. Quoting returns of negative 4% on agricultural investments at the end of a prolonged period of depression in prices is misleading. There are plenty of profitable agricultural investment opportunities from biofuels to food production and processing. The Permanent Secretary's glib response on agriculture does an injustice to those peoples and societies whom would most benefit from investment in renewable natural resources. Targets should be set. In 1987 CDC had £179 million invested in 42 smallholder projects which at full development involved 1.2 million smallholders across 13 main cash crops and covering 880,000 ha of rural economic activity with benefits that went far beyond. Further detail is attached.<sup>10</sup>
- There have been no bankruptcies and where large settlements and towns have grown up as a result of these agricultural investments. Instead, to the detriment of local peoples, China is investing heavily in natural resources in Africa but mostly extracting raw materials with little added value and often unsustainably.

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<sup>9</sup> Not printed.

<sup>10</sup> Not printed.

- Agriculture is no more important than other sectors: “I think the consensus is that promoting agriculture has a greater impact on alleviating poverty, but progress in industry remains fundamental to economic development and ultimate wealth, eg China. I think Deng talked of walking on two legs—agriculture and industry, if progress is made in both then they re-enforce each other—raw materials for industry, chemical inputs and machines for agriculture, rural and urban markets for each other’s produce. A key step is not to neglect agriculture while promoting the industrial projects that politicians tend to love.” It is also a fact that agriculture has a high beneficiary to investment ratio.
- There needs to be a balance by the CEO of CDC: \$100 million agribusiness fund, most of which comprises of existing agricultural assets, compared to a \$4 billion total portfolio is insignificant. Agriculture and renewable natural resources in general are being neglected and are not adequately represented in CDC’s investment policies despite high beneficiary to investment ratios. There is operating agricultural expertise in Africa most of which have ex-CDC staff. In other words there is existing manpower allowing more financial resources to be allocated to this basic and fundamental sector.
- Additionality: On a number of occasions the example of under subscribed funds was used to defend the use of public funds. The point however is there are already some other private investors available. In the case of additionality one is referring to investments that would not occur without the participation of CDC and often taking the lead in highly beneficial investments justifying the use of public funds.
- Field staff: The Chairman of CDC dismissed a return to field staff. I believe he is mistaken. Britain needs a presence in these countries and needs to adopt a far more hands on role in order to facilitate much needed new investment in the most marginal markets (countries) and sectors. In fact as a CDC Country Representative I have found myself defending to the hilt country strategies which do not include the closure of offices and withdrawal of investment programmes. CDC’s current fund activities were the intention for what used to be called Financial Markets. There were however other activities including project finance and management in which CDC had a unique reputation such as agriculture and as was acknowledged in the Prime Ministers speech back in 1997 and which he promised to retain.
- The Chairman of CDC referring to the “old CDC” is mistaken. CDC has been in these countries for 60 years and will always be recognised as having help found industries of national and international importance such as palm in Malaysia and smallholder tea in Kenya. There are new industries out there to be developed requiring manpower and long term capital which will help stem urban migration and help fulfil the vision of vibrant rural market towns with capital cities unencumbered by expanding slums of unimaginable destitution.
- Rural versus Urban: I was shocked that the Permanent Secretary did not recognise how investment in rural areas and natural resources could help stem migration into urban slums and destitution for the majority.
- Financial incentives: “Although not a direct response, you really should emphasise the point about CDC management having only financial measures for their incentive calculations—I met one of the Mckinsey team who drew them up and they are embarrassed at what a hash they made of it and that they would include developmental measures if they were to do it again. That would make agriculture more important in management’s eyes because it is a sector that has a high beneficiary to investment ratio.”

Should there not have been competition with DFID for Treasury funds it may not have been necessary to sacrifice the rest of CDC’s capabilities which are still highly regarded and fondly remembered by host nations. There were, and still are, alternative models for Britain’s Development Finance Institution. One such model is attached<sup>11</sup> which would have been able to offer Africa bonds at a commercial rate for development finance and operate in a much larger capacity without the high financial return constraints currently imposed by DFID. Most of CDC’s investments would have high beneficiary to investment ratios justifying the use of public finance and enabling private investment that would otherwise not have taken place either as partners or through models subsequently adopted by the private sector. These various functions did previously co-exist and with a sense of public duty could exist again to the ultimate benefit of host nations for which these public funds are intended.

Since CDC currently have a cash mountain of \$1.4 billion and at least a four year track record of investment with a recent revised set of investment policies would now not be the time for the International Development Committee to conduct a review of CDC’s existing and intended investments in order to endorse, or otherwise, the current investment policy and ensure that the current surplus of funds is best invested to reduce poverty?

22 December 2008

<sup>11</sup> Not printed.