Development through Business: Illusion or Reality?

Maximising Development Impact through Home-Country Firms

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# Table of Contents

1. Introduction 6  
   1.1. Subject and Scope of Paper 6  
   1.2. Structure of Paper 7  

2. Methodology 9  
   2.1. Research Strategy 9  
      2.1.1. Research Focus  
   2.2. Research Design 11  
   2.3. Assessment of Methodology 12  
      2.3.1. External validity  
      2.3.2. Internal validity  
      2.3.3. Relevance of the Research Topic  
   2.4. Introducing Core Concepts 14  

3. Making Room for the Private Sector in the Development Agenda 16  
   3.1. The Role of Private Sector Development 16  
   3.2. The Role of Home-Country Measures 18  
   3.3. Summary 20  

4. The Win-Win Situation: Evidence on Impacts in Host Countries 21  
   4.1. Development Impact 22  
      4.1.1. Linkages and spillover effects  
      4.1.2. Knowledge and Technology Transfer  
      4.1.3. FDI and Poverty Reduction  
      4.1.4. Summary  
   4.2. Commercial Sustainability 31  
      4.2.1. Motives for Investments  
   4.3. Additionality 34  
   4.4. Summary 36  

5. Analytical framework 38  
   5.1. Analytical Framework 41  
   5.2. Strengths and Limitations of the Analytical Framework 46  
   5.3. Summary 47
List of tables, pictures and graphs

Picture 4.1. Capital Flows to Developing Countries 23
Table 4.2. FDI Flows to Groups of Countries, 1980-2002 24
Table 4.4. Development Effects of Affiliates 27
Table 4.5. Summary of Literature on Development Impact 30
Picture 5.1. The Win-Win Potential of Home-Country Companies in Developing Countries 38
Picture 5.2. The Development - Commercial Sustainability Equilibrium 40
Picture 5.3. Commercial Sustainability 42
Table 6.1. Selected Danish Home-Country Measures 48
Table 6.2. IFU Investments and Job Creation 50
Table 6.3. Investments by Countries 2007-2008 51
Picture 7.1. Results of Analysis 69
Picture 7.2. Results of Analysis 71
**List of abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>DANIDA</td>
<td>Danish International Development Agency</td>
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<tr>
<td>DFID</td>
<td>UK Department for International Development</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>IFC</td>
<td>International Financial Corporation</td>
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<td>IFU</td>
<td>Industrialization Fund for Developing Countries</td>
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<td>IRR</td>
<td>Internal Rate of Return</td>
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<td>HCM</td>
<td>Home Country Measures</td>
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<td>LDC</td>
<td>Least Developed Countries</td>
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<td>LIDC</td>
<td>Low Income Developing Countries</td>
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<td>MNC</td>
<td>Multinational Corporation</td>
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<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development</td>
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<tr>
<td>OPIC</td>
<td>Overseas Private Investment Corporation</td>
</tr>
<tr>
<td>PSD</td>
<td>Private Sector Development</td>
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<tr>
<td>RRR</td>
<td>Required Rate of Return</td>
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<tr>
<td>SAL</td>
<td>Structural Adjustment Loans</td>
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<td>SAP</td>
<td>Structural Adjustment Policies</td>
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<tr>
<td>TNC</td>
<td>Transnational Corporation</td>
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<tr>
<td>UMIC</td>
<td>Upper Middle Income Countries</td>
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<tr>
<td>WACC</td>
<td>Weighted Average Cost of Capital</td>
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1. Introduction

1.1. Subject and Scope of Paper
Since the mid 1980s the view towards Foreign Direct Investments (FDI) in Developing countries has changed dramatically. The popular view of FDI went from being a tool of resource extraction to being a vehicle of capital and knowledge transfer. This paradigm shift of more pro-FDI policies in host countries has also resulted in a change in home-country policies.

Most Western countries have for several decades operated programs that encourage and facilitate the participation of home-country firms in business operations in developing countries with the objective of creating a ‘win-win’ situation where business opportunities and positive development impact go hand in hand. Since the early 1990s donors, or home-countries, have increased efforts of encouraging FDI to developing countries, as FDI is expected to create jobs and stimulate development and poverty reduction, while at the same time bring new business opportunities to home-country firms. Each year home-country companies are supported to operate in developing countries by substantial financial amounts and donor funding to these types of programs has increased during the last years (UNCTAD, 2004).

Even though donors have been scaling up their support and focus on programs that involve home-country companies, studies on the impacts and the additionality of these programs are scarce. The critical question remains: are these programs igniting positive social and economic impacts in host-countries? Literature on the role of facilitating institutions is poor. A justification of the financial expenditure to home-country firm based programs needs to rest on evidence that indicate the importance of these programs for local private sector development in the host-country. So far, these evidence are missing, as there is a gap in the literature. This study makes an attempt to clarify and evaluate development programs that use home-country firms as drivers of development and their impacts on development. The central question discussed in this paper is under what conditions development impact can be increased under these programs, hence the following research question:

**How can development impact be increased through home-country firm based development programs?**

The underlying issue discussed in this paper is the validity of the ‘win-win’ idea, asking the fundamental question: can business really make a difference for development? Can home-country
firms play a decisive role in that development? And how can this development be guided by donor country policies and programs so that development impact and in particular poverty reduction is augmented? These are important questions as expectations towards home-country company’s positive contributions to host-country economic and social development are rising, as well as donor financial support.

The increased focus and support to home-country firm based development programs have created an unfulfilled need for increased research on methodologies and evaluation parameters of such programs. Major DFIs and Development Agencies such as IFC, DFID and OPIC are increasing their private sector focus. Furthermore, the last decade witnessed considerable criticism on development programs that finance Home-Country company operations in developing countries. Critics have argued that ODA contributions should not be used to support home country firm’s internationalization. These critical voices emerged partly because the development impact and poverty reduction of these programs had vaguely been documented. This study is an important contribution to fill in the gap of literature on home-country program’s development impact. The results of this study could shed a light on the question of whether home-country firms are important drivers of development, and furthermore how home-country measures can be transformed so that they measure the impacts they have in developing countries for more efficient use of resources. The results could therefore be of interest to policy makers, fund operators as well as researchers in international business studies and development studies.

1.2. Structure of Paper

The paper is organized as follows: Following the introduction the second chapter presents the paper’s methodology, its design and strategy as well as limitations of the study and relevance of the subject. The third chapter firstly reviews the rationale and role of home-country private companies in development and secondly it presents Home-Country Measures, their role and different types. The fourth chapter reviews relevant literature on home-country companies’ possibilities of igniting positive social and economic impacts in host countries. It also reviews relevant literature on commercial sustainability and additionality of home-country measures. In chapter five indicators for evaluating development impact, commercial sustainability and additionality are developed and an analytical framework with the purpose of analyzing home-country measures’ possibilities for creating positive development impact in host-countries is presented. Chapter six presents empirical evidence on two Danish development institutions, namely the Industrialization Fund for Developing Countries (IFU) and Danida’s Business-to-Business Program (B2B), and reviews criticism and
results of both programs. In chapter seven the analytical framework is applied to the cases of IFU and B2B and recommendations for increased development impact, commercial sustainability and fund additionality are presented. Finally, chapter eight discusses the results of the analysis and the dilemmas and opportunities of using home-country firms for creating development impact in developing countries.
2. Methodology

2.1. Research Strategy
The study focuses on explaining three variables and their relationships. These variables are 1) Development impact, 2) Commercial sustainability and 3) Development institution or fund additionality. Although we are not conducting a pure deductive study here, which would result in a cause-effect relationship, it is nevertheless helpful to assign particular roles to the three different variables.

Development Impact
The study examines how development impact can be increased through home-country firm based development programs. The study’s task is to explain how the possible development impact created by home-country companies in host-countries can be influenced through home-country measures. Thus, the main variable of the study is development impact. Most time and space will be devoted throughout the paper to explain this variable because development impact is a multi-dimensional concept. Development impact is a dependent variable that can be influenced by many factors, such as commercial sustainability, home-country measure type and home-country company type (Saunders, 2003).

Commercial Sustainability
The study focuses on the idea, popular with development institutions in the last decade, of a ‘win-win’ situation, implying that by operating in developing countries home-country companies can harness new business opportunities and spark positive social and economic development in the host country at the same time. An important variable that also needs clarification refers to the commercial opportunity associated with operating in developing countries. We refer to this variable as commercial sustainability and attempt to explain the relationship between it and the development impact variable. The commercial sustainability variable is a sub-variable which is independent because the elements that cause commercial sustainability of projects are generally well known within the financial sector. We do thus not explain in detail how to obtain commercial sustainability.

Development Institution Additionality
The study focuses on explaining the development impact that can possibly be created by home-country firm based development programs. Therefore it is important to explain the particular role
development institutions play in that process. The third variable the study discusses is the additionality of development institutions which attempts to evaluate the role of development institutions. This is an important variable which evaluates whether development institutions have a value added in the process of creating development impact. It is a dependent variable that depends primarily on the development impact and the commercial sustainability created by development institutions.

The lack of literature on the relationship between the three variables and in general, development program’s key parameters for creating development impact, made it necessary to construct an analytical framework based on relevant evidence on home-country companies development impacts. The framework is built on the three variables; development impact, commercial sustainability and additionality. The framework evaluates development program’s possibilities of enabling home-country companies to contribute to development in developing countries. This research approach, which highlights context, interpretation of data and building theory is often referred to as inductive. It does not necessarily lead to a cause-effect conclusion (Saunders et al., 2003). Most of the data are qualitative and the analysis is a qualitative evaluation emphasizing context rather than quantity. The study is based on a small sample of home-country measures and the discussion emphasizes the creation of a contextual understanding of the development impacts of home-country measures, which is important when applying an inductive research strategy (Saunders et al., 2003).

2.1.1. Research Focus

The focus of this study is on two levels as Private Sector Development can take place through different levels of action. First, the international or country level; second, the macro or state level; third, the meso or branch level and fourth, the micro or company level. The first level focuses on donor and trade policies, the second level on macroeconomic policies, good governance and physical infrastructure within states, the third level on state level actors such as labour unions, chambers of commerce and employers organizations and the last level on company’s contribution to an enabling environment, job creation, capacity development and technology transfer (Schulpen and Gibbon, 2002). The focus in this paper is primarily on the fourth level, i.e. individual company operations in developing countries and their impact on development and secondly on the first level, donor country policies. It discusses more precisely how donor country policies or home-country measures can improve the development impact of their interventions.
2.2. Research Design

Finding and selecting empirical evidence is an important part of the study. Although most donor countries have established some home-country measures that involve home-country companies, programs and projects vary considerably in terms of methodology, structure and operational methods between countries. This difference can make it problematic to compare programs between countries. Different methods of involving home-country private companies can however reveal important aspects of what works and what not in terms of creating development impact. This study examines the development impact of two Danish development programs but the two programs employ different methods to obtain development impact in host-countries. One uses FDI as a vehicle while the other focuses on match-making between a host- and a home-country company. Both programs have a similar objective however, to create development impact through stimulating the local private sector. The two programs are compared with respect to their development impact creation.

The choice of Denmark as a case example is firstly based on the fact that there is a relatively long tradition for private participation in development programs in Denmark. The Industrialization Fund for Developing Countries (IFU) was founded in 1967 and in the early 1990s numerous different programs that involved the Danish private sector were established. Secondly, support to home-country firm based programs has been a major recipient of ODA in Denmark (Schulpen and Gibbon, 2002; Kragelund, 2004). The Danish government has invested heavily in support to home-country private company operations in developing countries. The two programs analyzed in this paper have been one of the largest recipients of funding for the last two decades (Danida, 2004b).

It is important to highlight here that very limited literature exists on the development impact of home-country measures that use home-country companies as vehicles for development. There exist evaluations of programs and quantitative studies on program efficiency but very few qualitative analyses of program’s impacts on host-countries. This study is only a first step in improving the gap that exists in the literature. The study gathers relevant research from related fields and empirical evidence that examine the role of home-country companies. The studies available come from different sources, but all shed a light on the context of home-country measures and the impacts they create in host-countries. Research from international business studies and development studies are important sources, as well as studies from international organizations such as the World Bank,
UNDP, OECD and UNCTAD. Much of the theoretical literature is based on studies on Foreign Direct Investment.

The study is mainly based on primary and secondary data. Academic research articles, reports, government publications, annual reports, and evaluations are important sources of information. The paper also builds on relevant theories in international business and previous work of the author. Gathering empirical information on the two cases and their development impacts was not straightforward. First, there is little coherence in the evaluation methods and few direct examples provided of operational problems or successes. Gathering information to build a broad based picture of the impacts of the programs was therefore a lengthy process. Furthermore, the lack of measurable indicators in terms of development impact and poverty reduction meant that it was necessary to contact the organisations directly and ask for additional information. Attempts were made to get access to more written and oral documentations from Danida and IFU but these attempts were not successful. It was not possible on behalf of Danida to give an interview on the subject. Two documents, one on the B2B program in Vietnam and another on Bolivia were acquired through direct contact. Additional information was also demanded from IFU but the promised information was never received.

2.3. Assessment of Methodology

2.3.1. External validity

The paper is based on a study of two Danish home-country measures that involve home-country firms as vehicles for stimulating private sector development. The study gathers available evidence on the development impact of these programs on host-countries. Each program constitutes a case. Cases can be an important means of producing new knowledge as it can relate theory to real-life experiences (Flyvbjerg, 2001). This is precisely the point with the Danish cases as a heated debate has taken place in Denmark on these programs role and rationality.

The problem has been discussed both officially and publicly in Denmark. Questions such as “do financial contributions result in positive development impacts and poverty reduction?” have emerged and “can financial support to Danish firms for development purposes be defended from a public policy point of view?”1 Thus, examining the Danish cases where public funds are used for these purposes has high strategic relevance and reflects upon a real-life experience.

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1 Based on a discussion in several issues of Udvikling in 2005, a Danida monthly publication.
Taking Denmark as an example can limit the external validity of the study as Denmark is a small country, but there are at least three reasons for why the IFU and B2B cases are generally representative for the international debate:

1. Denmark has been one of the most active countries to involve its home-country firms in development programs and spends relatively high amounts each year to such programs per capita when compared with other donor countries (Danida, 2004b).

2. The cases are generally representative of three particular types of Home Country Measures (Te Velde, 2007). Those that support improved infrastructure in developing countries, those that focus on reducing economic and political risk of investments in developing countries and those that provide information on investment opportunities in developing countries. Both IFU and B2B serve all these criteria’s and are therefore generally representative for home-country measures involving home-country firms.

3. Both IFU and the B2B program have been operated for a relatively long time period and considerable experience has been gathered on running the programs. The empirical evidence available include evaluations from 2004 of both programs where a high number of professionals and stakeholders were consulted and questioned (Danida, 2004a; Danida, 2004b). Furthermore, an academic study conducted by Hansen et al. (2004) for IFU is rich of sources on IFU and Kragelund (2004) is a rich source on the case of the B2B program in Ghana.

2.3.2. **Internal validity**

The reliability of the presented data is in general high. Evaluations and reports on the programs have been carried out by independent consultants and reference groups, and theoretical references are based on academic research articles. A higher quantity and increased variety of available empirical evidence could however, as always have increased the study’s depth.

The nature of the empirical evidence and the lack of theory to analyze the data are the largest reasons for why an inductive research strategy was adopted in this paper. The gap in the literature created a pressing need to formulate an analytical framework on the subject. And the empirical evidence’s nature called for a qualitative rather than a quantitative treatment of the data. The research strategy allows this study to analyze, organize and discuss the relationship between the
three study variables. However, there are several concepts that need further definition or consensus, which can affect the internal validity of the study. Development impact is a multi-dimensional concept, which has many interpretations. Its relationship with the concept of poverty reduction needs some deeper clarification and can undermine the validity of the results. Poverty is also a multi-dimensional concept and it is beyond the scope of this paper to define a poverty reduction dimension of development impact. It is suggested here as a subject for further research.

2.3.3. Relevance of the Research Topic

There is a high priority in the development agenda to demonstrate that business opportunities and development can go hand in hand. First, the promotion of the win-win situation of business opportunities in least developed countries has been ongoing for several years now. However, empirical evidence has not demonstrated clearly that this model works. One of the reasons for that is not the lack of validity of that approach, but rather lack of methodology to evaluate results from development institutions that promote this model. Therefore the subject has relevance to many development institutions that are promoting this view, as it takes a small but important step in clarifying the assumptions of the model and designing methodologies to evaluate its validity.

Second, donors are increasingly focusing on producing results which can be measured in less poverty and better living conditions of people in developing countries. Most Western countries have been increasing their contributions to Private Sector Development and home-country measures that involve home-country firms in the recent years. The amount of contributions to PSD has increased but research on the efficiency and impact of these programs still remain fragmented. The challenges and possibilities of private sector development are not very well researched (Hansen et al., 2001). Thus it is highly relevant to contribute to research in this area, so that policy makers can increase the efficiency and impact of these types of programs in all countries that conduct Development Finance Institutions and Private Sector Development programs. Regarding Denmark in particular, the project focus can be of high relevance. This is first of all due to the fact that the cases used in this paper are Danish, and second, the paper contributes to the intense debate that has taken place on the validity of development programs that fund home-country firms.

2.4. Introducing Core Concepts

Many of the concepts that are introduced in this paper are explained throughout the text of the paper. The following concepts are however introduced here independently:
Home-Country Companies refers to companies from the country where the foreign direct investment or development institution is originated from (Te Velde, 2007).

Host-Country Companies refers to companies in the country where the investment or business operation takes place (Te Velde, 2007).

Least Developed Countries is a group of countries that are: a) low income based on a three-year average estimate of gross national income (GNI) (under 900 USD); b) have a human resource weakness based on indicators of nutrition, health, education and adult literacy, and c) are economically vulnerable based on indicators of instability of agricultural production, instability of exports, the share of manufacturing vs. modern services in GDP, d) merchandise export concentration, and e) handicap of economic smallness (E/2004/33)’’ http://www.un.org/special-rep/ohrrls/ldc/ldc%20criteria.htm, on June 4th, 2009).

Private Sector Development (PSD) refers to the overall initiative of stimulating development through the private sector. The private sector is regarded as a “basic organizing principle for economic activity where private ownership is an important factor, where markets and competition drive production and where private initiative and risk-taking set activities in motion” (OECD-DAC, 1995:7).
3. Making Room for the Private Sector in the Development Agenda

3.1. The Role of Private Sector Development

This chapter presents the historical background for private participation in development and the paradigm shift that took place within the development agenda associated with the cooperation with private actors and how as part of that change, home-country measures emerged. The second part of the chapter presents the objectives and different roles of home-country measures. The rationale behind private home-country participation in development is crucial to look at in order to answer how development impact can be increased through these methods.

For a long time, the Western private sector was seen as one of the problem-makers in developing countries. Multinational companies were accused of taking advantage of relaxed legal frameworks on environment, human rights and labour in developing countries and of exploiting resources with little benefit to the “underdeveloped” host-country. Since the early 1990s, the role of the Western private sector in development and the view towards its operations in developing countries has changed dramatically (Prieto-Carrón et al, 2006:970). Today most developed countries have measures to include home-country companies in development programs.

The consensus on behalf of international aid institutions on cooperating with the private sector was not reached overnight. In the 1960s and 1970s the state was viewed as the main actor in promoting economic development in developing countries. State led policies such as Import Substitution Industrialisation were supposed to increase local production and were carried out by many states. When these strategies failed, and most countries were left off with inefficient industries, foreign-exchange shortages and a bias against agriculture, more trade oriented policies were advised to developing countries (Schulpen & Gibbon, 2001). Instead of local industries, foreign investments became important to stimulate the local economy. At that time, some donor countries established investment funds to support foreign direct investments into developing countries. The World Bank established the International Finance Corporation (IFC) in 1956 with the objective of promoting investments in developing countries. Most other western countries followed this example and established development funds or financial institutions. In 1992 the Association of European Development Finance Institutions was established, which today has seventeen member institutions.
In the early 1980s Structural Adjustment Policies (SAPs) were adopted by most development institutions and developing country governments. Developing countries were subject to stringent conditionality in order to receive Structural Adjustment Loans (SALs) from international financial institutions (IFIs) (Schulpen & Gibbon, 2001). Overall, the thinking of IFIs moved away from looking at the state’s role in development as central (Danida, 2004b). Many developing countries receiving SALs from IFIs implemented changes according to SAPs conditionality, such as privatization, liberalization and deregulation of markets. Consequently, there was more room for private actors in these new markets.

By the end of the 1980s a growing criticism appeared on SALs, mostly because they failed to produce positive economic results. Critics pointed towards growing inequality and poverty as a consequence of neo-liberal economic strategies (Schulpen & Gibbon, 2001). Thus, by the early 1990s, the development debate moved towards a more balanced role between the state, and the market. The role of governments was now proposed under the term ‘good governance’ and the role of the market was proposed under the name ‘Private Sector Development’ (PSD).

The private sector was now seen as an efficient producer and distributor of goods and services, while the state was seen as a provider of legal and regulatory frameworks (Schulpen & Gibbon, 2001). Poverty reduction became the main objective of development and was to be promoted through economic growth. Economic growth was best reached through the private sector, and in particular with Foreign Direct Investment, while the state had a role to play in ensuring equal distribution of economic growth (Schulpen & Gibbon, 2002). Consequently many different programs involving home-country private actors were started up by donor institutions. The programs had different functions, such as promoting imports from developing countries, stimulating FDI to developing countries, increasing capacity for transfer of technology and providing subsidized loans to projects in developing countries (Danida, 2004b). An umbrella term over donor initiatives to stimulate economic activity in developing countries has recently emerged, and is referred to as home-country measures.

During the 1990s this mixed role of the public and the private became further established in international development thinking. At the Earth Summit in 1992, business played a particularly large role and the UN started to show signs of acknowledging the role of business in global development and poverty reduction. Consequently TNCs were acknowledged as possible drivers of development and the late nineties saw new innovative approaches and partnerships emerge (Beausang, 2003). The UN established the Commission on the Private Sector and Development which had the task to
recommend how the potential of the private sector in developing countries could be unleashed, and how the home-country private sector could be engaged in meeting that challenge (Beausang, 2003).

In 1994, the role of home-country firms in development was further confirmed when OECD issued the first donor statement on PSD policy, referred to as the OECD-DAC guidelines (OECD, 1995). The potential of involving home-country companies in development projects, was according to OECD to build the capacity of the developing country private sector by promoting efficient economic growth, be a source of wealth, knowledge, competitiveness and dynamism. Furthermore, jobs created by private companies were regarded as a more equal way of distributing growth (OECD, 1995).

The development described above reviews the historical involvement of donor country companies, also referred to as home-country firms, in development. It highlights the controversy within the development agenda associated in the past with defining the role of the state versus the role of the market, and furthermore the increased support to private actors in playing a role in development and poverty reduction.

3.2. The Role of Home-Country Measures
Home Country Measures (HCMs) are donor country efforts to stimulate FDI to developing countries, with the assumption that FDI promotes development and encourages poverty reduction (Te Velde, 2007). HCMs are one element of Private Sector Development: actions that are undertaken by home-countries to improve private sector activity in developing countries (UNDP, 2004). This section reviews the role and different categories of HCMs.

There is no standard definition of HCMs but Kline (2003) proposes that HCMs include laws, regulations, policies and programmes in home countries that affect outflows of FDI (Quoted in Te Velde, 2007). According to UNCTAD (2004) home country measures are incentives provided by developed countries to private firms and include:

a) Measures to encourage technology transfer through FDI to developing countries
b) Measures encouraging the participation of home-country firms in public projects in developing countries.

HCMs can be in the form of support for risk reduction, technical assistance, technology transfer or home-country market access (Te Velde, 2007). This means that HCMs include both FDI stimulation
and support, as well as preparatory functions such as partnerships of a home-country firm and a host-country firm. Many different types of programs that include HCM have been established in most developed countries and the financial and capacity support to these measures has increased heavily (UNCTAD, 2004). In UK alone bilateral investment related aid was in 2007 30% of UKs bilateral aid (Te Velde, 2007). Table 2 in Appendix offers some examples of different HCMs and their operational methods.

Te Velde offers four categories of HCMs:

A) Support for economic fundamentals and governance structures in host countries.
B) Support for reducing economic and political risks of investment projects.
C) Support for providing information surrounding investment projects.
D) Other policies that affect the viability of investment projects.

The first category supports FDI in overcoming a lack of or ill developed *enabling environment* in a developing country. The second category focuses on reducing political and economic risks that arise from investing in developing countries. The third category focuses on reducing an information-related market failure, such as alerting potential investors that profitable opportunities exist in developing countries. The last category includes other measures undertaken by home-countries that affect FDI to developing countries such as tax policies on double taxation or trade preferences (Te Velde, 2007).

Te Velde (2007), points out that there is a lack of research on HCMs which is surprising given the fact that many donor governments have increased their efforts to promote FDI in developing countries.

The development programs that are discussed in this paper represent different types of HCMs. One is a Development Finance Institution (DFI) and functions as a means of increasing FDI flows to developing countries. DFIs provide funds, consultancies and guarantees that reduce the economic and political risks of investing in developing countries, i.e. assist home-country companies in overcoming market failures associated with lack of information, and lack of experience of investing in developing countries (Te Velde, 2007; Yaron, 1992). Their purpose is to support certain types of home-country business activities that have the potential to create broad social benefits in host-countries. Most DFIs accept below-market rates of return on their capital because of their development priorities (Caskey
& Hollister, 2001). DFIIs mainly focus on Te Velde’s category B of reducing economic and political risk in investment projects and category C of providing information.

The other HCM discussed in this paper are partnerships. They are characterized by a matchmaking function between a Western company and a developing country company. The objective of such programs is to create long-term business relationships between home-country companies and companies in developing countries with the aim to facilitate transfer of technology and managerial skills to the developing country partner (Kragelund, 2004). These programs operate at the micro-level (firm-level) and attempt to contribute to economic growth through facilitating partnerships (Danida, 2004b). Partnerships also cover categories B and C of Te Velde’s classification.

3.3. Summary
In this chapter the historical emergence and purpose of home-country measures have been presented as well as different types of HCMs. It depicted how development institutions and home-country measures focus on overcoming market failures associated with lack of capital or information, needed to stimulate economic activity in developing countries. The paper attempts to answer whether HCMs that involve home-country firms are an effective way to stimulate development in host-countries. Before moving on to that discussion the next chapter will introduce and discuss the theoretical foundation for why and how home-country companies are believed to impact development and poverty reduction.
4. The Win-Win Situation: Evidence on Impacts in Host Countries

For several years now, a model that associates business opportunities in developing countries with progress in development and poverty reduction has been presented by international and bilateral development institutions. The model presents doing business in developing countries to Western companies as a win-win opportunity, where successful businesses also improve the lives of the billions that live in poverty in the world today. Most international and bilateral development institutions offer programs that assist home-country companies in investing or undertaking business in various developing countries. The idea is that by participating in such development programs, business can gain information, capital and advice while at the same time improving their possibilities of affecting the host-country economy and society in a positive way (UNCTAD, 2003).

The win-win situation described above is very appealing to many that want to improve the state of the worlds poorest. The problem with the argument is that almost no studies exist on the quality and relevance of the programs that guide companies to the win-win situation. Are development institutions’ setting the right criteria’s for the participation of home-country companies so that they really have positive influence on economic and social development in developing countries?

Very little focus has been on examining the proposed win-win situation and whether and then how home-country companies have the possibility to reach the win-win situation through co-operation with relevant development institutions. This paper takes the first steps to examine the possibilities and conditions under which home-country companies have the opportunity to engage in business and lead to positive impact. In order to do that it is important to identify and discuss three criteria’s.

The first one is obviously development impact and a discussion of what kind of business activities maximize development impacts. Here it is necessary to discuss whether there is a relationship between foreign investments or operations and development? Through what mechanisms or processes positive impacts take place? Furthermore, can we expect poverty reduction when stimulating economic and social development?

The second issue that is necessary to discuss is the business opportunity. Under what conditions do companies succeed in developing countries? How can the commercial sustainability of home-

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2 Several institutions have presented this model, e.g. United Nations Development Program, World Bank Institute, Department for International Development, Danida and more.
country projects be improved? Does emphasis on commercial sustainability undermine or support the objective of creating development impact?

The third issue that needs to be examined is the role of the home-country program. Does it serve an important role in the process? Does it add important factors, such as information or capital to the investment process? Could other, e.g. market institutions have provided these factors? In other words, what is the additionality of the program?

This chapter presents the existing literature that is relevant to these three issues. First it presents literature related to the discussion on development impacts. Within this section evidence on several important categories are presented such as linkages and spillover effects, knowledge and technology transfer and poverty reduction. Second, it reviews briefly the existing literature on commercial sustainability of business projects in developing countries. Third, it reviews and presents existing information on fund additionality.

4.1. Development Impact
The effects of Foreign Direct Investment (FDI) on host economies have been widely debated within international business studies. In general FDI is considered to provide certain advantages to the host country. Several studies suggest that FDI increases capital flows to host countries, contributes to economic growth, and ignites a flow of modern technology, skills and management to those countries (Lall, 2000; Klein et al., 2001; Forsgren, 2002; Te Velde, 2007).

One of the reasons for the lively discussion on FDI and its development impact is the dramatic increase in the scale of private external finance to developing countries in the last decades. Since 1993 FDI flows to developing countries have exceeded the flow of total Overseas Development Assistance (ODA) (Danida, 2004a).
Despite the dramatic increase in FDI flows to developing countries the precise effects of FDI on host economies remain an issue for discussion. Up until mid 1980s the discussion was very focused on the negative and exploitative effects of TNCs on host countries. Since the late 1980s the discussion balanced towards a broader view on TNCs and their impacts on host countries, i.e. that multinational companies differ in terms of their possibilities of transferring knowledge and positively influence the local economy and society (Forsgren, 2002). Although many scholars have contributed to the discussion on the social and economic impact of FDI in host countries (e.g. Hansen et al., 2008; Forsgren, 2002; Altenburg, 2000), more research needs to be conducted in order to be able to generalize about the development impact of FDI. While some claim that evidence increasingly point towards the importance of FDI on poverty reduction (Klein et al. 2001), others argue that FDI can have both benefits and costs for developing countries (Lall, 2000).

Today we at least know that the dramatic increase in FDI to developing countries in the last decade cannot be directly translated into development impact or poverty reduction. First, the bulk of investments to developing countries have been invested in large developing countries or countries with rapid economic growth. 80% of all FDI in year 2000 went to a limited group of ten countries (Danida, 2004a). And in 1998, less than 2% of FDI flows went to the 48 poorest countries in the world (Dunning, 1997). In 2003 foreign direct investment to the least developed countries had risen

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3 These were: Hong Kong, China, Brazil, Mexico, Argentina, Bermuda, Korea, Cayman Islands, Singapore and Taiwan.
to $10.4 billion but represented only 1.6% of global FDI flows. As table 4.2 and picture 4.3 depict, most of the poorest countries are left out of the high increase in FDI. And as globalization unfolds, more evidence has appeared on increasing inequalities, both between and within developing countries (UNDP, 2007).

Table 4.2. FDI Flows to Groups of Countries, 1980-2002

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>699</td>
<td>1.954</td>
<td>3.002</td>
<td>6.147</td>
<td>6.607</td>
<td>7.123</td>
</tr>
<tr>
<td>Developed countries</td>
<td>392</td>
<td>1.400</td>
<td>2.041</td>
<td>3.988</td>
<td>4.277</td>
<td>4.595</td>
</tr>
<tr>
<td>Developing countries</td>
<td>307</td>
<td>551</td>
<td>921</td>
<td>2.030</td>
<td>2.174</td>
<td>2.340</td>
</tr>
<tr>
<td>Africa</td>
<td>32</td>
<td>51</td>
<td>78</td>
<td>145</td>
<td>158</td>
<td>171</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>50</td>
<td>117</td>
<td>202</td>
<td>609</td>
<td>706</td>
<td>762</td>
</tr>
<tr>
<td>Developing Asia</td>
<td>216</td>
<td>340</td>
<td>583</td>
<td>1.186</td>
<td>1.215</td>
<td>1.305</td>
</tr>
<tr>
<td>Central and Eastern Europe</td>
<td>3</td>
<td>40</td>
<td>129</td>
<td>156</td>
<td>188</td>
<td></td>
</tr>
<tr>
<td>Least developed countries</td>
<td>3</td>
<td>8</td>
<td>16</td>
<td>36</td>
<td>41</td>
<td>46</td>
</tr>
</tbody>
</table>

Billions of USD

Picture 4.3. Inward FDI Flows, 1980-2002 (Billion USD)


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4 LDCs share of FDI flows is so small that it can hardly be seen in the picture.
5 See also picture 3 in Appendix.
Second, the type of FDI seems to matter regarding its impacts on development and poverty reduction. According to UNCTAD’s Trade and Development Report, trade without technological innovations, capacity development, and value added in the production processes has limited development effects (UNCTAD, 2002). Consequently, FDI offers a potential for stimulating economic and social development and poverty reduction, but does not automatically do so. Central to this discussion is the literature on linkages and spillover effects of home-country firms in developing countries which has been widely discussed recently (Hansen et al. 2008; Altenburg, 2000; Te Velde 2002; Lall, 2002; OECD, 2002).

The focus on explaining the impacts of foreign business activity in developing countries has also resulted in research about the potentially damaging effects of FDI or home-country operations in developing countries. The argument about the global ‘race to the bottom’ is well known, and suggests that MNCs invest in countries with lowest costs associated with labour and environment. Developing countries that wish to attract FDI race amongst each other to keep labour and environmental costs low, with deteriorating effects on local welfare (Doh and Oetzel, 2009).

4.1.1. Linkages and spillover effects
Linkages refer to the range of relationships undertaken by a home-country company in the host-country. Linkages can be both forward and backward. Forward linkages “result from the utilization of output, ‘i.e. every activity that does not by its nature cater exclusively to final demands, will induce attempts to utilize its outputs as inputs in some new activities’” (Hirschman, 1958, in Altenburg, 2000). Backward linkages on the other hand “’comprise the attempts to supply through domestic production the inputs needed’ in a given activity” (Hirschman, 1958 in Altenburg, 2000).

Lall argues that though most developing countries consider FDI as a vital source for development, the economic effects of FDI are very difficult, “if not impossible” to measure (Lall, 2000). Lall argues that the main benefits of FDI are increased foreign exchange, increased employment and investments in resources. The main costs are exchange rate problems, crowding out of local investment and low labour standards. Lall also notes that in order to attract FDI a developing country has to offer competitive immobile assets such as skills, infrastructure, services, supply networks and institutions. Lall offers a distinction between FDI that contributes to development and FDI that does not. According to Lall, ‘static’ FDI does not contribute to development in the host country while ‘dynamic’ FDI does. When an FDI is static it fails to invest in improving local capabilities and create linkages in the host economy. Consequently, the impacts of FDI can even become negative, as for
example when FDI ‘crowds out’ local investments and local enterprises (Lall, 2002). How dynamic the FDI is depends on how much upgrading of local capabilities take place over time, how deep local linkages evolve and how intensely the affiliates integrate themselves into the local learning system (Lall, 2002). Dynamic FDI opens a door for upgrading of local capacity and access to the global marketplace.

Forsgren (2002) suggests that three underlying factors influence the types of social and economic consequences of MNC activity in host countries. First is the impact of the MNC on competition, second the bargaining power of companies vis-à-vis host country governments and third, the impact of MNCs on knowledge transfer between borders.

Klein et al. (2001) argue that FDI has the potential to improve the quality of economic growth in host countries. The quality improvement takes place through reducing volatility of capital flows and incomes, improving asset and income distribution at times of privatization, help improve social and environmental standards, and help improve social safety nets and basic services for the poor.

Altenburg (2000) argues that the development impact of FDI depends on the types of linkages that an MNC establishes in the host country. He distinguishes five types of linkages and spillovers and analyses how they differently impact the host country: Backwards linkages with suppliers, forward linkages with customers, linkages with competitors, linkages with technology partners and other spillover effects. Spillover effects can for example be increased capacity of human capital or imitations by local entrepreneurs of MNC technologies (Altenburg, 2000). He concludes that backward linkages with suppliers are the main vehicle for technology spillovers from TNCs. Spillovers refers to “positive effects of interventions other than on direct beneficiaries” (Danida, 2004b:54).

The welfare effects of FDI are also discussed by Hansen et al. (2006). Their research indicates that capital formation, job creation, as well as technology and knowledge transfer are important direct development effects of FDI. They argue that investments within certain sectors can have more development impacts than others. This applies in particular to labour intensive industries which are more beneficial to development than capital intensive sectors. The reason being more potential for job creation.
Development impact has been defined as a measurement of intended and unintended effects by an intervention on a society, economy, a region or a company (Danida, 2004b). Development impact includes a measurement of a range of variables that have been monitored by the intervention. Development impact can be difficult to evaluate as different interventions monitor different variables, or there is lack of monitoring and evaluation of several variables.

Hansen et al. (2008) identify three types of development effects: direct, indirect and diffused effects generated by home-country companies in developing countries. The direct effects are suggested to be only ‘the top of the iceberg’ indicating that indirect effects and spillovers are considerable. However there are difficulties bound to measuring and evaluating them. Hansen et al. agree with Altenburg that indirect effects take place through the linkages that become established between home-country firms and host-country partner firms (Hansen et al. 2006). The types of development effects on the host-country are summarized in Table 4.5.

Hansen et al. (2008) have pointed towards the importance of linkages and linkage effects. Linkages are transactions between foreign affiliates and host-country businesses as well as non-business entities such as universities, government institutions, research centres and other official or private institutions (Hansen et al. 2008). Inter-firm linkages are transactions that take place between firms and involve long-term collaboration. Hansen et al.’s conclusion is that affiliates that are closely managed by the home-country company create stronger linkages and generate more upgrading in the host-country.

<table>
<thead>
<tr>
<th>Direct effects</th>
<th>E.g. import / export, job creation, technology transfer, knowledge upgrading, and income generation at affiliate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect effects</td>
<td>E.g. generation of activities and jobs at local partner firms</td>
</tr>
<tr>
<td>Diffused effects</td>
<td>E.g. demonstration effects, effects on productivity, overall effect on country's private sector development and competitiveness</td>
</tr>
</tbody>
</table>

From Hansen et al. 2006 (p.62)
The OECD Observer summarized the benefits and costs of FDI in developing countries (2002). The main benefits of FDI according to OECD are technology spillovers, human capital formation, integration of local companies into the global economy and increased competitiveness. All this contributes to higher economic growth, and in addition FDI could trigger additional social and environmental improvements through clean technologies and more socially responsible business practices.

4.1.2. Knowledge and Technology Transfer

Knowledge and technology transfer are one of the main positive development impacts that take place through home-country measures. But how does knowledge transfer take place? Forsgren (2002) argues that the tendency to internalize production will become stronger the more intangible the firm-specific asset is, because intangible assets are difficult to do business with. Flows of knowledge between independent organizations are an inefficient solution due to high internal organization costs related to enforcing monitoring of staff effort and quality standards (Forsgren, 2002, Hennart, 1991). Kogut and Zander’s (2003) empirical results also show that the more complex the technology or knowledge that is to be transferred, the more likely is that the transfer will be internalized. They however, regard knowledge as an asset that cannot be transferred and sold between two firms, because knowledge is based on ‘dynamic capabilities’ (Kogut and Zander, 2003) and risks losing its value in the transfer (Forsgren, 2002). According to this interpretation, today’s firms that rely extensively on technology, knowledge and innovation should rather invest in own subsidiaries in developing countries than engage in business transactions with other firms if they would like to have positive development impact. This view provokes at least a generalization of the idea of knowledge transfer from home-country firms to host-country firms through partnerships.

Given this assumption, the question arises under what conditions technology and knowledge transfer can take place?

Previous evidence indicates that it is highly inefficient or impossible to transfer knowledge between firms, depending on the degree of the intangibility of firm-specific assets (Kogut and Zander, 2003; Hennart, 1991). Knowledge is highly intangible but can be transferred within companies. Thus: “MNCs contribute to welfare of societies because they are more efficient vehicles for knowledge transfer than between countries than other forms of institutions” (Forsgren, 2002:32). And from a host country perspective the implications are the same. “A foreign investment in the country improves its possibility to get access to new technology, which will contribute to the welfare of the
country” (Forsgren, 2002:32). According to these views there are much more transaction costs associated with partnerships than direct investments or wholly owned subsidiaries. Trust is also an important factor, and is likely to be higher when home-country firms establish own subsidiary. Knowledge and technology transfer thus depend to a large extent on the relationships between the home-country company and the host-country partner. This is supported by Hansen et al. (2008).

Another important issue which OECD highlights is that in order for technology and knowledge transfer to take place, technologies and knowledge need to be “relevant to the host-country business sector and not just the company that receives them first” (OECD, 2002:3). Foreign investors need to avoid a “technology or knowledge gap” which emerges when the levels between the host and the home country firms are too high.

4.1.3. FDI and Poverty Reduction

The relationship between FDI and poverty reduction is not very well documented empirically (OECD, 2002). Evidence claim that FDI stimulates economic growth and higher incomes, which generally benefits proportionately the poorest segments of the population (OECD, 2002). Also that investments in host-country capabilities and infrastructure help improve basic services for the poor as suggests by Klein (2001). Others do not agree and point to empirical evidence that show that inequality within countries has increased despite increased economic growth (UNDP, 2007) and can lead to a race to the bottom (Doh & Oetzel, 2009). Evidence on how FDI or home-country company activities stimulate poverty reduction is very scarce. Doh and Oetzel (2009) argue however that current MNC strategies in developing countries are ineffective in delivering poverty reduction and suggest a partnership strategy with local NGOs to reach effective poverty reduction through MNCs.

OECD (2002) and Hansen et al. (2006) suggest that poverty reduction effects of FDI are stronger when FDI is labour intensive, due to high employment creation. Here it is important to question also the quality of FDI, i.e. how deeply it impacts social and economic issues, not only the job creation effect. OECD suggests that FDI has potentially more impact when it is conducted in a socially responsible manner (OECD, 2002). In general investments with criteria’s that make up for lacking social safety nets can have a potential for increasing poverty reduction.

4.1.4. Summary

The discussion on development impact spans different literature from different theoretical schools. The discussion here has covered different aspects of how development impact can be a result of
home-country company operations in developing countries, and also how poverty reduction can be a part of development impact. Different views of authors and theoretical perspectives are summarized in table 4.5.

Table 4.5. Summary of Literature on Development Impact

<table>
<thead>
<tr>
<th>Author/ Theory</th>
<th>Development impact</th>
<th>Type of HCM</th>
<th>Applies to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lall</td>
<td>Depends on dynamic and static nature of FDI. Dynamic FDI invests in improving local capabilities and creates linkages</td>
<td>FDI</td>
<td>Linkages</td>
</tr>
<tr>
<td>Altenburg</td>
<td>Is strongest through backward linkages with suppliers</td>
<td>FDI</td>
<td>Linkages</td>
</tr>
<tr>
<td>Blomstrom et al.</td>
<td>Takes place through a) productivity spillovers b)market access spillovers</td>
<td>FDI</td>
<td>Spillover effects</td>
</tr>
<tr>
<td>Te Velde</td>
<td>Country specific investment related aid is useful in facilitating FDI</td>
<td>HCM / FDI</td>
<td>HCMs</td>
</tr>
<tr>
<td>Klein et al.</td>
<td>FDI reduces volatility of capital flows, improves income distribution, social safety nets and basic services to poor. Only development impact of FDI when existing enabling environment in LIC</td>
<td>FDI</td>
<td>FDI</td>
</tr>
<tr>
<td>Hansen et al.</td>
<td>a) Takes place through job creation and technology and knowledge transfer b) depends on sectors and company types</td>
<td>FDI</td>
<td>Linkages and technology transfer</td>
</tr>
<tr>
<td>Transaction Cost Theory</td>
<td>Knowledge transfer possible through own subsidiary</td>
<td>FDI</td>
<td>Knowledge transfer</td>
</tr>
<tr>
<td>Global Value Chain Perspective</td>
<td>Upgrading possibilities depend on type of network relationship</td>
<td>FDI</td>
<td>Development impact</td>
</tr>
<tr>
<td>Resource Based Theory</td>
<td>Knowledge transfer is more likely to be successful with hierarchical mode. Depends on complexity of knowledge</td>
<td>FDI</td>
<td>Knowledge transfer</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
4.2. Commercial Sustainability

Commercial Sustainability refers to the continued commercial operation of a project after official support for it has stopped. Sustainability is in evaluation methodology defined as “whether the effects of an intervention will continue after the withdrawal of support for it” (Danida, 2004b:25). Sustainable businesses are the prerequisites for the creation of development impact and poverty reduction. Without commercially viable business projects the long term impacts on host-economies are bound to fail. Therefore one of the criteria’s for evaluating development impact of HCMs is the degree of project or investments’ commercial sustainability.

Within international business theory it is generally accepted that there are four major reasons for why firms undertake business activity outside of their home country. First, firms can be gaining access to resources by entering new countries; second, they can be gaining access to new markets for their products or services; third, firms can be looking for increased efficiency and fourth, they can be seeking strategic assets or new capabilities (Dunning, 1992). Hence, in order for a business project to be successful a new market has to offer firms one or more of these four attributes.

There exists a rich literature on entry strategies into new markets (Arnold & Quelch, 1998; Hoskisson et al., 2000; Peng, 2000; Meyer, 2001; London & Hart, 2004) and several analytical frameworks to assess which business plans or entry strategies suit a particular new market. The PESTEL framework is one example. It offers a framework that analyses political, economic, social, technology and risk associated with entering new markets (Laserre, 2003). Meyer’s Eclectic Framework is another tool that analyses home-country company’s entry strategies into new markets (Meyer, 2002). Meyer’s framework builds on two factors, location and entry modes and evaluates the influence of different factors such as location, timing, entry mode logistics, marketing and human resource management on the entry strategy.

The major difference between emerging economies and developed markets has been described in terms of less macroeconomic stability, less developed market institutions, unclear definition of property rights, lack of institutional features such as skilled labour, and lack of trust towards foreign firms (Hoskisson et al. 2000). In broad terms, the international business literature focuses on the consequences of a different institutional environment in emerging markets and firms’ strategic attempts to overcome the transaction costs associated with these institutional barriers. Thus, a company’s emerging market strategy needs to understand the institutional context of the host country.
in order for it to be commercially successful and in order for the expected value creation to take place.

Another theoretical view emphasizes that a foreign company has to overcome social and economic costs associated with being a foreign company in a new market. These costs have been termed liability of foreignness (LOF) (Doh and Oetzel, 2009) and according to the LOF view these costs create additional operating costs for foreign firms in new markets. The LOF view focuses on how the home country company conceptualized and relates to the host-country (Doh and Oetzel, 2009). LOFs can impede home-country companies’ profitability in host-countries as increased uncertainty creates higher risk. Home-country companies can work to “mitigate liabilities by hiring local staff, putting a local face on the firm, and otherwise seeking to become isomorphic with the local society and culture” (Doh and Oetzel, 2009).

Both the LOF approach and general IB theories regard knowledge of the host country environment as essential for commercial success. This also highlights that knowledge of the local market is highly valuable and that the benefits of high integration between the home-country and the host-country affiliate need not only be in one direction. Increased integration and investment in local capacity may benefit home-country companies in their quest for overcoming LOF.

The high transaction costs or LOFs associated with investments in developing countries make investments in this type of countries high-risk investments as uncertainty is high. High-risk results in a high required rate of return (RRR) of investments (Buckley, 1998). Investors will thus tend to establish an internal rate of return (IRR) that exceeds the RRR in order to make a profitable investment. Investments with high IRR are capital intensive and require funding that often consists partly of equity (Buckley, 1998).

4.2.1. Motives for Investments

It is interesting to examine why home-country companies consider investing in low-income countries. The most obvious advantages for home-country firms are access to new markets with limited risk, access to raw materials, promoting their own machines and know-how, publicity and coping with changing demands (Kragelund, 2004). Participating in a partnership under a home-country scheme gives home-country companies protection and decreases the high risk of exploring a new market. This is true for companies that are co-operating with Development Finance Institutions and also for companies forming partnerships under a partnership scheme. Altenburg (2000) discusses partnerships
and partnership dilemmas. He points towards conflicts that can arise due to different expectations of partners. Also that different bargaining power of partners can lead to instable partnerships or joint ventures that can result in negative outcomes. Altenburg also notes that partnerships have to be created on a common interest and common goals. Partnerships that are ‘forced’ do not work. This is interesting because one of the roles of HCMs is a match-making function that host- and home-country companies participate in with facilitating institutions before becoming partners. Kragelund (2004) notes that the match making of partners under a partnership scheme is a biased process in many cases, where the home-country company receives much more advanced assistance. This can lead to power asymmetries within the partnership. This is further discussed by Beausang (2003) who notes that knowledge gaps between firms can be problematic. Differing capabilities of firms need to be complementary to benefit the partnership.

A study by IFC conducted in 1996 (Miller et al.) revealed the major contributions made by local and foreign companies in joint ventures. Major foreign partner contributions were (in rank of importance) process and product technology, international reputation, provision of finance and management know-how. Major local partner contributions were (in rank of importance) knowledge of local politics, government regulations, local customs, local markets; provision of financing, local reputation and access to local market (Altenburg, 2000). These results give an indication of what is expected from each partner and what the additionality of each partner in a joint venture can be.

Schulpen and Gibbon (2002) point out that there are numerous trade related interventions by donor countries, in the form of investment or export promotion that do not have a particular focus on developing countries. Consequently it can be more natural for home-country companies to rely on direct export promotion interventions, rather than HCM based on the development agenda which also, in most cases have more stringent conditions to be fulfilled. Thus, in order to attract home-country firms to participate in HCMs certain conditions favourable for home-country firms have been established. Most donors established aid tying within their home-country firm support programs to attract donor country companies to participate (Schulpen and Gibbon, 2002). The tying gives home-country companies certain economic advantages to increase the likelihood of their participation. But the tying also creates some imbalances between the home and the host-country firms in their co-operation which can affect the development impact potential of the partnerships (Schulpen and Gibbon, 2002; Kragelund, 2004). The question remains about the motivation of the home-country company. Do they participate under the development program because of economic advantages, or because they want to influence the world’s poverty level?
4.3. Additionality

We have now presented literature on development impact and commercial strategies related to home-country companies operations in developing countries. Both discussions are derived from studies on firm activities. The discussion on additionality focuses on the role of the home-country measures. It raises questions on the role of Home-Country Measures in influencing the development impact and poverty reduction in developing country markets? Which welfare effects and investments would have taken place without the home-country program? What is the alternative if these programs weren’t available?

There does not exist a general additionality measure. The difficulties of defining additionality are related to the lack of measurable outcomes and benchmarks of HCMs. Yaron (1992) suggests a parameter to capture the efficiency of development finance institutions, that is, whether the capital spent in DFIs are yielding returns in terms of social and developmental benefits (Yaron, 1992). Yaron suggests the Subsidy Dependence Index (SDI), which provides a public interest analysis of DFI financial performance and subsidy dependence, and takes account of the social costs of operating a DFI. It does however not capture qualitative analysis of fund additionality.

If we look at the rationality for home-country measures that involve home-country companies, their objective is to assist home-country companies in undertaking business activity in developing countries. One of the main reasons for the existence of HCMs is to reduce transaction costs (Te Velde, 2007) or overcome market failures associated with lack of capital and information (Yaron, 1992). The transaction costs for companies entering new markets are high (Meyer and Peng, 2005; Lall, 2000), and market failure is the best-known case for policy interventions (Altenburg, 2000). Most LDCs are countries with weak enabling environments, which in turn creates high transaction costs for home country companies entering those markets. Weak enabling environment and weak institutions create uncertainty because of malfunctioning or dysfunctional information systems, lack of law enforcement, monitoring costs and opportunistic behaviour (Meyer and Peng, 2005). There is a market failure between western companies and developing country markets and HCMs’ objectives are to overcome these market failures. In more detail, Lall (2000) notes that policies on FDI need to counter two sets of market failures. Those that arise from information or coordination failures in the investment process, and those that arise from divergences between investor’s interests versus interests of the host country. In general investments in high-risk countries have a high Required Rate of Return (RRR) (Buckley, 1998). Thus capital in the form of equity and loans with low RRR provided by DFIs
can play a decisive role in making investments in developing countries possible for investors, as it brings down the financial costs of market entry. This can be an important part of fund additionality.

Altenburg (2000) is of the opinion that HCMs can play an important role in development. He argues that public policy helps maximize spillover effects in host countries and concludes that public policy is one of the key factors in explaining success stories. Hansen et al. (2008) underline Altenburg’s view and argue that “without linkages, FDI may create enclaves in the local economy, which exploit resource and labour pools, and limit the number of lasting and positive effects on the host country” (p.8). Thus it is a core task of public policy to ensure that FDI has positive impacts on host countries.

Recently, some studies have focused directly on HCMs and their effectiveness (Kline, 2003; UNCTAD, 2004; Te Velde, 2007). Te Velde (2007) examined whether there was a correlation between UK HCMs and increase in FDI to particular countries. The results suggest firstly that there exists a positive correlation between the level of development finance and the level of FDI. Secondly, that DFIs can have a demonstration effect that facilitates inflows of private capital to companies that are funding investments in developing countries. Thirdly, the effectiveness of HCMs depends on the conditions under which the FDI is undertaken. These conditions are a) type of HCM, b) type of industry, as some industries are more likely to use certain types of HCMs; c) the size and age of the home-country company and d) the motivation of investors, for example whether a company is seeking market access or access to resources (Te Velde, 2007). These results indicate that HCM stimulate home-country company activity in developing countries. They do however not look into the direct impact or degree of development and poverty reduction in host-countries.

Batra and Mahmood (2003), argue in a World Bank study of direct support to private companies that their evidence indicates that active interventions do not work unless the basic environment for private sector development is sound. Klein agrees and argues that there are certain preconditions for achieving positive welfare effects of FDI in host countries. The main precondition being a “right” enabling environment, with an equal and competitive level playing field and without special protection for foreign or domestic investors (Klein, 2001:3). This relates to the discussion on knowledge gaps (OECD, 2002; Doh and Oetzel, 2009). The studies cited above (Lall, 2000; Meyer and Peng, 2005; Altenburg, 2000) indicate however that development institutions can have different additionality depending on where they operate and with whom they partner.
To sum up, development institutions additionality to home-country investments in developing countries is twofold. A home-country measure can play a key role in a) providing capital to a project, and/or b) providing information, experience and know-how to a project. Development institutions have the role to correct the market failures that exist on the flow of information and capital between donor-countries and developing countries and bring down the required rate of return (RRR) for investors seeking to invest in developing countries.

“The challenge for HCMs is to encourage firms and to create appropriate conditions so that more and better FDI flows into developing countries” (Te Velde, 2007:84).

In other words, HCMs additionality is based on their ability to a) stimulate the quantity of FDI to developing countries which rests on abundance of capital, and b) to enhance the quality of FDI to developing countries which rests on providing information and establish a selection criterion that triggers positive development impacts.

4.4. Summary
Section 4.1 reviewed several different genres of literature within both international business studies and development studies that reflect upon the role and the impacts that home-country private companies can have in developing countries. Section 4.1 furthermore revealed that the IB literature has distinguished linkages and spillover effects to be the main channel of MNCs development effects in developing countries. This highlights that the relationship between the home-country company and its partners in the host-country is an important and a defining factor for the home-country company impacts on the host-country. One of the most important development impacts of home-country companies is the stimulation of human capital in the host-country which takes place through both knowledge and technology transfer. We saw how knowledge transfer also depends on the type of relationship undertaken between the home- and the host-country, and that the level of technology or knowledge in both organizations should not be too different, as ‘knowledge gaps’ undermine knowledge transfer. The section furthermore highlighted the lack of literature and analysis on the link between international business operations in developing countries and poverty reduction.

The chapter revealed that home-country firms need to overcome transaction costs in order to invest or undertake activities in a developing country. HCMs are mechanisms to reduce transaction costs. Transaction costs and liabilities of foreignness are high when investing in developing countries and a
high internal rate of return is in general established for such investments. Moreover it revealed that home country measures can offer advantages to the host country. These can be capital, technology transfer, skills, management and market access to home-country markets. And that host-country firm upgrading possibly depends on the type of relationship created between home- and host-country partners. Capital in the form of equity and loans with low RRR provided by DFIs can play a decisive role in making investments in developing countries possible for investors, as it brings down the financial costs related to market entry.

Home-country measures and development institutions are different in respect to their focus on creating development impact or enhancing commercial sustainability. Their additionality also depends on this focus. A home-country measure can play a key role in a) providing capital to a project, and/or b) providing information, experience and know-how to a project. Development institutions have the role to correct the market failures that exist on the flow of information and capital between donor-countries and developing countries and bring down the required rate of return for investors seeking to invest in developing countries.
5. Analytical framework

Literature on the role of home-country firms in creating development impact has been reviewed and discussed in the previous chapter. Building on the evidence already available, an analytical framework is put forward in this chapter. The objective is to identify conditions under which the scope and quality of development impact can be increased by home-country measures that encourage home-country firms as vehicles for development. The aim is to get closer to answering the research question: **How can development impact be increased through home-country firm based development programs?**

The optimal outcome of HCM operations in developing countries would be a win-win situation. Namely, that home-country business activity in developing countries would increase and have extensive positive impacts on the host economy and society, and on poverty reduction. However, when home-country companies undertake business in a developing country several outcomes are possible. To describe the different outcomes the table below depicts four outcomes for home-country company operations in developing countries. These four outcomes depend on a different mix of commercial sustainability and development impact.

**Picture 5.1. The Win-Win Potential of Home-Country Companies in Developing Countries**

<table>
<thead>
<tr>
<th>Development Impact</th>
<th>Commercial Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Own elaboration

1. The optimal objective of DFIs and other international agencies promoting home-country business participation in developing countries is the ‘win-win’ situation. That is when a business is economically successful and commercially sustainable in a developing country, and also has a
considerable development impact. Building on literature presented in the last chapter examples of this type of projects would be large investments or joint ventures that create a high number of jobs locally and create strong linkages to the local environment that enable knowledge transfer and upgrading into the global value chain.

2. A second scenario is when a project or an investment in a developing country is commercially viable, but its impacts on the local community are low or negative. Examples of this category of projects can be large investment projects that seek a factor endowment that is abundant in the host-country, but has little or no linkages to the local economy and lacks a social criterion guiding their investment process.

3. The third option is projects with high development impact but which are vaguely commercially sustainable. Examples can be taken of highly subsidized development projects that have not been economically viable from start but have been established to fulfil a development objective. Typically, jobs have been created and technology transfer and upgrading facilitated, but the underlying business idea does not function without a HCM support.

4. A fourth option is a lose-lose situation where commercial sustainability is low and development impact is minimal, lacking or negative.

A perfect relationship between commercially sustainable business projects and positive development impact, a true win-win situation is called a Development – Commercial Sustainability Equilibrium (Own elaboration) and can be seen in picture 5.2.
The straight diagonal line in Picture 5.2. depicts the optimal relationship which home-country measures that involve home-country firms are attempting to obtain: a win-win situation where development impact and commercial gains go hand in hand. The lower curved dotted line describes home-country investment focus in developing countries without any support, consultancy or established development impact criteria. Home country companies may not have a particular focus on creating development impact but instead seek commercial sustainability. When, and if their business becomes successful in the developing country market, we assume that in most cases development impact follows naturally as jobs are being created and relationships in the local market are being established.

The dotted line above the DCS equilibrium represents the focus of home-country projects with the participation of HCMs given that the institutions’ objective is primarily that of creating development impact. In such cases projects’ commercial viability may be neglected. As mentioned earlier, the objective of HCMs is to decrease transaction costs for donor country companies and enable them to invest in developing countries that have difficulties of attracting FDI. This can both create business opportunities and welfare effects for the developing country. One of the consequences of the development approach is the danger of supporting projects and companies that are vaguely ‘commercially viable’ but that have high development impact. There are numerous examples in the history of Private Sector Development that depict this taking place.
The small arrows pointing towards the DCS Equilibrium depict the optimal additionality of HCMs. First, HCMs with development impact additionality increase the focus on development impact of free market investment projects in developing countries, by setting minimum standards and criteria’s for support – thus, bringing free market investments closer to the DCS equilibrium. Furthermore HCMs that add commercial sustainability to investments in developing countries can bring development projects closer to the DCS Equilibrium. The optimal result is to keep these two variables balanced.

Now that the Development – Commercial Sustainability (DCS) Equilibrium has been presented the next task is to examine how DFIs and PSDs can in their investments, selection criteria’s and co-operation strategies influence investments so that they come closer to the DCS Equilibrium, and hence maximize development impact as well as commercial sustainability.

5.1. Analytical Framework
The previous section presented a theoretical basis for a more detailed and applicable analytical framework for evaluating HCMs development impact. This section will present the next step of the framework, a specific assessment based on the three variables: development impact, commercial sustainability and additionality.

**STEP 1: Commercial Sustainability**
The key role of home-country measures is to assist companies in overcoming transaction costs and certain types of transaction costs, namely liabilities of foreignness. These can be reducing political and economic risks, acquiring information on local markets or creating necessary network connections to the local market. As presented earlier there exist different frameworks of project’s commercial feasibility (Laserre, 2003; Meyer, 2003). These frameworks can be applied when development institutions are evaluating the commercial feasibility of a project. The main variables that influence commercial sustainability in this framework are company strategy, market attributes and internal rate of return (Meyer and Thran, 2004).

First, there needs to be a fit between market attributes and company strategy in order to obtain commercial sustainability. Therefore, if a company is seeking to exploit resources in a particular developing country market, that needs to be clearly defined in the firm strategy and accessible
resources have to be available in the new market. The emerging market strategy and host-economy assets as described by Dunning (1992) are depicted in picture 5.3.

**Picture 5.3. Commercial Sustainability**

<table>
<thead>
<tr>
<th>Home-country company</th>
<th>Emerging market strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource seeking</td>
<td>Market seeking</td>
</tr>
<tr>
<td>Efficiency Seeking</td>
<td>Strategic assets</td>
</tr>
<tr>
<td>New capabilities</td>
<td></td>
</tr>
</tbody>
</table>

Source: Own elaboration.

Thus, Step 1 in the analysis evaluates the commercial viability of a project and asks the basic question: Do company strategy and market attributes fit together? How is the company overcoming costs associated with liabilities of foreignness? Is there enough information available on the host-country market to build a reliable entry strategy?\(^6\)

The extent to which company strategy and market attributes fit together are reflected in the commercial success of a project. Thus, the internal Rate of Return (IRR) of a project or a fund should also be evaluated. Positive IRR equals high commercial sustainability and negative IRR indicates low commercial sustainability.

**STEP 2: Development Impact**

When evaluating development impact it is necessary to evaluate both the scope, or the quantity of the impact, and the quality of the impact. This is because “there may be a real and tangible trade-off between building broad, shallow linkages or a few, deep linkages (Hansen et al. 2008). Consequently these two factors need to be evaluated separately.

Development impact of home-country companies takes place through several factors. First, the direct creation of jobs, second the strength and depth of linkages created to local partners or other

\(^6\) For deeper analysis the PESTEL framework or Meyer’s eclectic framework are suggested.
commercial and non-commercial actors, third, the extent and quality of investments in local capabilities and fourth, the degree of knowledge and technology transfer. Some of these factors are interrelated, such as where linkages are weak, there are little chances of technology transfer or upgrading to take place, and where linkages are strong, the chances of transferring technology and upgrading of the host company to the global economy are higher. Also, projects that are labour seeking tend to create many jobs but can on the other hand create weak linkages to local partners. The degree of poverty reduction needs to be discussed but all factors do to some extent evaluate poverty reduction. For example, investments in local capabilities which can benefit the poor and create jobs.

STEP 2 evaluates the extent and quality of development impact by estimating job creation, linkage strength, possibilities of upgrading and knowledge transfer in steps 2.1-2.4.

**Step 2.1:**
First, we evaluate the extent of development impact by calculating the number of jobs created per invested capital. Job creation can be important for poverty reduction as it provides people with opportunities to improve their living conditions through earning income. The average Cost per Job can be calculated by dividing the total jobs created by total investment:

\[
\frac{\text{Total Investment}}{\text{Total Jobs Created}} = \text{Average Cost Per Job}
\]

If the average cost per employment is relatively low, the extent of development impact is high as relatively more employment can be created per invested capital. If the average cost per job is high the extent of development impact is relatively low, as the cost for each job created is high.

By evaluating the effectiveness of creating one job and the number of jobs created we evaluate the extent of development impact.

As we have seen, it is not sufficient to evaluate the extent of development impact we also need to evaluate the quality of the impact. I.e. do the jobs that are created carry a potential for improved economic and social well-being and poverty reduction? We suggest the quality of development
impact is measured by three factors which all reflect upon a project's possibility for integrating, upgrading and transferring knowledge to the host country. First we suggest an evaluation of the strength of linkages.

**Step 2.2:**
Linkage strength depends on the type of MNC coordination. MNCs that have highly coordinated affiliates are more likely to upgrade their local linkage partners than MNCs with loosely coordinated structure (Hansen et al. 2008). And MNCs that integrate their activities in the host country into their global operations create fewer but deeper effects, while less integrated activities may produce broader development impacts but more shallow (Hansen et al. 2008). Thus:

<table>
<thead>
<tr>
<th>Affiliate coordination</th>
<th>Closely coordinated = High quality of development impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loosely coordinated = Low quality of development impact</td>
</tr>
</tbody>
</table>

**Step 2.3:**
Another important indicator for evaluating the depth or quality of development impact is investments in local capabilities. Without such investments the FDI risks being ‘static’ (Lall, 2000), that is, without any welfare effects. Host-country operations that are closely managed by the parent company are more likely to invest resources in upgrading their local linkage partners (Hansen et al., 2008). This is also an important indicator of poverty reduction as it indicates the extent of investments in local capabilities which can improve social safety nets and standard of living.

<table>
<thead>
<tr>
<th>Investments in local capabilities</th>
<th>High = High quality of development impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low = Low quality of development impact</td>
</tr>
</tbody>
</table>

**Step 2.4:**
The third measure for evaluating the quality or depth of development impact is the possibility of knowledge transfer to the host-country partner. As shown by several studies (Hansen et al., 2008; Forsgren, 2002; Kogut & Zander, 2003) the possibilities of knowledge transfer depend on the relationship between the home-country company and the host-country partner. Thus:

<table>
<thead>
<tr>
<th>Possibilities of knowledge transfer</th>
<th>Own subsidiary = High quality of dev. impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Partner / JV = Medium quality of dev. impact</td>
</tr>
<tr>
<td></td>
<td>Outsourcing = Low quality of dev. impact</td>
</tr>
</tbody>
</table>
**STEP 3: Fund Additionality**

The last step of the framework is an evaluation of fund additionality. The two previous steps focused on evaluating projects’ commercial sustainability and development impact. In order to evaluate the role of the HCM we need to examine whether the participation of the HCM is crucial or not? Would the projects have taken place without the participation of the fund/program? Is it possible to design selection criteria to increase fund additionality?

HCM additionality has many dimensions (Danida, 2004a). Fund additionality can be evaluated by the fund’s ability to provide capital or information and know-how. Funds can have important value-added in terms of a local network in the host-country, information and know-how about how to operate business in a given country, information and know-how on how to impact the host-country economy and society positively. It can also have important value added in terms of providing capital which is under conditions that are not available on the market. E.g. high-risk capital with low required rate of return, or ‘patient’ capital. In fact it is important to link the additionality evaluation to the IRR and the Weighted Average Cost of Capital (WACC) of projects (Laserre, 2003). The additionality of the fund seems not least related to its capacity to decrease the WACC of projects, both by providing soft capital in the form of equity and debt, which decrease the WACC. Funds that provide information, network and infrastructure to home-country companies can furthermore decrease the risk of entering a developing country market and thereby should be able to decrease the required rate of return of the company by decreasing the perceived risk of market entry. At the same time, the IRR calculation can be affected by the HCM by more precise and even more favourable inputs by access to more market knowledge.

Therefore the measure of additionality should focus on evaluating program or fund’s possibility of increasing the probability of an investment taking place in a Low Income Country through its provision of a) capital and b) information and know-how. Fund additionality is furthermore influenced by 1) the type of company the institution is providing service to, and 2) the type of host country (Te Velde, 2007).

1. Companies with significant business experience in other countries and of significant size are more likely to have access to capital on market rates and have resources and experience to gather market information in a new market (Danida, 2004a). Smaller companies with less internationalization experience may have difficulties both in acquiring capital and build up know-how for internationalization.
2. High-risk countries are generally outside the agenda of market investment funds as the rate of return for such market is very high because of high risk. Weak market institutions are one of the factors which creates high risk environment as it increases the transaction costs and LOFs for foreign companies. In countries with a weak enabling environment an institution or a program that has gathered information on doing business in the particular type of institutional setting can be an important value added. Providing capital to investment projects in such countries is also an important value added.

We suggest the additionality measure mainly focuses on evaluating 1) the fund’s possibility of providing capital and information to possible LDC country investments, 2) type of home-country partner and 3) the type of host-country. It is important to evaluate additionality qualitatively and discuss with regard to each HCM objective.

5.2. Strengths and Limitations of the Analytical Framework
The framework presented here is not regarded as a final product. The model needs refinement and further work in co-operation with development institutions could be very fruitful. Cooperation would be highly beneficial as it is important that the framework takes departure in variables that are or can be measured by the relevant development institutions. The framework’s strength is that it establishes an analytical relationship between commercial opportunities and development impact built on research and theory, which is a novelty as research on the real win-win possibilities of business and development are very limited. Another strength is that it includes the additionality criteria, which is important to define the role of public development institutions in this process and evaluate their contributions. This is important in order to increase the efficiency of their use of resources and to legitimize their roles in the donor countries.

There are several weaknesses of the analytical framework at this development stage, which most are related to the need for further testing and refining of the framework. Further elaboration on measuring each of the three variables would be a clear advantage. Further testing of the framework with richer empirical data from development institutions would be a logic next step. Furthermore, it is important to elaborate in more depth on the development impact criteria and its poverty reduction dimension. It also needs to be discussed whether and how the framework can evaluate possible negative impacts of home-country operations in developing countries, such as distorting competition or crowding out local investments.
The analytical framework’s development impact criteria assumes a higher possibility of creating development impact through smaller companies. The extent of small companies’ or projects’ development impact is however limited as it reaches only a small proportion of the host-country population. There is a need for examining in further detail this relationship between home-country company size and development impact.

5.3. Summary
The analytical framework evaluates three variables, commercial sustainability, development impact and fund additionality.

1. Commercial sustainability is evaluated with a projects’ internal rate of return and the fit between home-country internationalization strategy and host-country market attributes.

2. The framework evaluates two aspects of development impact.
   A) Firstly it measures the extent of development impact which is measured with job creation.
   B) Secondly it measures the quality of development impact, i.e. the strength of linkages created, the possibilities of knowledge transfer and investments in local capabilities.

3. Additionality is evaluated through examining the fund or program’s capacity to provide capital or information, that increase the likelihood of an investment taking place in a LDC, the type of home-country partners and type of host-countries. Furthermore it is important to be aware of the relationship between additionality and the IRR of projects.
6. Empirical evidence

Denmark is one of the most active countries in promoting private sector development through home-country firms (Danida, 2004b). Denmark has conducted numerous HCMs that involve home-country companies. Two of Denmark's largest HCMs are the Industrialization Fund for Developing Countries and the Business-to-Business Program, previously known as the Private Sector Development Program. These two programs have for the last decade been among the largest recipients of funding from the Danish government, and have both been operated for numerous years which has generated considerable experience around their operations. A review of the programmes and the functions they undertake can be seen in table 6.1.

Table 6.1. Selected Danish Home-Country Measures

<table>
<thead>
<tr>
<th>Programme</th>
<th>Objective</th>
<th>Direct Beneficiaries / Coverage (2008)</th>
<th>Modality</th>
<th>Funding / Portfolio Magnitude</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFU (1967-)</td>
<td>Promote economic activities through Danish FDI</td>
<td>Danish foreign investors / joint ventures / developing countries with GNI p.c. &lt; USD 2.964</td>
<td>Equity, loans and guarantees</td>
<td>Accumulated funding (2003) DKK 1.050 billion</td>
</tr>
<tr>
<td>PSD (1993-2006)/B2B (2006-)</td>
<td>Partnerships between Danish companies and partner firms in developing countries</td>
<td>Partnership / companies / Danida Programme Countries</td>
<td>Grants and loans up to DKK 5 million / project</td>
<td>Accumulated funding (2003) DKK 1.278</td>
</tr>
</tbody>
</table>

Source: Danida, 2004b; IFU 2009.

In the next two sections the cases of IFU and B2B will be presented separately.

6.1. The Industrialization Fund for Developing Countries (IFU)

IFU was founded in 1967 based on the Act on International Development Cooperation, with the objective to promote economic and social development in developing countries through Danish FDI (Danida, 2004a). IFUs legal mandate is: “For the purpose of promoting economic activity in the developing countries, IFU has been created to promote investments in these countries in collaboration with Danish trade and industry” (IFU 2008:2). IFUs mission is: “To enhance global
economic growth, development and more equitable income distribution through increased global flow of socially and environmentally responsible, productive investments making optimal use of comparative advantages” (IFU, 2009:2).

IFU has from its start offered equity, loans and guarantees for Danish companies investing in developing countries. It furthermore provides information and consultancy to Danish companies operating in developing countries. By collaborating with IFU, Danish partners gain access not only to financing, but also to IFU’s know-how and experience from investments in more than 660 projects in 78 countries since 1967, and support from an extensive network of advisers and financial institutions. IFU is actively involved in both the start-up phase and the operations of a project, e.g. by taking a seat on the boards of the projects (IFU, 2008).

In 2008, IFU financed 36 new projects, with a total investment of DKK 323m, and continued to support 21 ongoing projects, with a total investment of DKK 129m. The expected direct employment of new projects in 2008 was 4,045 jobs. Three of the 36 new projects had an Africa focus. In 2007, IFU financed 33 new projects, and continued to support 17 projects. Expected direct employment by new projects in 2007 was 2,344 jobs (IFU, 2008). From its start in 1967 to the end of 2007, IFU has co-financed a total of 616 projects in 78 countries. Of these, 201 are active projects, while IFU has exited 415 projects. See table 6.2. for more detail.

IFU operates on commercial terms and is self-financing. During the period between 1968-2001, IFUs total income on project activities was DKK 1.2 billion, total financial income DKK 1.9 billion and a paid in capital from Government DKK 1.05 billion. Financial rates of investment (ROI) had increased over the period indicating that performance of the portfolio was improving. Furthermore the overall Internal Rate of Return (IRR) was 3.13% (Danida, 2004a). IFU has an operational goal of net return of 2% and IFU’s internal return on capital during the period 1967-1997 was above the 2% minimum per annum (IFU, 1999). This implies that IFU is a self-sustaining organization but also that its expectations of returns are well below market required rate of return, especially to projects in emerging markets and developing countries.
Table 6.2. IFU Investments and Job Creation

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of new projects</th>
<th>Investment (Million DKK)</th>
<th>Job creation</th>
<th>Fund Profit (Million DKK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>33</td>
<td>236</td>
<td>2.344</td>
<td>332</td>
</tr>
<tr>
<td>2008</td>
<td>36</td>
<td>323</td>
<td>4.045</td>
<td>106</td>
</tr>
<tr>
<td>1967 - 2008</td>
<td>662</td>
<td>7.661</td>
<td>124.594*</td>
<td>1051**</td>
</tr>
</tbody>
</table>

*expected direct employment  
**total capital repayment to owner  

IFU cooperates with Danish companies of all sizes. During the period 1967-1997 40% of IFU’s Danish partners were large enterprises (more than 500 employees), 20% were medium-sized enterprises (100-500 employees) and 40% were small enterprises (less than 100 employees). An analysis of project profitability from approximately 145 projects reveals that large projects are more profitable than small and medium sized-projects (IFU, 1999). Thus the analysis reveals that area, project size and partner size influence project’s profitability, Africa being the most difficult continent, and small projects and small partners being the most difficult in terms of profitability.

A comparison between European DFIs showed that from a purely financial perspective, large projects were also more profitable than small projects. Each project is costly but the larger the project, the more likely the success is and less funds put into it by the DFI. On the other hand, large companies tend to have more international experience and be able to implement projects without the support of DFIs. Small and medium sized companies are the ones that would more often need the extra resources provided by the DFIs to be willing to undertake their projects in developing country markets (Danida, 2004a).

6.1.1. IFU Home-Country Partners and Host-Country Types

IFU has from its start cooperated in projects in all continents. However, the geographical distribution of IFU investments has changed over time. From IFUs start in 1967 up to the mid 1970s IFU supported projects in Latin America were dominant. From the mid 1970s to mid 1980s there was a shift towards investments in Africa. Projects in Asia then took lead in the mid 1980s but over the

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7 Total investments of more than DKK 50 million (IFU, 1999).  
8 Total investments between DKK 10 – 50 million (IFU, 1999).
whole operational period of IFU, from 1967 to 2001, 45% of all realised projects have taken place in Asia (Danida, 2004a).

According to data on IFU investments by host-country incomes, poverty reduction has not been a prominent feature of IFU investments. IFUs investment profile has been sharpened towards an increased focus on LDCs during the last decade. In 1996-2000 there was a particular focus on Low Income Countries, especially countries in Africa. Today, countries that technically qualify for IFU investments have to be listed on OECD’s DAC-list. The list represents countries that receive official development aid and have Gross National Income (GNI) per capita below USD 2,964, with exceptions9. But in 2004, the maximum GNI in a host-country was 5,128 USD (Danida, 2004b). Table 6.3 gives and indications of IFUs portfolio by countries in 2007-2008.

Table 6.3. Investments by Countries 2007-2008 (Percentage of total funding)

<table>
<thead>
<tr>
<th>Country</th>
<th>2008 %</th>
<th>2007 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>15</td>
<td>14</td>
</tr>
<tr>
<td>Africa (regional)</td>
<td>10</td>
<td>7</td>
</tr>
<tr>
<td>Vietnam</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Egypt</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>India</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Serbia</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Thailand</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>Kenya</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Benin</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>64</strong></td>
<td><strong>61</strong></td>
</tr>
</tbody>
</table>

Note: Malaysia, Serbia and Thailand are no longer eligible for IFU investments. Africa (regional): projects included cover more than one country


IFU investment strategy is in general reactive, i.e. it goes by Danish partner’s interests, although the fund has limitations for where it can invest. A high concentration of IFU investments has taken place within a number of more wealthy developing countries and a rather limited focus has been on the

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9 Exceptions are Botswana, Namibia, South-Africa, The Dominican Republic, Columbia, Maldives and Ecuador. These countries have a higher GDP per capita but qualify for IFU investments.
Least Developed Countries (Danida, 2004a). The fund has had some difficulties in attracting investments to the poorest countries:

“IFU continues to focus strongly on promoting investment activities in Africa. In 2007, IFU co-financed 11 new projects and granted additional financing to seven IFU projects in Africa. IFU has good working relations with Danish companies pursuing a regional strategy for Africa, but such Danish companies are few in number. Attracting other companies requires a long-term promotional effort, particularly when dealing with SMEs. The investment climate is generally considered to be favourable, but vulnerable to political and economic turbulence.”
IFU, 2008:12.

During the period 1967-2008, 94 of 662 projects invested in by IFU took place in the Least Developed Countries\(^{10}\), or 14% of all projects. Projects by IFU undertaken in countries on World Bank’s list of Low Income Countries, which is solely based on GNI per capita, are 40% of IFU investments.

6.1.2. IFUs Development Impact and Additionality

The lack of home-country companies’ interest in investing in LDCs has been discussed openly in IFU evaluations. In the 2004 evaluation of IFU it is argued that IFU has largely bypassed the problem of undertaking investments in countries with a poor enabling environment by investing heavily in richer developing countries (Danida, 2004a). Furthermore that this ‘supply orientation’ of IFUs investment strategy has downgraded IFUs accomplishment of reaching its goal of development impact, and thus the fund’s development objective has not been fulfilled “to the full potential” (Danida, 2004a:60). The fund’s lack of focus on low-income countries and small and medium sized home-country partners has decreased its additionality (Danida, 2004a). In an evaluation of the fund in 2004 the following in stated:

“IFU’s economic additionality is low when cooperating with well-established, internationally experienced and larger Danish companies – many of whom would have made the investment without IFU’s assistance – in countries with good enabling environments. The security of these investments is relatively high.” (Danida, 2004a).

\(^{10}\) The measure is according to UNCTADs list of LDCs in 2007. Because IFU investments took place during a long time period some of the countries may have been classified as LDCs when the investments initially took place. The percentage of 14% may therefore be biased towards the low end.
This statement reflects the discussion that recently has taken place on IFU’s fund additionality. It is argued in the evaluation that IFU’s additionality is marginal in larger projects and ‘safe’ developing countries, but essential in projects where partners are SMEs and in poor developing countries that have difficulties in attracting FDI on its own (Danida, 2004a). In 2004 it was recommended that IFU should increase its focus on poor countries with weak enabling environments, and IFU has made efforts to increase focus on poorer developing countries. In 2007, 33% of new contracted projects were in Africa or related to Africa and in 2008 39% of all contracted projects were in Africa (IFU, 2008).

According to the debate on IFU there exists a trade-off between high development impact additionality and high fund profitability and sustainability. IFU is a highly self-sustaining fund and appears to have chosen more secure investments in order to be so rather than increasing risk and obtaining high additionality on the development front (IFU, 1999).

Despite this focus there remains a consensus that the principal role of DFI’s is to fill gaps where there are capital market failures (Danida, 2004a:31). DFIs can do this by acting as catalyst between international investors that are rich in capital and local business communities. IFU has clearly put more weight on supporting commercially viable projects in safe destinations, rather than focusing on investments in countries that are not attracting FDI on their own with the objective of influencing development and poverty reduction. The 2004 evaluation argues that IFU has not been well equipped to focus on the investment potential in Africa. There is a regional office in South Africa which provides advisory and local knowledge, but an absence of IFU presence in East Africa has limited the fund’s possibilities for proactively addressing SMEs in the region. A regional office was established in Kenya in 2007 (www.ifu.dk, May 20th 2009).

The evaluation team conducting the 2004 evaluation concluded that most IFU projects had positive development impact. The question remains however, whether the positive impacts are attributable to IFU or the Danish companies. Direct job creation and indirect job creation – through subcontracting jobs – is the largest development impact. Increased competencies of the workforce are also an important effect on the host country. Investments in training of local staff as well as management and technology transfer are important factors as well although the extent of how this took place is not explained (Danida, 2004a).
The 2004 evaluation of IFU points out that two-thirds of all investments projects are joint ventures. In Asia half of the projects were with a local partner. In Latin-America large projects do not have local partners while most of smaller projects have local partners. In Africa almost all projects are with a local partner (Danida, 2004a).

An evaluation of the development impacts created by IFU reveals three important issues.

First, IFUs overall objective does not in itself focus on creating direct development impacts or poverty reduction. IFUs objective is to promote economic activity in developing countries, which could but does in itself not necessarily generate positive development effects. IFUs investments are however expected to be socially and environmentally responsible which increases their chances of having positive development impact.

Second, the economic impacts of one IFU supported project on a country’s economy are marginal (Danida, 2004a).

Third, evaluating long-term direct and indirect impacts of IFU projects is difficult because IFU does not gather information about project’s impacts in a systematic manner, other than number of jobs created. Evaluating the development impacts of IFU operations in a qualitative manner is difficult because of lack of information.

6.2. Danida’s Business-to-Business Program
The Danish Private Sector Development Program was established in 1993. In 2005 it underwent major changes and in 2006 it was re-launched under the name Business-to-Business program (B2B), underlining the program’s inter-firm collaboration. The program’s objectives are to promote pro-poor growth; build “an ‘enabling business’ environment and strengthening the capacity of the private sector itself to fulfil specific economic, poverty-reducing, socio-economic and environmental objectives” (Danida, 2004b:53). Its objectives are furthermore to reduce poverty, improve gender equality, protect the environment and work on the establishment of democracy. These objectives should be obtained through the establishment of business collaborations between private firms in developing countries and private firms in Denmark.

It was initially hoped that inter-firm co-operation would result in increased economic growth and social development (Danida, 2004b). It was furthermore assumed that co-operation between a donor
country firm and a developing country firm would result in transfer of technology, know-how and other resources, and these factors would spill-over to other developing country firms and the local private sector would in that way reduce poverty (Danida, 2006). The nature of the program, that is, its base in inter-firm collaboration, means that the program has a strong micro-level focus (Schulpen and Gibbon, 2001). Furthermore, the B2B program’s poverty orientation emerges already in the selection criteria for eligible Danish partners.

“The immediate objective is to promote the establishment of long-term, sustainable partnerships between companies in Danida’s programme countries and Danish companies, with a view to promoting local business development. Through advisory and economic support, the B2B Programme encourages companies in developing countries and in Denmark to establish long-term, commercially viable partnerships. The objective is accomplished through transfer of know-how and technology from Danish companies to companies in developing countries” (Danida, 2008).

In addition, four development criteria’s have been established by the program. The program should seek to impact:

a) Increased employment, with particular focus on employment for women
b) Improve environment, both external and the working environment
c) Improve labour rights
d) Strengthen local company competitiveness

(Danida, 2008)


The B2B program operates in selected partner countries, which fall under different country groups. They range from Least Developed Countries to Upper Middle Income Countries. The selection of countries is based on the capacity of staff and private sector focal points in Danida offices and royal Danish embassies around the world. The B2B partner countries are: Bangladesh, Bolivia, Egypt, Ghana, Kenya, Mozambique, Nepal, South-Africa, Tanzania, Uganda and Vietnam (B2Bprogramme.com, June 4th 2009). B2B’s predecessor, the Private Sector Programme operated in most B2B program countries and in addition in the following countries: Benin, Burkina Faso, India, Malaysia, Mozambique, Nicaragua, Thailand, Zambia and Zimbabwe (B2Bprogram.com, June, 4th 2009).
A list of all (n=85) B2B projects reveal that 31% of the projects took place in LDCs\textsuperscript{11} while 36% of all (n=889) PSD projects took place in LDCs. If we widen the category and look at the percentage of projects in Low Income Countries, 78% of a list of all PSD projects took place in LICs and 76% of B2B projects. These numbers indicate that the B2B program is operating in majority in countries where the enabling environment is weak and where there is a lack of FDI or home-country operations. According to Danida, many companies in partner countries have had difficulties finding competent foreign partners that are willing to establish cooperation (Danida, 2006).

The support given on behalf of the B2B program to home-country partners is for three purposes. For feasibility studies, for studies on the scope of possible co-operation as well as financial support for both partners to visit each other (Danida, 2004b). Firms can apply for two types of support:

1. Start-up facility support which is granted to a maximum of one year and designed to test the possibilities of co-operation.
2. Business Partnership support which lasts a minimum of three years and supports co-operation and technology transfer. The business partnership support must be “commercially based” and the partners bear the commercial risks (Danida, 2004b).

The program is open for all sectors that are relevant for Danish trade and industry, although certain sectors have been excluded for ethical and environmental reasons. The program has been conducted in a co-operation between Danida, relevant embassies in developing countries, the Confederation of Danish Industries and the Danish Federation of Small and Medium-Sized Enterprises, with the two last institutions taking care of the matchmaking (Danida, 2004b).

In 2004, the PSD program had financed the establishment of 187 partnerships and 259 start-ups. Total investment on behalf of Danida was 1.03 billion DKK. The types of firms that are eligible for PSD support have typically been medium sized firms that do not have operations in many countries (Normann, 20.9.2006). According to Normann, it has sometimes been difficult to find the right type of Danish firms to participate in the program. The Danish embassies and trade missions in developing countries have however according to Normann, been doing an excellent job in finding local firms to participate in the program, firms that operate within fields where there is need for development in the local country.

\textsuperscript{11} LDCs as defined by UNCTAD in 2007.
6.2.2. B2Bs Development Impact and Additionality

In order for Danish companies to be qualified for support the partnership is anticipated to have a clear developmental impact (Danida, 2006). However, Danida only requires that the collaboration has some development impact, as for example job creation, job preservation, production increase, export experience, environmental improvement, improved working environment, promotion of employee rights or strengthening the local company’s competitiveness (Danida, 2004b; Kragelund, 2004).

The collaboration is based on the prerequisite that suitable partners in both countries are found. This has proved to be problematic. There are examples of Danida turning down a partnership proposal from companies in a program country because the agency was not able to find a suitable partner in Denmark. This has also been the case the other way around, with Danida or embassies in program countries not being able to find partners for a Danish company (Kragelund, 2004).

Despite Danida’s requirements about development impact of partnerships, there is almost no quantitative information available on the outreach and impact of the B2B program, such as job creation or number of trained people as an output of the projects. Evaluations tend to focus on arbitrary impacts, and there is a lack of consistency in order to compare results of the program between countries and time periods (Danida, 2004b). There are signs of success as reported in an evaluation of the PSD program carried out in 2004. It concluded that the program had been reasonably successful in attaining its immediate objective, i.e. to promote long term sustainable partnerships between firms in Denmark and firms in Danida’s program countries. Furthermore, technology transfer between firms had been successful, both in terms of technical aspects, as well as organizational, marketing and management expertise, which contributed to improvements for the local businesses. However, many host-country firms also faced other constraints that limited the effects and long-term sustainability of the technology transfer (Danida, 2004b).

The PSD program was considered less successful in obtaining its immediate objective i.e. to improve the local private sector. Even though there had been clear effects on employment creation and foreign exchange earnings in several local companies, the overall effect on private sector development in the respective countries was considered weak. This influenced the project’s overall, or development objective, of contributing to poverty reduction and social development, which was in turn also evaluated as weak (Danida, 2004b).
From January 2006 the PSD program became the Business to Business program (B2B). The new name highlighted the important role of the program as a vehicle of transferring expertise, technology and know-how from Danish firms to host-country firms. The micro-level of the program was valued as highly important in the restructuring phase and a unique opportunity to contribute to poverty alleviation in Danida’s fifteen program countries and South-Africa (Danida, 2006). One of the reasons for the re-launch of the PSD program was a debate about the program in Danish media, where the objectives of the program were questioned (Danida, 2006).

One of the main criticisms that have been directed towards the PSD program is the absence of clear objectives (Schulpen and Gibbon, 2001). Critics have argued that this has made it difficult to distinguish how the program is supposed to contribute to poverty reduction and gender equality. Furthermore, the lack of objectives has created lack of clarity about the program’s target group. This lack was identified by the Danish media who asked in 2005 whether Danish firms should be one of the main beneficiaries of the program. (Danida, 2006). The question was raised whether Danida was supporting development objectives or Danish export promotion? (Normann, 20.9.2006). Substantial part of the support in the PSD program went directly to the Danish firms that participated in the program. When the program did not show clear development impact the objectives of the program were questioned.

Researchers have also criticized the program in a similar vein. The sincerity of the donor in its claim to be working towards PSD in developing countries has been questioned and also the PSD program’s function as a development tool. Several questions have been asked: Was the program functioning as a tool to secure Danish firm’s position in new markets rather than promoting host-country development? Was the program necessary for Denmark as a donor country to secure its position in new markets vis-à-vis other donors? (Schulpen and Gibbon, 2002). The aim of the transition from the PSD program to the B2B program was to react to these kinds of critical questions and improve the focus and clarity of the program’s objectives. Thus the following statement:

“In order for the MFA to be able to support a collaboration project, it is also crucial that the project is anticipated to have a clear developmental impact” (Danida, 2006:10). In order to fulfil this statement, Danish firms were asked to account for increased local employment, environmental improvement, improved working environment, promotion of employee rights and strengthening the local company’s competitiveness (Danida, 2006).
The B2B program’s claims about successful technology and knowledge transfer to developing country partners have also been criticized. According to Kragelund, the transfer of knowledge and technology is an issue which depends to a great extent on local culture. Kragelund’s research on the PSD program in Ghana revealed that the local Ghanaian culture builds on the idea of managers retaining knowledge to them. The impact of technology and knowledge transfer within the program was therefore not satisfactory, because the information provided by the donor firm only reached several persons and did not spread out to other employees or firms (Kragelund, 2004). Furthermore, this type of culture lead to a creation of very weak or no vertical and horizontal linkages between Ghanaian firms and suppliers, consequently undermining the developmental impact of the PSD program (Kragelund, 2004). This indicates that knowledge of local business culture and business systems is highly important in order to obtain development impact of transfer of technology and knowledge. In other words, in order to increase the sustainability of the PSD program, knowledge of the local business system or business culture is necessary.

The lack of knowledge on local business culture and systems as described by Kragelund, indicates that culture has not been taken into account in the way the PSD program has been organised and implemented. According to Schulpen and Gibbon (2001), the program has in most cases taken its point of departure in the capabilities and knowledge of home-country firms. Most private sector development related interventions “lack a point of departure in the real capacities, modes of operation and internal relationships found in private sectors firms and institutions in developing countries. Instead, interventions are usually based on models of business development derived from developed countries” (Schulpen & Gibbon, 2001:107).

A bias towards support for the donor country firm in the project’s implementation phase, which can be traced to lack of knowledge and network in the developing country private sector, is one of several factors which led to poor developmental impact of the PSD program in Ghana according to Kragelund’s research (2004). Kragelund argues that the PSD program has not worked for the majority of Ghanaian firms. The main reason being that most firms are family owned firms where trust remains within the family. Therefore a joint venture with a foreign partner is culturally unacceptable for most Ghanaian companies. Consequently the majority of business collaborations have been restricted to technical assistance with low sustainability (Kragelund, 2004). Furthermore the support has been directed towards relatively well established Ghanaian firms, leaving out the micro enterprises operating within the informal sector, which are the ones that according to UNDP lead to most poverty reduction (UNDP, 2004; Kuada & Sørensen, 2005).
The absence of partner country firm’s influence on the PSD program’s implementation phase is supported by other sources (Schulpen & Gibbon, 2002; Kuada & Sørensen, 2005). Research from Ghana indicates that local firms have had major difficulties in attracting Danish and other partners. This is due to the local firms’ small size, resource disadvantages, and limited strategic importance within the global business environment (Kuada & Sørensen, 2005). This is confirmed by Normann (Interview, 20.9.2006), who says that it has at times been difficult to attract Danish firms into this type of co-operation (Normann, 20.9.2006). This has led to actions by Danida to attract developed country firms into collaboration. The result has been substantial tying of aid, meaning that PSD instruments have involved subsidies to the Danish partners (Danida, 2004b). Program efficiency is therefore not optimal although Danida counter-argues that the tying of aid is necessary to maintain the commitment of the Danish business community to private sector aid initiatives (Danida, 2006).

The resource asymmetry between firms in developing and developed countries has been found to be a major challenge in PSD inter-firm collaboration. The business literature argues that where mutual dependence is not balanced, the more dependent partner is under pressure to adhere to the dictates of the dominant partner. This can clearly lead to tensions in the co-operation, erosion of trust between the business partners which can eventually lead to capacity displacement for the developing country partner and thereby undermine the overall objective of the PSD programme (Kuada & Sørensen, 2005). This is supported by Altenburg who acknowledges that different expectations in a partnership often lead to conflicts (2000).

6.3. Summary
In this chapter cases of two different Danish home-country measures were presented. IFU is a development finance institution while B2B is a development program. Both have similar objectives although poverty reduction is more explicit in the B2B program.

IFU is a commercially sustainable fund that operates by majority in Upper Middle Income Countries and has an IRR measurement of its projects. The B2B program on the other hand has no IRR to evaluate its financial sustainability.

Both programs have been subject to criticism in their home-country. B2B for not being able to show clear development impacts by its operations and IFU for downgrading its development additionality by investing in richer developing countries.
7. Analysis

In this chapter we will analyse IFU and the B2B program with the analytical framework put forward in chapter 5. The framework evaluates the program’s development impact, commercial sustainability and additionality.

7.1. Analysis of IFU

7.1.1. Commercial sustainability

IFU is a highly sustainable fund and has emphasized relatively low risk investments in relatively low risk countries. This investment strategy is within the fund’s mandate, and in accordance with the funds objectives. 14% of all IFU investments have taken place in LDCs. The commercial sustainability of IFU projects has been different by regions. An evaluation claims that in Asia ¾ of all projects have probabilities of financial sustainability, half of all projects in Latin America and less than half in Africa (Danida, 2004a). In Africa, poor project preparation and partner assessment, insufficient monitoring, absence of IFU representatives in board of directors, and too much reliance on the PSD/B2B program have been identified as reasons for failed projects (Danida 2004a). This information indicates that in Asia, company strategy and market attributes are fitting together. This fit is less in Latin-America but according to the 2004 evaluation on IFU the fund had put extra effort into working out problems in Latin America. The reason why most failed projects are in Africa could be related to a lack of knowledge on market attributes in Africa. Therefore the quality of company strategies is not sufficient for entering those markets. There might for example be lack of knowledge on the local business culture, local networks, and the selection of partners needs more preparation than projects in other markets.

Over the whole, IFU is a self-sustaining fund with overall IRR 3.13%, which indicates commercial sustainability. IFU’s commercial sustainability depends on the fund’s operation areas. The high commercial sustainability might reflect IFUs focus which has mainly been on investing in rather “safe” developing countries, with well established enabling environments and less risk than associated with investing in poorer developing countries. There seems in other words to be a clear focus by IFU on commercial sustainability. But IFUs level of IRR around 3%, suggests that the fund has other objectives than pure profits.
7.1.2. Development impact:

i) Job creation: IFU funded projects are responsible for creating several thousand jobs each year in their operating countries. The cost of each job varies between years but if we look at IFUs whole operation period between 1967-2008, the expected direct employment of the fund are 124,594 jobs. The actual number of direct employment can be expected to be dramatically lower or 30-40% as some projects have not been realized and because estimates tend to be higher than actual numbers (IFU, 2009). IFUs total direct investment for the same period was 85,568 m DKK. This means that the average cost per job is 0,69 million DKK, i.e. it costs 0,7 million DKK to create one job. In total IFU has created between 75 and 80 thousand direct jobs during its 41 years of operation, which translates into between 1.829 and 1.951 jobs each year. Indirect job creation is not included in this estimate but evidence suggest that for each direct job created 1.3 indirect jobs follow (Hansen et al. 2008). If we add the indirect jobs a total of 286,566 jobs are created, lowering the cost of jobs down to 0,3 million DKK. IFUs development impact through job creation is high.

ii) Affiliate coordination: According to Hansen et al.’s (2007) research on IFU partners, affiliates of SMEs integrate their affiliates more closely than their larger counterparts. And affiliates that are closely managed by the parent are more likely to commit resources to upgrade local linkage partners (Hansen et al. 2008). During the period from 1967 to 1997 40% of IFU Danish partners were large enterprises with more than 500 employees, 20% were medium-sized enterprises with between 100 to 500 employees and 40% were small enterprises with less than 100 employees (IFU, 1999). 60% of home-country partners were larger than 100 employees during this period, which indicates that the majority of the projects were not closely coordinated and therefore less likely to create strong linkages or invest in upgrading.

iii) Investments in local capabilities: Research of IFU affiliates indicate that “the poorer the host country (or the region of the host country), the more Danish affiliates will tend to work with the local community on building infrastructure and schools or support local civil organizations” (Hansen et al. 2007:72). The explanation could be that in poorer locations foreign companies need to legitimize its presence by “ensuring that surrounding communities can also see the benefits of its activities” (Hansen et al. 2006:73), in other words, they attempt to overcome liabilities of foreignness (LOF) by investing in local infrastructure and capabilities. If we look at the distribution of IFU investments by country, seven out of 57 ongoing and new investments in 2008 are in Least Developed Countries.

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12 According to UNCTADs classification of LDCs, 2007.
Thus 12% of IFU investments in 2008 were in LDCs. During the period 1967-2008, 14% of all projects invested in by IFU took place in the Least Developed Countries (IFU, 2009). This indicates that a vast majority of investments took place outside of the countries with weak enabling environment. In such countries investments in local capabilities are less likely to be prioritized by the home-country firm and therefore it is less likely that IFU home-country partners invested in local capabilities.

iv) Possibilities of knowledge transfer: Possibilities of knowledge transfer depend primarily on the type of relationship between the home-country company and the host-country partner company, and the degree of trust between those two parties. About two thirds of all IFU projects are with a local partner. Half of all projects in Asia are with a local partner but almost all projects in Africa have a local partner. The analytical framework predicts that this set-up results in moderate transfer of knowledge and technology. Transfer of valuable information to partners is a delicate process, whereas it would take place faster and in more depth through own subsidiary, and to a less extent through outsourcing.

7.1.3. Fund Additionality

As discussed in chapter 4.3, measuring additionality is complex. Focusing on and identifying fund additionality is nevertheless very important. IFU invests in majority of its projects with medium sized and large Danish companies that are likely to have access to market rate capital. IFU has by majority invested in Upper Middle Income Countries that are likely to be able to attract FDI. This means that IFU is providing services to companies that have other possibilities for funding and in countries that already are attracting FDI. These results indicate that IFUs additionality in terms of creating development impact is not high.

However, if we look at commercial additionality, the market knowledge that IFU has built through its 42 years of operation, and the know-how of entering developing country markets, has high value-added to Danish companies. IFUs know-how can lower home-country firm’s perceived risk and consequently lower the RRR of the investment. Furthermore, by providing loans and equity at a lower than market rate to home-country companies IFU can increase the likelihood of projects taking place in a high-risk country by decreasing the capital necessary to put into the project by the home-country company. To add to that, IFUs local knowledge and network can increase the commercial sustainability of projects and thereby the IRR of investments. IFUs commercial additionality is high.
7.1.4. Summary IFU Analysis

1. IFU is a commercially sustainable fund, i.e. self-sustaining. It has created extensive impact in host-countries by creating a large number of new jobs at moderate costs. Although the scope of IFU development impact is high, the depth or quality of the development impact can be questioned.

2. A large proportion of the job creation has taken place outside the Least Developed Countries, the group of countries that has most difficulties in attracting FDI, but only 14% of IFU operations have taken place in LDCs. IFUs focus on investing in ‘safe’ countries downgrades the fund’s additionality in terms of creating development impact.

3. IFU partners have not predominantly been SMEs that lack capital and advice when investing in new markets, but rather large companies that have the possibility and experience to undertake such investments on their own. This decreases IFUs additionality in terms of providing information and know-how to companies that lack resources to undertake investments in developing countries, as the larger and more experienced Danish partners are more likely to be able to undertake such investments without IFU as a partner.

4. IFU partner size and countries of operation make investments in local infrastructure highly unlikely by the majority of the operations. IFUs strategy of joint ventures with host-country firms results in moderate possibilities for knowledge transfer.

5. IFU has low development impact additionality but high commercial additionality.

7.2. Analysis of the B2B program

7.2.1. Commercial sustainability

The total investment on behalf of Danida to the B2B programme from its start in 1993 to 2004 was 1.03 billion DKK. During that period the program had financed the establishment of 187 partnerships and 259 start-ups. The approximate cost of each project is around 2.3 million DKK. Compared to IFU, funding is much lower, as IFUs average investment in each project is 129,2 million DKK. The difference is however that IFU contributions are investments while B2B contributions are mostly subsidies.
We do not have information on the number of jobs created by the B2B program which means that we cannot calculate the average cost per job. We can however estimate that total jobs created by the B2B are much lower than total jobs created by IFU as the size and number of projects is lower than that of IFU. The B2B program does not have an IRR criteria but Danida has recently introduced specific requirements and conditions in order to support the financial sustainability of projects and prevent failure of projects (Danida, 2008). The B2B support criteria attempts to sort out companies that have strategies that do not have synergies with poverty reduction and has introduced a step by step support function to increase commercial sustainability of projects increase the fit between home-country company strategy and market attributes. As the B2B program is based on subsidies and has no established internal or required rate of return, this indicates that commercial sustainability is not a priority of the program. Thus it is not possible to evaluate the IRR of the program.

Although Danida has now inserted criteria’s for reporting on activities, little information exists on the actual commercial sustainability of projects. No information is available on the number of projects that continue after B2B support is stopped, or the number of failed partnerships. Thus it is very difficult to evaluate B2B projects’ commercial sustainability. This is in fact a weakness, especially given the public nature of the project, i.e. it builds on funds from Danish taxpayers.

7.2.2. Development Impact

i) Job creation: Numbers on estimated or actual job creation created by B2B partnerships are not available. The investments undertaken within the B2B program are however in most cases of a smaller scale than the investments carried out with IFU. The disbursements made by Danida are generally between 1 and 5 million DKK (www.b2bprogramme.com, June 4th 2009). The B2B program also supports fewer projects each year than IFU and operates in a limited number of countries which limits the extent of development impacts through job creation. The B2B programs possibilities for creating a high number of direct employments are more limited than IFU. This is also because Danish companies, as well as host-country partners, are already established companies when they start their participation in the program, while IFU investments often involve an establishment of a new company in the host-country and should therefore be more likely to create a higher number of new jobs. The extent of the B2B development impact is low.

ii) Affiliate coordination: SMEs are the B2B program’s target group and the majority of Danish companies participating in the B2B program are SMEs. SMEs are more inclined to closely coordinate
their operations in developing countries than their larger counterparts which increases the likelihood of the establishment of strong linkages and willingness to invest in local capabilities and upgrading of local partners. On top of that, all B2B projects are partnerships, which means that all home-country companies have a partner to cooperate with, rather than being engaged in outsourcing for example. The B2B program’s requirements on reporting also put pressure on home-country companies to closely coordinate their activities. B2B criteria and partner size are likely to lead to creation of strong linkages.

iii) Investments in local capabilities: One of the main purposes of the B2B program is to contribute to social and economic development in the host-country by strengthening the competitive position of the host-country company. “The B2B partnership should contribute to introduction of new products, processes, technologies or skills and thereby lead to increased turnover and earnings” (b2bprogramme.com, June 4th, 2009). Thus, one of the main purposes of the B2B program is to improve local capabilities which attach an importance for the program to be able to prove that this takes place in reality. A review of the B2B program in Vietnam discusses the tendency of Danish partners to transfer value-added functions to the Vietnamese partners, thus giving them a chance to “move up the value chain”. Interviews with Vietnamese partners furthermore confirmed the positive value of a partnership, over the sourcing or subcontracting relationship (Danida, 2008). We do not have evidence from other B2B countries that support that this tendency is taking place outside of Vietnam and we do not have information from Danish partners about investments in local capabilities. However, all B2B projects are based on partnerships and by establishing a partnership, a common goal is set. It is therefore to the benefit of both/all parties to reach the common goal (Beausang, 2004). Thus it is more likely than less that Danish partners tend to invest in host-country local capabilities than not when operating through the B2B program.

iv) Possibilities of knowledge transfer: The general rationale behind the B2B program is based on the idea that co-operation between a home-country firm and a host country firm will result in transfer of technology, know–how and other resources, and these factors spill-over to other developing country firms and the local private sector (Danida, 2006). Furthermore theory predicts that the transfer of knowledge is most likely to take place within the boundaries of the firm, to an affiliate or a subsidiary of the home-country firm (Kogut & Zander, 2003). The example from Vietnam indicates that Danish companies under the B2B scheme are taking knowledge transfer seriously and value added functions are being transferred to the local partner. However, an example from Ghana indicates the contrary. According to Kragelund, the intended impact of the B2B program in Ghana on job creation,
technology transfer and poverty reduction are limited because of lack of knowledge on the Ghanaian partner, the local business culture and institutional environment. In Kragelund’s words: the real reality of the local private sector is not known. Kragelund includes an example of the training of local Ghanaian people, which provides evidence that indicate that the intended technology transfer is not successful. The reasons are lack of trust between Ghanaian managers and their staff. Knowledge transfer was not successful in Ghana.

OECD points out that ‘technology’ and ‘knowledge gaps’ between the host- and the home-country company will have negative effects on the success of technology or knowledge transfer (OECD, 2004). We do not have information from Danida that show that this is a factor Danida evaluates before entering partnerships.

We can assume that culture plays a vital role in determining the success of knowledge transfer in all program countries and that the degree of success varies between countries, even though knowledge transfer is one of the key intended consequences of the B2B program. The structure of the B2B program invites for a careful planning and preparation of knowledge transfer but the empirical evidence to confirm the actual success are not available. All in all, the B2B program has high quality of development impact, but low extent.

7.2.3. Fund Additionality

The B2B program is to a high extent operating in LDCs that have difficulties of attracting FDI. Thus the B2B program is an important link in providing capital to home country companies that are operating in this group of countries and thereby increasing the probability of a project taking place in a developing country.

The majority of home-country partners that operate under the B2B program are SMEs that do not have operations in many countries. Most funds that operate on commercial terms, and even IFU do not support projects of such small scale as the B2B projects are, and thus the program provides smaller companies with capital and information.

The B2B programs’ low focus on commercial sustainability can result in a high percentage of failed projects. Failed projects can lead to a lose-lose situation. The B2B programs’ additionality lies in providing smaller and less experienced home-country companies with opportunities in countries that
are in need for FDI. B2B has high additionality when creating development impact but low regarding commercial sustainability.

7.2.4. Summary B2B Analysis

1. The B2B program focuses on an important group of home-country companies that are likely to create development impact in host countries. This is both because they enter the host-country through partnerships, which have a moderate likelihood of knowledge and technology transfer and because smaller partners are more likely to invest in local capabilities to overcome their liabilities of foreignness and reap the benefits of operating with a local partner.

2. The criteria used by the B2B program to evaluate whether companies are eligible for support are stringent. A partnership has to result in strengthened competitiveness of the local company, increased employment opportunities especially for women, environmental improvements and improved working environment, and promotion of CSR. These criteria’s are likely to encourage technology and knowledge transfer, investments in local capabilities and upgrading. However, the evidence provided by Danida on the actual results of partnerships are scarce which makes it difficult to evaluate the development impacts created by the program. There is no information available on the number of jobs created by each projects or number of locals that have received training or investments in local capabilities.

3. The B2B programs strengths lie in its development impact additionality, the support to activities and co-operations that would not otherwise have been undertaken. However the question of sustainability of projects arises, which is important to create a long-term development impact.

7.3. Conclusion

The analysis reveals the strengths and weaknesses of IFU and B2B in creating development impact. The following section summarizes the results and discusses how successful the two programs, IFU and B2B are in promoting the ‘win-win’ situation of business and development. Have these programs been able to guide home-country companies to a ‘win-win’ situation where profitability and positive social and economic impacts go hand in hand? If so, what is the relationship between commercial sustainability and development impact? And under what conditions can development impact be increased? It furthermore discusses the two program’s additionality.
IFU and B2B are very different programs, as one is an investment fund and the other an official development assistance program. While IFU has high focus on commercial sustainability caused by its internal rate of return, B2B has no such criteria, indicating a relaxed attitude towards the commercial sustainability of B2B supported projects. Although B2B has criteria on commercial sustainability of home-country partners as eligibility of support, there are no indications that Danida monitors the commercial success of supported projects and Danida does not publish the number of failed projects. IFUs ability to sustain itself financially indicates on the other hand that the fund focuses on collecting returns from projects, which means the fund is sustainable.

IFU has created a number of jobs with its investments and in that sense created extensive development impacts. The quality of these impacts and their links to poverty reduction can however be questioned as most of the job creation has taken place outside the poorest developing countries. Such countries are already attracting FDI which puts a question mark to the fund’s additionality. IFUs home-country partner type furthermore suggests that they are not likely to coordinate their affiliates closely, which undermines both the home-country partners’ intentions of knowledge transfer and investments in local capabilities. See IFUs positioning in picture 7.1.

**Picture 7.1. Results of Analysis**

<table>
<thead>
<tr>
<th>Development impact</th>
<th>Commercial sustainability</th>
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<tr>
<td>Low</td>
<td>Low</td>
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<tr>
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<td>High</td>
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</table>

Source: Own elaboration

The B2B program’s results for development impact are highly different from IFUs. The program has not demonstrated that it has created a high number of jobs so the extent of development impact is low. The program has however high focus on LDCs which increases the quality of the development impacts created and strengthens its relationship with poverty reduction. B2Bs home-country partner
type furthermore suggests that they have the possibility of creating high quality development impacts as smaller home-country partners are more likely to coordinate their affiliates closely and invest in local capabilities. B2Bs success of knowledge transfer can be questioned. See B2B positioning in picture 7.1.

IFU and the B2B program both have different additionality in terms of their capabilities of creating development impact and supporting commercially sustainable projects. IFUs focus on investing in ‘safe’ countries undermines the fund’s additionality in terms of creating development impact, while B2Bs focus on creating development impact through applying stringent home-country partner criteria’s, undermines the program’s commercial additionality. Ideally – and according to the win-win model – a program should be able to promote both factors at the same time. These results indicate however that either there exists a trade-off between development and commercial additionality of home-country programs, or there could be a need for re-examining the positioning of IFU and B2B. By re-examination we mean that fund criteria’s and orientation be adjusted to focus on the ‘win-win’ potential and weaknesses of each program in that respect limited. A re-examination can also lead to synergies between the programs, where B2B serves as an incubator for projects that have a high development impact but are not viable because of high required rate or return and where IFU could continue to function as a co-investor and supporter of commercial sustainability.

7.3.1. General recommendations

The central question that emerges from these results is to what extent development institutions can reduce the trade-off between commercial focus and development focus by designing appropriate criteria’s, methods, strategies and objectives? We believe that HCMs that provide high quality consultancy, guidance and patient capital can have important value added for home-country companies under the objective of getting closer to the DCS Equilibrium, or obtaining a ‘win-win’ situation. By increasing IFUs development impact additionality and B2Bs commercial additionality the programs would be placed closer to the DCS Equilibrium in picture 7.2.
The following section provides general suggestions based on the results of our analysis of both IFU and the B2B program. It furthermore provides answers to the research question, on how development impact can be increased through home-country firm based development programs?

7.3.2. Increasing Development Impact

1. Establish an Internal Rate of Return
An important factor for creating development impact is commercial sustainability. The ‘win-win’ case assumes a commercial opportunity and the results of our analysis indicate that focus on commercial sustainability of projects is neglected when there is no evaluation or focus on IRR. This in turn increases the likelihood of failed projects, or a lose-lose situation. We argue that projects with an established IRR are more likely to create long-term development impact through their commercial sustainability.

2. Tighten support criteria
By tightening the support criteria’s for home-country investors/firms static FDI can be excluded and positive development impacts increased. It is recommended to take special action to secure
increased depth of linkages in labour intensive projects. A broad Corporate Social Responsibility criteria can form the basis for the support criteria but additional criteria’s that regard plans of investing in local capabilities and selection of local partners can also be important. An incremental focus on high-risk countries can also be part of a tighter support criteria, especially for IFU.

3. Evaluate development impacts extent and quality
It is not enough to evaluate the extent of development impact by estimating the number of jobs created. High job creation does not guarantee high development impact. Thus it is very important to evaluate and encourage the quality of development impact. This is suggested in the framework by an evaluation of strength of linkages, possibilities of knowledge transfer and investments in local capabilities. By combining these two approaches we get a clearer picture of the broad development impacts created by a home-country company in a developing country. The trade-off between these two factors needs to be examined in more depth.

4. Stimulate investments in local capabilities
Create a stimulus for investments in local capabilities in the host-country with the objective of strengthening linkages. Highlight that home-country companies face liabilities of foreignness (LOF) and target consultancy on how to overcome the market failures associated with LOF. Overcoming transaction costs and LOFs also contributes to increased commercial sustainability.

5. Focus on outputs
We recommend that home-country institutions measure and evaluate the result of their home-country firm based programs. This will encourage research on the performance of subsidized home-country companies and the establishment of methodology and evaluation criteria’s which can in turn further legitimize the programs existence in home-countries.

6. Avoid knowledge gaps
Avoid knowledge and technology gaps and assess whether there are wide gaps between the host and the home-country partners in the feasibility study of the partnership. Acknowledge that the success of knowledge transfer is based on local culture, and therefore it is necessary to undertake studies in each country to predict how knowledge transfer can take place, and identify obstacles for it taking place. Establish criteria’s for evaluating the possibilities for successful transfer of knowledge and technology
7. **Support field research**

Support and fund field research in target countries on the link between home-country companies and poverty reduction with the objective of increasing fund additionality by gathering exclusive information and know-how. Increased research on LDC markets – structure, informal sector, institutions etc. – are recommended to increase additionality of HCMs associated with lack of information. Supporting research also contributes to higher commercial sustainability as more knowledge is established about market opportunities in host-countries.

8. **Avoid ‘forced’ partnerships**

Ensure partner symmetry in partnerships and JV and create awareness of the danger of ‘forced’ partnerships.

These recommendations are a list of ideas that emerge from our study. We do not look at this list as a final suggestion of how development impact can be increased but rather ideas that can be elaborated on with more research.
8. Dilemmas and Opportunities of Increasing Development Impact

8.1. Discussion of Results

Last year exposed private actors to new and unprecedented dilemmas, but despite these difficulties private ownership and private actor’s role in the global economy still remains strong. Private firms are important drivers of change and as has been presented in this paper, a consensus has emerged on their important role in creating development results. The burden that many developing countries carry for improving the living standards of their populations is still immense. The private sector can participate in lifting some of that burden by providing solutions that suit in each country. The important role of the private sector highlights however the equally important role of the state. The state has to set clear rules for private actors and donor country governments have to set clear guidelines and criteria’s for support to private actors.

8.1.1. Opportunities and Dilemmas of the ‘Win-Win’

The opportunity associated with the use of home-country firms as vehicles for growth is great. We have argued that the win-win situation of home-country company operations in developing countries and their possibilities of creating positive development impacts is not an illusion. It is however the role of home-country measures to set goals, criteria’s and incentives that harness the positive impacts of home-country company operations in developing countries, and our analysis yielded initial suggestions for such criteria’s. Even few successes of home-country firms in poor countries can have rapid spillover effects.

As we have seen throughout the paper there are dilemmas associated with obtaining the ‘win-win’ situation that private companies can offer to development. Our results indicate that development programs or funds that focus on returns, tend to ignore high-risk countries, which most often are the poorest countries and left out of the process of foreign direct investments and economic globalisation. High-risk environment jeopardizes the returns of the investment and the interest of home country firms and programs. IFU represents such a case, where focus on commercial sustainability of projects downgrades the focus on developing countries and poverty reduction. IFU has somewhat bypassed the insecurity involved with investing in poorer countries by investing in less risky countries. Increased research and knowledge of LDC markets can be of extreme value for IFU if the fund wishes to fulfil its development objectives by investing more in LDCs with continued focus on commercial sustainability.
Our results also indicate that programs that lack an investment criteria, e.g. financial measures such as an Internal Rate of Return, put projects’ commercial sustainability at stake and consequently the long term development impact also. The ‘win-win’ opportunity cannot take place without commercial sustainability. A partnership program’s weakness, such as the B2Bs, is a lack of investment criteria. High focus on development impact without a clear focus on commercial sustainability is not sufficient for a ‘win-win’ situation. Thus emphasis on commercial sustainability can support development impact taking place. And a focus on creating development impact only, can put projects sustainability at risk and consequently its positive development impacts.

8.1.2. Creating Methodology and Increasing Further Research

Several issues emerge as well regarding methodology and availability of research. Information from a broad range but somewhat scattered academic research allowed us to create an analytical framework that evaluates and measures the potential of home-country companies for creating positive development impact in host-countries. The framework is seen as an initial step to build grounded methodology for evaluating development impact in host-countries. And furthermore establish a relationship between development impact, commercial sustainability and fund additionality with the objective of creating a ‘win-win’ situation of business and development.

It is also important to highlight that this paper focuses on an analysis of two levels. Firstly on the micro or firm level, i.e. how company co-operation or strategies can improve impact on social environment in host-countries. Secondly, on the policy level, and how policy change can create conditions that improve development impact of home-country company operations in host-countries.

One of the most striking issues that emerge from this study is the current lack of methodology to evaluate program’s development impacts. This has meant that development institutions carrying out private sector programs have not collected data in a systematic manner that can be used for impact assessment. Within development programs that use home-country companies as vehicles for PSD there has been very high focus on inputs and lack of focus on results. New methods are needed to measure the effectiveness, quality and extent of development programs that involve home-country companies and this study gives some guidance to solving that important issue. A suggestion is made for improvement on the policy level by increasing donor efforts to establish applicable methodology to evaluate development impact of programs that involve home-country companies.
The micro or firm level also calls for improved methodology. Fragmented information and research exist on donor country firm strategy in developing countries and in particular LDCs. This paper has put emphasis on applying the available information to the context of developing countries and the impacts different home-country firm structures can have for creating development impact. When it comes to examining firm capabilities in host-countries, for example how firm capabilities enable or hinder development impacts, one almost comes down to a dead end in the literature. A scarce pool of information is available on host-country firm structure and firm capabilities. However it is essential for policy makers to understand market structure, land and labour markets and the influences of culture on business practices in a host country. As firm capabilities are the drivers of development, an understanding of what the host-country companies are lacking is essential in order to provide suitable knowledge or technology transfer for example. Questions such as: What do host-countries offer in terms of market attributes? What kind of businesses is successful in this particular business culture? What are the opportunities for home-country firms of operating in LDCs and what is the relevance of these opportunities for their current business models? How can HCMs facilitate answers to these questions, are important for future studies.

The example of the B2B program in Ghana by Kragelund (2004) is a vivid example of how existing local culture can hinder the diffusion of development impact. Increased previous knowledge on the local culture could have overcome the problems expressed in the Ghanaian case. Understanding what is lacking or existing in each country will increase the possibilities of designing policies that allow firms to be more effective vehicles for development. Increased knowledge of local context has been encouraged by scholars within international business e.g. Meyer and Thran (2004) as well as within development studies, e.g. Kragelund (2004), Schulpen and Gibbon (2002).

8.2. Limitations of the Study
There are several limitations to this study. First, it is a complex task to measure the broad development effects of home-country firm operations in developing countries. The framework has included available evidence that shed a light on home-country company impacts on development and poverty reduction in host-countries, but more research is encouraged to deepen our understanding of the development effects.

Second, the framework has focused on evaluating HCM role in creating development impact. A further elaboration on the link between development impact and poverty reduction and the link between FDI and poverty reduction is necessary to further validate the framework. Also it would
have been an advantage to establish a particular evaluation of poverty reduction in the framework. Poverty is however a complex and multi-dimensional concept (Sen, 1999) and would make the framework more complex. Evaluating poverty reduction separately is therefore out of the scope of this paper. Third, the overlap that exists between the factors that are evaluated in the development impact section can also downgrade the frameworks internal validity.

Fourth, the framework is highly focused on capturing positive impact of home-country firm operations in developing countries. It is a limitation that it does not capture possible negative impacts of FDI, such as crowding out of local investments. Fifth, the study’s lack of access to reliable information from Danida can be seen as a limitation. The study builds heavily on research on development impacts created by IFU investments but to a lesser extent on Danida partnerships. It would have been an advantage to build on similar data from both institutions and get access to more data from Danida. Finally, the fact that the empirical evidence is only based on examples from a small country, Denmark, can be a limitation to the external validity of the study.

Despite its limitations the framework can be applied to all home-country measures using home-country firms as drivers. More than a dozen donor countries have established such programs and can use the framework for evaluating the strengths and weaknesses of their programs.

8.3. Conclusion

FDI can have deep and extensive positive development impacts. The real challenge is about how it is possible to establish conditions under which the positive effects are maximized and negative impacts minimized. To meet this challenge HCMs and DFIs play an important role.

The study reveals that the framework needs further elaboration such as establishing a stronger analytical relationship with poverty reduction, and further testing. It is highly beneficial if the framework can be tested with more accurate, comparable and coherent information from development institutions.

However, the results reveal that IFU and the B2B program are different with regard to their impacts on a) development and b) commercial opportunities. IFU has a strong commercial focus but has weak additionality related to creating development impact. The B2B program is on the other hand creating strong development impact while its commercial sustainability is not convincing. This suggests that there is a trade-off between development additionality and commercial additionality.
The study stresses the importance of evaluating the *extent* and the *quality* of development impact separately. This is because extensive development impact such as job creation is not necessarily positive. Thus we suggest that development impact depends on the strength of linkages, possibilities of knowledge transfer and upgrading possibilities. The analysis reveals that there are several actions that can be taken by Home-country measures to increase the development impact their operations. Strengthening commercial sustainability, tightening support criteria, stimulating investments in host-country capacities, and avoiding knowledge gaps are among important factors that can be improved to stimulate the increase of development impact.

Furthermore we suggest that commercial sustainability of projects influences the possibilities of creating long-term development impact.

Finally, is the ‘win-win’ case of business and development just an illusion or a reality? We argue that Home-country measures that provide high quality value added know-how, and capital below market rates, can guide home-country companies to creating ‘win-win’ solutions by their business operations in developing countries.
List of references


Normann, Marc. Head of Business Co-operation. Danida. Interviewed on 20.9.2006 as part of CBS internship paper.


Appendix

Thesis Summary

Each year home-country companies are supported to operate in developing countries by substantial financial amounts. Donor funding to these types of programs has in fact increased during the last years. But even though donors have been scaling up their support and focus on programs that involve home-country companies, studies on the impacts and the additionality of these programs are scarce. Therefore we face a critical question about these programs and whether they are igniting positive social and economic impacts in host-countries? The answer to this question is missing from today’s literature on international business and development.

This study makes an attempt to clarify and evaluate development programs that use home-country firms as drivers of development and their impacts on development in host-countries. The central question that is discussed in this paper is, under what conditions development impact can be maximized under these programs. Hence, the following research question: **How can development impact be increased through home-country firm based development programs?** The study attempts to answer this question while at the same time discussing the validity of the ‘win-win’ approach. We ask the fundamental question: can business really make a difference for development?

In order to evaluate how development impact can be increased through home-country measures that use home-country firms as vehicles of development, we identify and study three variables: 1. Development Impact. 2. Commercial Sustainability and 3. Fund Additionality. We establish an analytical framework based on the existing relevant literature where a relationship between these variables is suggested. In order to test the framework, we use examples of two different home-country measures from Denmark. These are the cases of the Industrialisation Fund for Developing Countries and the Danish International Development Agency’s Business-to-Business program.

The analysis reveals that the framework needs further elaboration such as establishing a stronger analytical relationship with poverty reduction, and further testing with more accurate and coherent information from development institutions.
However, the results reveal that IFU and the B2B program are different with regard to their impacts on a) development and b) commercial opportunities. IFU has strong commercial focus but lacks additionality related to creating development impact. The B2B program is on the other hand creating development impact while its commercial sustainability is not convincing. This suggests that there is a trade-off between development additionality and commercial additionality.

The study stresses the importance of evaluating the *extent* and the *quality* of development impact separately. Development impact depends on both job creation as well as the strength of linkages, possibilities of knowledge transfer and upgrading opportunities.

In conclusion the study discusses under what conditions development impact can be increased by HCMs. Strengthening commercial sustainability, tightening support criteria, stimulating investments in host-country capacities, and avoiding knowledge gaps are among important factors that can be improved to stimulate the increase of development impact.

Finally the paper discusses whether the ‘win-win’ case of business and development is an illusion or a reality? We argue that Home-country measures that provide high quality value added know-how, and capital below market rates, can guide home-country companies to creating ‘win-win’ solutions by their business operations in developing countries.
Table 1. Development Finance Institutions and Product Focus

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Investments 2000 in USD million</th>
<th>Targets for distribution on country categories / regions</th>
<th>Product Focus</th>
<th>Tied / untied</th>
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</thead>
<tbody>
<tr>
<td>CDC</td>
<td>400</td>
<td>50% to Africa and South Asia; 70% to LMIC and LIC</td>
<td>Equity and fund management</td>
<td>Untied</td>
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<td>Equity, loans and guarantees</td>
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<td>60</td>
<td>Up to World Bank loan threshold</td>
<td>Equity, loans and guarantees</td>
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<tr>
<td>Norfund</td>
<td>20</td>
<td>33% in LDC; Up to WB loan threshold</td>
<td>Equity, SME funds and fund management</td>
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<td>Up to LMIC</td>
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<td>EDFI total</td>
<td>ca. 2,000</td>
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<td>Equity and loans</td>
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<td>DFI total</td>
<td>10.418</td>
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Note: LDC: Least Developed Countries; LIC: other Low Income Countries; LMIC: Lower Middle Income Countries; UMIC: Upper Middle Income Countries, according to OECD DAC’s List of Aid Recipients. Source: Danida, 2004:24.
### Table 2. Home Country Measures and Operational Methods

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<th>Country</th>
<th>Agency</th>
<th>Financing TOT</th>
<th>FDI</th>
<th>Matching</th>
<th>PPP</th>
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Source: UNCTAD 2004
Picture 3. Inward FDI to Groups of Countries, 2002

Developed countries 49%
Developing Asia 14%
Latin America and Carribean 8%
Africa 2%
Developing countries 25%
Least developed countries 0%
Central and Eastern Europe 2%