Screening prospective investors

This note provides guidance to governments on how to screen and select prospective investment projects to ensure they maximize the social, economic, and environmental benefits while minimizing the risks. It provides investors information on what can be expected in cases of good screening practice.

The acceptance of investors that later fail financially or have poor social and environmental outcomes has had damaging impacts on many countries as well as communities. Screening investors is a critical component of a country's policy framework to mitigate those risks and to improve the likelihood that investments will have a positive effect on sustainable development priorities. This note summarizes available resources on how to screen agricultural investments and calls on donors, international organizations, and civil society to develop more. It is complemented by Note 7: Tools for screening investors, which provides a detailed toolkit that can be adapted to host countries' individual circumstances.

For the full Notes series please go to the Notes web page: www.worldbank.org/responsibleinvestment Alternatively use the QR code above.

The UNCTAD–World Bank Knowledge Into Action Note Series is a compendium of practical, thematic guidance documents for use by governments, investors, and other stakeholders in the implementation of responsible agricultural investment principles. Background and a complete list of notes are in Note 1: Introduction.

WHAT RESEARCH AND EXPERIENCE TELLS US

UNCTAD–World Bank research and other work shows that agricultural investments vary greatly in the extent to which they generate benefits or impose risks on host countries and affected communities. From the country perspective, a significant proportion of agricultural investments fail to meet anticipated outcomes, many for reasons that could have and should have been foreseen and dealt with at the outset through a comprehensive screening of prospective investors and investments (World Bank and UNCTAD, 2014). The acceptance of investors that fail financially or have poor social and environmental outcomes has had damaging impacts on host countries (box 1). For projects in other sectors screening for financial soundness may be inappropriate, but for agricultural investments, the potential impacts on local economies and communities justify such screening. Sound pre-screening procedures by governments are therefore necessary for all investors applying for land, investment incentives, and/or other required approvals—and should be conducted using pre-established objective criteria (UNCTAD, 2015). A robust screening process will also encourage investors to realistically assess the viability of business models and to adopt enhanced approaches to social and environmental assessments.

UNCTAD–World Bank field research identified the following key dimensions of investors’ approaches that determined whether their overall impact on sustainable development was positive or negative and, relatedly, whether the project was an operational and financial success or not. These dimensions give an indication of several key issues that need to be included in the screening process.

Alignment with development goals. Investors diverged in the extent to which their business model aligned with the development goals of the country. The screening procedure needs to consider how the proposed investment fits with national, regional, and local development goals.
Failed or struggling investments have consequences that extend well beyond the financial losses incurred by investors themselves. About a quarter of investments surveyed recently by UNCTAD and the World Bank used less than 10 per cent of their allocated land: a detrimental under-utilization of productive resources, especially in cases where this affects future land use by local communities. Failing investments also lead to unmet expectations and broken commitments, which can sour relations with the local community and negatively affect the local socioeconomic conditions and environment. Where investments are large scale, surrounding communities can become economically dependent on the operation. If the investment fails entirely it can leave a void in its wake, particularly where local communities have become reliant upon the investment for employment or income through outgrower schemes.

**Box 1. Why financial performance of investors matters**

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**Broad focus when screening.** Investors had wide-ranging impacts—financial, social, environmental, and developmental. Screening therefore needs to encompass more than just financial considerations. It should include investors’ approach to social and environmental responsibility; how they plan to consult and engage the local community; plans for training local staff; plans for community development agreements; and how the business model contributes to development of the local and the national economy.

**Track record.** It is important that the investor and the management team have a proven track record, in the proposed crop and/or enterprise, in consultation with communities, in environmental sustainability, and/or in the country in question. Investors that had not had experience in similar countries and projects found it particularly difficult to succeed; they should proceed with caution and/or demonstrate clear evidence of systems and practices that can contribute to future success.

**Access to finance.** Many early-stage businesses failed or struggled due to insufficient capital or incorrectly structured funding, resulting in cash flow pressures, especially if financial and operational performance projections are overly optimistic. More successful operations had patient sources of capital and contingency funding plans.

**Realistic business plan.** A robust business plan should be based on a set of technical and financial assumptions that are both realistic and achievable. Poor planning can result in the selection of the wrong crops, an inappropriate location, and overoptimistic assumptions. This leads to wasted resources and unprofitable projects for investors.

**Interaction with the local economy.** There was divergence in the extent to which investors became integrated with and generated spillovers to the domestic and local economies. Some investors were effectively enclaves, employing few local people, sourcing inputs from abroad and exporting outputs. The screening process is important for assessing the likely economic linkages that an investment is expected to generate (see **Note 24: Economic linkages**).

**Environment and social impact assessments.** Although ESIA are usually a legal requirement, the diligence with which investors conducted them diverged, as did the extent to which they actively incorporated mitigation measures and recommendations into the business plan. Businesses that fail often do so because of a business plan that is not grounded in an adequate environmental and social assessment (see **Note 14: Environmental and social impact assessments**). Some investors failed due to factors identified in the Environment and Social Impact Assessments (ESIA) but not considered during implementation and operation.

**Approaches to dealing with the community.** Sound, constructive relations with local communities are a critical determinant of investor success (see **Note 15: Community engagement strategies**). An investor should be able to demonstrate a responsible approach to community interactions for assessment during screening procedures, including applying principles of free, prior, and informed consent.

**Incentives.** There was a tendency to offer generous incentives to attract investors. It is important to assess whether investors can sustainably operate a successful business without incentives, or with lower ones. Some investors were found to have the financial capacity only to acquire land at low (incentivised) prices, but not the funding to develop the operation as promised. Others became financially stressed when incentives were removed.

**Tests of innovations.** Innovation (for example, new crops and technology) should be encouraged but not at large scale until there is sufficient proof of concept and especially should not be promoted to smallholders or small enterprises until proven. Phasing should be considered for introducing new technology. This is especially important for non-food crops, such as biofuels.

**Alternative plan.** Investors and governments should have a “plan B” in case the originally proposed plan encounters significant delays or unexpected difficulties. However, if an investor needs to materially alter the business plan, this move should be subject to further approval by the government.

**Preparation for failure.** Even with the most rigorous screening process, some investments will inevitably fail. Governments must ask: is there an exit plan, and if so what are the implications for a country or region or communities? Governments can protect themselves in two ways: (1) enshrine commitments and performance metrics within the contract (see **Note 8: Investment contracts**); (2) develop an early-warning system of ongoing monitoring and evaluation (see **Note 9: Monitoring investments**).
In some countries, responsibility for screening investors was devolved to provincial or regional governments. While this may be appropriate for smaller projects, it is important that the central government retains oversight over the process. In some instances, provincial governments had signed many more land concessions – to poor-quality investors – than the central government was aware, resulting in a nation-wide moratorium on new investment. Consideration also needs to be given to the technical capacity to screen, which may be limited at lower tiers of government.

Transparency and openness about the screening and investment process. Transparency and disclosure are particularly important in the initial phases of an investment (see Note 10: Public transparency). This applies to many elements: appropriate public information on prospective investors, mechanisms used in the bidding and screening process, incentives provided, and information on the negotiated terms of agreements that fall within the domain of the public interest, between investors and governments, or between investors and communities.

Inadequate screening owing to capacity constraints. In general, the screening processes applied were too cursory and lacked the rigor required to ensure that the investments selected were those with the best chance of delivering development benefits. Government officials stated that they needed more guidance on precisely how to screen investors and their business plans.

Pressure from commercial expediency. Many governments signed investment contracts at a rate that outstripped their ability to screen and monitor investment proposals effectively. This was in part due to commercial pressure from investors to get deals signed quickly. Investors expect and should be provided with a speedy turnaround in processing proposals. A balance needs to be struck between speed in processing and the need to undertake what can be time-consuming complete assessments. Where the screening process was shortcut, the investors selected were more likely to generate negative impacts.

Monitoring. The process of screening does not end with approval of the investment. There should be a system of ongoing monitoring and adherence to commitments from both parties (see Note 9: Monitoring investments), and a system for enforcing contractual obligations (see Note 8: Investment contracts).

**How to Screen Projects**

Financial and operational success is an essential precondition for investments to make a positive contribution to sustainable development in the country and to local communities. At the same time, screening investors allows governments (and others empowered in the process) to go beyond the purely financial, and ensure that an investment is a sound proposition for the economy, communities, and environment.

The screening process should take a staged approach (figure 1) allowing for “go” or “no go” decisions at each stage. Each stage includes consideration of different information sets and can draw upon screening tools. Some tools and approaches for screening prospective investors, including detail of the content of screening procedures, are covered in Note 7: Tools for screening investors. The current Note focuses primarily on the screening process and its key elements. It is important that governments make their screening procedures transparent and clear, so that investors are aware of the process. Information about screening procedures can be provided through investment promotion and facilitation activities.

**Stage 1: Business Concept and Investor Screening**

Stage 1 is initial screening by the government of the concept proposal and the investor credentials for a “go” or “no go” decision to accept or not accept a complete proposal. If positive, it also enables government to identify issues that need to be addressed in the complete business plan and ultimately in the investment contract. This is normally based on an “expression of interest” document submitted by the investor, typically a 10- to 20-page document that outlines the core details of the proposed project, including site, crop, business model, and information about the investor including its historical performance and financial backing. The initial screening considers three aspects:

1. **Alignment with country development plan** – How does the investor proposal align with the strategic national, regional, or local development plan and goals? What are likely to be the main impacts on sustainable development?

2. **Site suitability** – Is the site proposed suitable for the project? Is the local community positively disposed to working with investors? Is the infrastructure (roads, electricity, water) at or to the site up to specification or is further investment required by government—and if so, is it within the infrastructure planning budget or can the investment be accommodated? Are there other sites that are more suitable?

3. **Investor credibility** – Does the investor have a credible track record and relevant expertise in areas that the concept proposal addresses, such as expertise and past environmental management practices? What information can be gleaned from the Internet or any other reliable sources about the investor’s previous projects? Does the investor have a good credit record? Is the investor likely to raise the capital needed abroad or to tap local capital markets? Are the break-even analysis and forecasts reasonable, and based on practical assumptions?
**Stage 2: Business Proposal Screening**

Governments are interested in assessing two dimensions of investments: first, the likely impact on various aspects of sustainable development (that is, job creation, tax revenues, human capital development, socioeconomic spillovers, environmental protection); and second, whether the investment is likely to be financially and operationally sustainable. After successfully completing stage 1, investors should submit a detailed business and operational plan to enable the government to assess these two dimensions.

The evaluation of the business plan should cover the technical and financial details to assess whether the assumptions are realistically grounded, given the local context of natural resource potential and climate, infrastructural tenure, and institutional realities, as well as the characteristics and viability of the targeted market. Consideration needs to be given to the fact that certain process-related information may be highly confidential and proprietary to the investor and thus not to be disclosed; however, the resulting financial impacts should be provided.

The business and operational plan includes more detail on many aspects of the operation: consultation with the local community; technical agronomic information (soils, climate, response to climate change, production levels, and so on); financial information (cash flow, break-even, debt and equity structuring, and sources, among others); management and staffing; environmental and social assessment and impacts; community relations; land audit and resettlement plans (see Note 12: Relocation and resettlement); outgrower schemes (see Note 4: Outgrower schemes); customers, suppliers, and business linkages; legal status of the investor; and risks and contingency plans. Note 7: Tools for screening investors provides more detail on the required contents of a business plan.

This stage can be resource-intensive, depending on the type, scale, and complexity of the investment, but the impacts of the business need to be known and quantified. Several impact tools are available, and countries’ investment promotion guidelines should specify for investors which impacts need to be assessed and included in proposals.

Owing to the resource-intensive nature of this phase, governments may want to involve independent third parties with the requisite expertise to assess components of the business plan. Over-optimism by investors in planning and inadequate natural resource assessment for the enterprise in question are high-risk areas that need careful assessment.

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1 Tools include the United Nations Environmental Programme toolbox (measuring the economic, social, and environmental element); the Arup and Engineers against Poverty framework, which includes a fourth dimension of institutions; and the Measuring Impact Framework Methodology—from the World Business Council for Sustainable Development—which addresses eight dimensions.
Stage 3: Due diligence screening

If a government accepts a detailed plan, then the project is approved subject to successful completion of due diligence in Stage 3. Due diligence screening essentially involves formal verification and tabling of evidence for the information and commitments provided in the business plan and/or required by law. It can include the provision of audited financial statements, letters of credit from funders, results of soil or other viability assessments, signed minutes and resolutions of community consultations, issuance of ESIA certification, and so on. Verification should include documentation of the land acquisition process as well as records of any disputes over land access and proof of resolution, where applicable to the investment. The screening institution should also see evidence that mitigation measures associated with the ESIA are in place and that commitments made to communities (for example, community development agreements) are in force. Where investors have made commitments to training local staff, developing outgrower schemes, or setting up processing operations, the investor needs to submit the associated documentation.

Post-screening: Monitoring of project

Once the due diligence is conducted satisfactorily, an investment contract is signed (see Note 8: Investment contracts). Thereafter, contractual commitments need to be monitored. The monitoring may be conducted by different agencies than those responsible for the screening (see Note 9: Monitoring investments).

RESPONSIBILITY FOR SCREENING

Before considering investment proposals, governments should have a clear view on national, regional, and local development goals. Investment promotion activities should be targeted to reflect these by making investors aware of development priorities and desired types and locations for investments. To avoid potential conflicts of interest, responsibility and accountability for screening procedures should be separate from investment promotion and facilitation functions (UNCTAD, 2015).

Apart from that principle, there is no prescription as to which government agency or department is responsible for screening. The choice depends on individual country circumstances, with the proviso that the entity must be effective in its mandate. Governments may decide to assign the responsibility to either a specified ministry or department, or to establish a statutory board with broad representation to manage the screening and approval of investment applications. An important consideration is that for ease of doing business, it is preferable that investors deal with one screening body, which may coordinate approvals from several relevant ministries and bodies. This is preferable to investors “round-tripping” (seeking approval from multiple departments).

Whichever structure is chosen, screening investors requires appropriate organizational and technical capacity and by implication a team of suitably skilled professionals, with experience in at least these matters:

- Corporate governance
- Agribusiness
- Tax, accounting, and legal matters
- Financial and business planning
- Community engagement, participation, development, and social responsibility
- Land rights mapping
- Environmental and social impact assessment

It may not always be possible to staff an entity with all the requisite skills. In such cases consideration should be given to appointing a panel of experts that can be called upon and/or private companies that offer screening and due diligence services. This panel would be selected on the basis of the areas of competence set out above and across the range of enterprise types the country is targeting as potential investors. If a country does not have full-scale in-house capacity (or the budget to hire external experts), it is possible over time to train staff to develop skills using a range of tools (see Note 7: Tools for screening investors).
REFERENCES AND RESOURCES

This Note is complementary to the literature and guidance documents to which many organizations have contributed, a selection of which is provided below. Further resources are provided in Note 2: Additional resources.


