

Concessional Credits from Finland

GUIDELINES FOR FEASIBILITY STUDIES

Introduction

The objective of this guideline is to provide advice on the preparation of project proposals seeking for concessional financing for exports to developing countries from Finland. Because of the various rules and conditions that govern the concessional credit scheme, it is important that the credit applications cover certain standard set of issues.

To ensure the compliance of the proposals with the rules and conditions the responsible authorities, the Ministry for Foreign Affairs and FINNVERA Ltd., require a Feasibility Study in English that addresses the technical, financial, environmental and social aspects of the projects and shows that the project proposal is eligible for concessional financing. The authorities make their initial judgment on the basis of the Feasibility Study.

General Conditions

The Concessional Credit Scheme is basically a combination of export credits and public funds. The scheme is established to increase financial flows from developed countries to low- and middle-income countries, and to promote economic co-operation between the countries.

Projects financed by Concessional Credits are part of the official development co-operation of Finland, tying them both to the OECD terms for soft financing and to the general objectives of Finnish development co-operation, while they are also meant to support economic co-operation and Finnish exports to developing countries. Thus the projects are assessed against these two sets of conditions.

Concessional Credits can be extended to eligible developing countries listed by OECD. All proposals must comply with the guidelines published by OECD and amended periodically (Arrangement on Guidelines for Officially Supported Export Credits, OECD). The key principle of OECD for concessional financing is that the project must be commercially non-viable as commercially viable projects should be financed on market terms. The litmus test in this respect is whether the project can generate sufficient cash flow to cover the operating costs and service the capital costs. Exception from this principle can be made in cases when the recipient country has the Least Developed Country Status or the project is classified as small-scale industrial project (less than EUR 2.7 million). All projects to be supported by concessional financing must be reported to OECD in advance.

The projects have to be economically, environmentally and socially sustainable and meet Finland's policy in its relations and cooperation with developing countries in helping them to manage the political and economic process of change and to create the preconditions for sustainable development and welfare. The central aim is to alleviate poverty, prevent global environmental problems, to promote democracy and human rights and to increase economic

cooperation. Against this background the project should comply with the host country's sectoral development plans, derive from the needs of the target group and have a lasting positive effect on them. The project has to be planned and implemented in a sustainable way and the risks must be manageable.

The Ministry for Foreign Affairs assesses the compliance of project proposals with the above conditions and objectives. FINNVERA Ltd. Assesses the project proposals from the point of view of its eligibility for an export guarantee. The compliance of the projects is considered in several stages on the basis of the Feasibility Study (Annex 1. Terms and Conditions of Concessional Credits).

The Concessional Credit Project Cycle

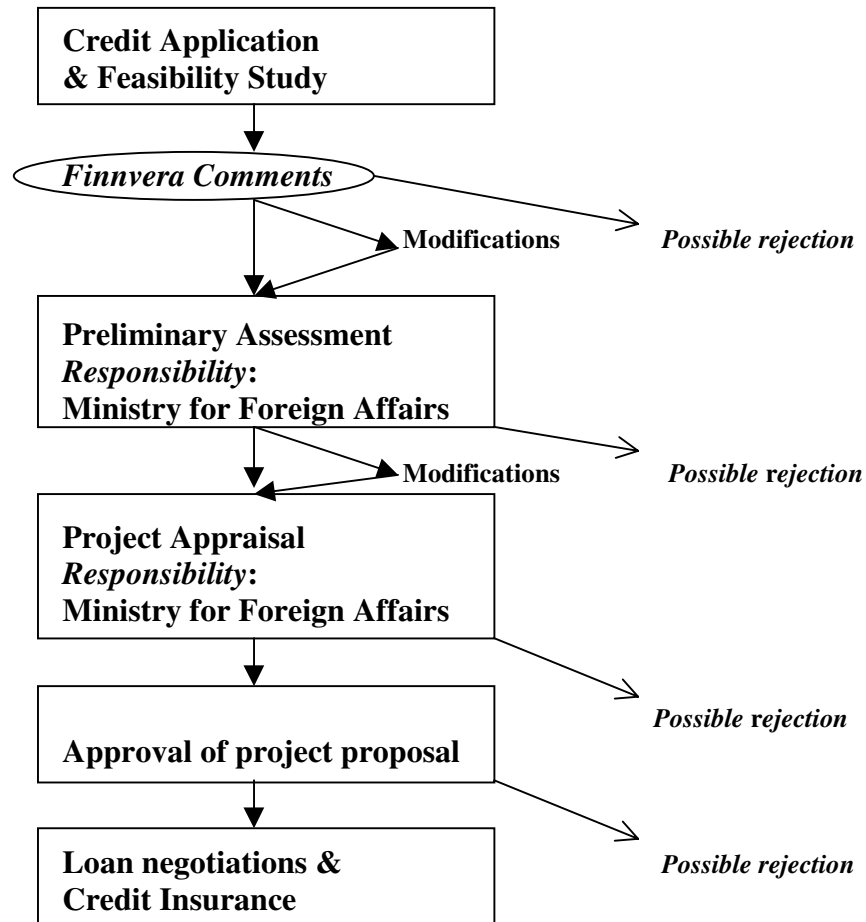
The Concessional Credit application is first submitted to FINNVERA Ltd. for preliminary evaluation concentrating on its credit worthiness and the eligibility for **export guarantee**. FINNVERA sends its comments to the Ministry for Foreign Affairs. The comments include a draft for credit guarantee conditions.

Thereafter, at the **preliminary assessment stage** the Ministry assesses the compliance with the aforementioned development cooperation and trade policies of Finland, the general OECD terms for soft financing, as well as with the development plans and objectives of the recipient country, and studies other relevant factors of the project. This assessment is made as a desk study on the basis of the Feasibility Study, which underlines the Feasibility Study's importance and its need for sufficiently wide coverage of issues.

Moving next into the **appraisal stage**, the Ministry is already basically satisfied that the project complies with the general conditions. At this stage the Ministry wants to verify that facts on the ground correspond with the descriptions and conclusions of the Feasibility Study.

During the appraisal mission, the contents of the Feasibility Study are studied item by item and the findings are published in the **Project Appraisal Report**, which will be the basis for consideration of the project and eventual approval by the Ministry for Foreign Affairs. At this stage it is possible that changes can be required in the project or it may still be rejected if the discovered facts do not give justification for its approval.

Figure 1.
Concessional Credit Cycle



The Purpose the Feasibility Study

A Feasibility Study is a document that provides a basis for an investment decision on the proposed development project. The Study should thus include the relevant technical, economic, environmental, institutional and social elements that affect the project and show its sustainability. The feasibility study must show that the project complies with the development policies and objectives of both Finland and the recipient country.

As the decision-making instrument, the Feasibility Study is **the key document** of the project proposal. First of all, the information and justifications of the Feasibility Study determine whether FINNVERA and the Ministry for Foreign Affairs consider the project proposal worth any further analysis. Secondly, if the proposal is accepted for appraisal, the Feasibility Study will be the basis of the appraisal process.

The Contents of a Feasibility Study

The nature of development projects vary depending on the size, technology and the economic sector and some projects require special attention on sector-specific issues. Concessional Credits can be extended mainly to projects focusing on the environment, health care and the

social sector or to small industrial projects. The projects vary from improving water supply to upgrading health facilities to supporting agricultural production and handling of foodstuffs and further to improving the environment, preventing flooding, industrial production, improving social services etc. etc. Therefore it is difficult to describe a detailed uniform pattern for a Feasibility Study that could be applied similarly in all cases. Reasonable flexibility is required.

Despite the differences, there are some requirements that each Feasibility Study has to cover. In several cases the Feasibility Studies have been made using a different format. The important factor is that the crucial items and issues are covered, not the order. The extent of coverage depends on the size and complexity of the project, bearing in mind that normally the larger the project the more complex is the information required.

Practice shows that usually the technical description of the project is provided in the Feasibility Study. Sometimes the financial calculations on the project's viability are also contained. Description of the project's functioning vis-à-vis the beneficiaries, the market and the surrounding environment as well as organizational and manpower considerations and training needs are often lacking. Seldom have Feasibility Studies contained development consideration and an analysis of developmental effects and sustainability. However, without those considerations the project has little chances of being approved for concessional financing. At least this shortcoming will cause considerable delays, as such questions will have to be answered and addressed before the process continues to the appraisal stage. Environmental considerations should also be addressed in all Feasibility Studies be the environmental effect of the project small or large. Finally, very seldom is there any mention of possible risks with the project. Most projects do have risks or preconditions for their success. Addressing these issues will convince the decision makers of good preparation of the project which usually will strongly support the approval.

Annex 2. shows the standard issues that will be checked from the Feasibility Study during the preliminary assessment. All of these issues may not apply to all projects. At this stage it is decided whether the project proposal is eligible for soft financing and therefore the quality and standard of the attached Feasibility Study is crucial.

Standard Table of Contents

1. Executive Summary
 - Description of the project
 - Conclusions and recommendations
2. Project Description, Background and History
 - Project and project objective
 - Location
 - Products and markets
 - Local conditions (physical, regulatory)
 - Project promoters, ownership
 - Previous studies and investigations
 - Implementation and time-schedule
3. Markets and Capacity
 - Size and composition of markets
 - Competition
 - Sales forecast by products
 - Product mix and production program
 - Capacity
 - Sales and distribution

4. Materials and inputs
 - Raw materials
 - Auxiliary materials
 - Utilities
 - Materials management & transportation
5. Project engineering and technical solutions
 - Conditions at the project site
 - Technology and industrial rights
 - Machinery and equipment
 - Structures and facilities
 - Operation and maintenance
6. Project organization and human resources
 - Organization lay-out
 - Manpower and skills assessment
 - Training plan
 - Management information system
7. Project costs and financing
 - Investment cost by component in local and foreign currencies
 - Production cost by component (operating cost, financial cost, depreciation)
 - Sources of finance, and regulations of financing
 - Debt servicing of the project
8. Procurement and Contracting
 - Procurement
 - Contracting
 - Sourcing
9. Socio-cultural Analysis
 - Beneficiaries
 - Social and cultural impacts
 - Poverty reduction
 - Human rights and social justice
 - Employment effects
10. Environmental Assessment
 - Ecology and landscape
 - Environmental legislation and regulations
 - Working safety and health
11. Financial and Economic Analysis
 - Financial analysis (FIRR, sensitivity analysis)
 - Economic analysis (EIRR, sensitivity analysis)
12. Implementation, Assumptions and Risks
 - Assumptions for implementation
 - Implementation program and time schedules
 - Risk analysis
13. Conclusions and recommendations
 - Major advantages and drawbacks of the project
 - Sustainability
 - Justification for concessional credit support

Description of the Contents for a Feasibility Study

A Feasibility Study should contain a brief description of the relevant facts relating to the following issues - if and when they are applicable to the project under consideration.

1. *Executive Summary*

The executive summary should summarize all conclusions and recommendations covering the critical aspects of the study.

2. *Project Description, Background and History*

This chapter should give *first* an overview of the project idea, products and product mixes, capacity, location, markets, promoters and local conditions (physical, political, legal etc.) *Secondly*, the history of the project should be covered together with a list of studies and investigations that have already taken place. *Thirdly*, the overall project time-schedule, logic and implementation model should be shown.

3. *Markets and Capacity*

The size and composition of the market and demand should be investigated in order to estimate the likely sales of the products/services. The revenue from sales should be projected to form the basis for a detailed production program and capacity.

4. *Materials and Inputs*

This part should cover the requirements and availability and sustainability of raw materials, auxiliary materials, and utilities. The basis for the estimates for material requirements should be derived from the estimates of markets and capacity. Describe transport and storage facilities and arrangements.

5. *Project Engineering and Technical Solutions*

The appropriate technological processes should be described together with the required types and sizes of machinery and equipment as well as industrial rights. The various structures, civil works and infrastructure facilities have to be defined. The sustainability of the selected solution should be justified.

6. *Project Organization and Human Resources*

Project engineering, organizational planning and the determination of manpower resources are closely related and should be studied both together and separately. The organizational layout should be supported by manpower and skills assessments and a training plan.

7. *Project costs and financing*

The estimates for investment costs and annual production costs should be shown by components and cost items for the whole project period. The production costs should be estimated on an annual basis with the assumed capacity utilization. The sources of finance should be described and justified and annual financial costs should be estimated.

8. *Procurement*

Describe procurement and contracting methods and rules. Describe rules for sourcing of inputs, including raw materials, utilities, machinery and equipment.

9. *Socio-cultural Analysis*

The beneficiaries of the project should be identified and the impact of the project on them should be assessed in relation to their needs and absorption capacities. Issues concerning poverty reduction, gender, equality, social justice, human rights and cultural issues and should be covered. Employment effects should be quantified.

10. Environmental Assessment

The expected environmental impacts should be described in relation to ecology and landscape (emissions, waste water, building of infrastructure, etc.). Describe environmental legislation and regulations and their impacts on the project. Describe working safety and health hazards and measures.

11. Financial and Economic Analysis

The financial and economic analysis should cover the whole lifetime of the project or at least the loan payback period. Because the projects are supposed to be non-viable on normal commercial terms this aspect should be clearly explained. All assumptions for the economic and financial analysis must be clearly explained.

The financial viability in this context means that the project can generate a cash flow that is sufficient to cover production costs and service the capital that is invested in the project. The financial viability is assessed by the calculation of the Financial Internal Rate of Return (FIRR)

In the economic analysis all taxes, subsidies and duties are excluded and prices are corrected from distortions. The external effects of the projects may be taken into account by including their monetarized costs and benefits into the calculation. The economic viability is assessed by the calculation of the Economic Internal Rate of Return (EIRR).

In the absence of EIRR calculations, at least the main external impacts (both positive and negative) need to be identified. External impacts are costs and benefits caused by the project to the society and people but are not included in the financial analysis. Some of these may have monetary value while others can be assessed only in qualitative terms.

Transfer payments (such as taxes, duties, subsidies etc.) as well as price distortions caused by administrative regulations included in the financial analysis need to be identified.

12. Implementation, Assumptions and Risks

The project implementation stage comprises the period from investment decision to the start of commercial production, including contracting, project design, construction and start-up. A detailed implementation program and time-schedule must be included with the description of assumptions and possible risks.

13. Conclusions and Recommendations

The conclusions should summarize the main findings of the project proposal and the appraisal of its feasibility. It is important to focus the conclusions and recommendations on key issues as these findings will largely be the main basis for decision makers to assess if the project meets the OECD and Finnish criteria and if concessional financing can therefore be provided to the project. Key issues should cover at least commercial viability, development effect and social sustainability (particularly the project's impact on poverty reduction and gender equality), environmental effects and organizational development and training needs.

ANNEXES:

- | | |
|----------|---|
| Annex 1. | Terms and Conditions for Concessional Credits |
| Annex 2. | Preliminary Assessment of a Concessional Credit Application |
| Annex 3. | Key Terms, Concepts and Definitions |

ANNEX 1.

TERMS AND CONDITIONS FOR CONCESSIONAL CREDITS

Sourcing from Finland:

- High risk countries **50%**
- Other countries **75%**

Credit amount

- Small-scale industry projects (under 2 mill. SDR) **85-100%**
- All other projects **100%**

Securities:

- For financier **100%**
- Recourse agreement between exporter and Finnvera **5-15%**

Interest rates:

- Reference interest rate **EURIBOR/LIBOR**
- Interest rate for beneficiary **0%**
- Marginal for financing institution **Max. 0.75%**

Repayment period:

10-15 years

Financing fees:

- Credit insurance premium for Finnvera **on case by**
- Financing fees for lending institution **case basis**

ANNEX 2.

Date

The Ministry for Foreign Affairs of Finland
Department of International Development Cooperation

PRELIMINARY ASSESSMENT OF A CONCESSIONAL CREDIT APPLICATION

Project Title :

Country :

Borrower :

Supplier in Finland :

Requested Amount :

Credit Currency :

Annexes :

- pre-appraisal report
- approval of Finvera
- feasibility study
- commercial contract
- letter of intent

RECOMMENDATION :

Signed by:

1. DESCRIPTION OF THE PROJECT

2. COMPLIANCE WITH THE DEVELOPMENT COOPERATION POLICY OF FINLAND

	No	Comment	Yes
• compliance with Finland's policy on relations with developing countries	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• compliance with Finnish development policy objectives	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• promotion of economic interaction between Finland and developing countries	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• compliance with Finnish procurement prerequisites	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

3. COMPLIANCE WITH OECD TERMS FOR SOFT FINANCING

	Yes	No	Comment
• commercial viability	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• existence of Least Developed Country Status	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• if small (under 2 million SDR) industrial commercially viable project; does it			
1) <i>promote technological exports from Finland</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2) <i>improve the state of environment in the recipient country</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

4. COMPLIANCE WITH DEVELOPMENT OBJECTIVES AND PLANS OF THE RECIPIENT COUNTRY AND LOCAL AUTHORITIES

	Yes	No	Comment
• relevance of the project objectives against the stated priority problems	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• compliance with the recipient country's development policies, strategies and priorities			
1) <i>overall policies and strategies</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2) <i>sector-specific policies and strategies</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• compliance with the local development plans			
1) <i>sector-specific plans</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2) <i>spatial plans</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

5. RESULTS AND RELEVANCE OF THE FEASIBILITY STUDY

	Yes	No	Comment
<ul style="list-style-type: none"> existence of adequate and relevant coverage of: 			
1) <i>technical solutions</i>			
2) <i>specifications of machinery and equipment</i>			
3) <i>O/M systems</i>			
4) <i>institutional set-up</i>			
5) <i>management and organization</i>			
6) <i>HRD and technical assistance</i>			
7) <i>gender issues</i>			
8) <i>poverty</i>			
9) <i>budget and implementation schedules</i>			
10) <i>financial management</i>			
11) <i>procurement</i>			
12) <i>marketing and consumer issues</i>			
<ul style="list-style-type: none"> existence of adequate and clear description and analysis of: 			
1) <i>assumptions</i>			
2) <i>risks</i>			
3) <i>costs and benefits</i>			

Comments:

6. SUSTAINABILITY

	Yes	No	Comment
<ul style="list-style-type: none"> analysis of the stability of policy & institutional environment 			
<ul style="list-style-type: none"> analysis of harmful impacts 			
<ul style="list-style-type: none"> analysis of management capabilities 			
<ul style="list-style-type: none"> analysis of socio-cultural and gender aspects 			
<ul style="list-style-type: none"> analysis of environmental aspects 			
<ul style="list-style-type: none"> analysis of the choice of technology (appropriate technology) 			
<ul style="list-style-type: none"> analysis of financial sustainability 			

Comments:

ANNEX 3.

KEY TERMS, CONCEPTS AND DEFINITIONS

ADJUSTMENT FACTOR(AF) is the percentage by which the financial price of an input or output must be raised or lowered to reflect the economic value.

AMORTIZATION is the reduction of debt by periodic charges to assets or liabilities, such as payments or mortgages.

ANNUITY is a series of equal payments for a specified period of time.

ARREARS means in default, overdue in payment

AVERAGE COST is the total cost of production divided by the total volume of output.

BOOK VALUE is the value of an asset as recorded in a organization's financial account book.

CAPITAL EXPENDITURE is an acquisition or an improvement that will have a life of more than one year.

CAPITAL STRUCTURE is an organization's financial framework, including long-term debt, equity and net worth.

CAPITALIZED VALUE is the amount of capital that would be required today to yield a flow of benefits equal to those expected from a project, in terms of PRESENT VALUE, discounted at a rate equal to the OPPORTUNITY COST OF CAPITAL.

CIF (Cost, Insurance, Freight) is the BORDER PRICE of an import that includes purchase cost abroad plus charges the international freight and insurance necessary to bring it to the port of entry and unload it on the dock alongside the ship.

COLLATERAL is the property offered as security for a loan.

CONTINGENCY is a financial provision which is made to meet costs which are certainly not expected to arise, but which have a fairly high likelihood of occurring. Physical Contingencies refer to possible extra work or needs of resources and Price Contingency for a possible increase in price.

CORPORATE TAX is the tax on profits made by companies.

COST CENTER is a non-revenue producing unit of an organization, where costs are separately figured and allocated, and for which someone has formal responsibility.

CONSTANT PRICE is the price from which the effects of inflation have been removed.

COST OF CAPITAL is the rate of return that a business could earn if it chose another investment with equivalent risk, that is, OPPORTUNITY COST of the funds employed as the result of the investment decision.

DISCOUNT RATE is the interest rate at which future values are discounted to the present.

DISTORTION is the difference between the actual market price and the economic price.

ECONOMIC PRICE is the price that reflects the relative value that should be assigned to inputs and outputs if the economy is to produce the maximum value of physical output efficiently.

ECONOMICS OF SCALE means the situation where the investment cost per unit of production drops as the plant capacity is increased.

EQUITY in investment means the ownership interest (stock) held by shareholders in a company.

FINANCIAL STRUCTURE is the right side of a company's balance sheet, explaining all the ways its assets are financed. Financial structure is distinguished from CAPITAL STRUCTURE, which includes only long-term debt and equity.

FIXED COSTS are costs which are unaffected by changes in the volume of output. Examples of fixed costs are rates, rent, insurance and administration expenses. Fixed costs can alter from year to year but the alteration does not reflect differences in the levels of output.

FOB (Free on Board) is the price of an export good loaded and ready for departure.

GROSS DOMESTIC PRODUCT (GDP) is the total product or VALUE ADDED within the physical borders of a country.

GROSS NATIONAL PRODUCT (GNP) is the total product or VALUE Added of factors production (capital and labor) that belongs to a country's citizens and is in the country at the end of the accounting period.

INDIRECT COST is a cost that cannot easily be associated with a product. Public utilities, insurances and real estate taxes are examples of indirect costs.

INVENTORY in corporate finance is the value of raw materials, work in process, supplies used in operations and finished goods.

LETTER OF CREDIT is an obligation of a bank to honor drafts drawn on a customer. This extension of credit is used mostly in foreign trade.

MARGINAL COST is the cost of more or one less one unit.

OPERATING COSTS are the costs incurred for the day-to-day operation of an organization. They exclude financing costs, depreciation and income taxes.

PRINCIPAL is the amount of money that must be repaid on a loan, exclusive of interest payments.

REVOLVING CREDIT is a legal commitment to extend credit up to some maximum amount over a stated period of time.

SALVAGE VALUE is the residual value of the investment at the end of the project's life.

SHADOW PRICE is calculated to reflect the economic value of inputs and outputs as opposed to their financial or market value. The term is used synonymously with ACCOUNTING PRICE.

TERM LOAN is a loan from a bank or insurance company with a maturity of more than 1 year.

VALUE ADDED is the value of the final product minus the value of material inputs purchased by the producer. In other words it is the value that has been added by labor and capital employed by the producer.

VARIABLE COSTS are costs which vary in proportion to the level of output. Examples of variable costs are direct material costs and direct labor costs.

VENTURE CAPITAL means the financing of a new venture either with stock or with securities.