FMO Annual Evaluation Review 2008/09

Good times, bad times and development effectiveness

Evaluation Unit,
Investment & Mission Review,
May 2009

FMO
Finance for *Development*

Note to the reader:

FMO's 2008/09 Annual Evaluation Review, the seventh of its kind, is a concise presentation of the findings from project evaluations carried out by FMO's internal Evaluation Unit in the course of 2008.

Any opinions and conclusions contained in this report are those of FMO's Evaluation Unit, and are based on evaluation findings. They do not necessarily coincide with the views of FMO's Management Board. Management's position on the Review's findings and conclusions is expressed in the Management Response, which is reproduced on page 23.

Interested readers may obtain further background information and documentation from FMO's Evaluation Unit:
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Highlights

FMO's evaluations of projects approved in 2003 and preceding years, evaluated before the current global financial crisis made an impact, have led to the following main findings and conclusions:

- ***The vast majority of FMO-A financed projects evaluated in the past three years have generated satisfactory or better development outcomes (83%), as well as good financial outcomes for FMO (79%). While FMO's work quality played an important part, good results were much helped by favorable economic developments in our markets in the years leading up to 2008.***

- ***Although government fund financed projects are more risky and have a higher chance of failing, they very frequently produced good to excellent development outcomes (71% of evaluated projects). They were less often financially successful. Government funds have enabled FMO to not just stretch the boundaries of commercially available finance, but to actually cross them. Funds allowed FMO to support activities with a high development potential, where risks are too high – not just for commercial finance, but even for DFIs that need to guard their continuity.***

- ***While generally meeting professional standards, there is room for improvement in the quality of FMO's work in relation to its projects. In particular, the quality of monitoring and supervision has suffered when staff responsible for clients frequently changed, transfers of responsibility were poorly handled, and new production was incentivized at a cost to supervision quality.***

- ***Whereas crises can seriously affect projects' development and investment outcomes, they also offer opportunities to DFIs. Post-crisis investments have typically generated very good outcomes. At such times, we made important contributions to mitigating the impact of crises, and to support economic recovery. Post-crisis interventions also offer good opportunities to get rewarded for risks taken.***
  FMO should, as much as possible, invest counter-cyclically. In the years leading up to 2008, FMO could have better guarded its development effectiveness by building up its solvency when liquidity in its markets increased. Looking forward, evaluation findings support the case for further injections into FMO-managed government funds, so that we may optimally respond to clients' needs in difficult times.

- ***As evaluation findings were used as inputs in the strategy formulation process, it is not surprising that the 2008 evaluation outcomes keep supporting many of the strategic choices made last year, such as the adoption of focus sectors, using the strengths of partners in other sectors, and an increased focus on sustainability. It was decided to shift the portfolio away from upper middle income countries, to increase the share of low income countries, and to grow the portfolio in Africa. Thematic evaluations will be undertaken for increased relevance to the strategy's implementation.***

- ***The formulation of a new FMO strategy in 2008 has triggered the elaboration of an improved development effectiveness framework. The framework, embodied in a new scorecard tool and helped by strengthened procedures, leads to greater consistency in ex-ante assessment, monitoring and ex-post evaluation of the contributions to development made by FMO and by the projects it supports. In combination with greater attention to economic capital, the framework will help to optimize development effectiveness throughout the project cycle, and thus development and investment outcomes.***

1. Introduction

In the midst of an unprecedented global financial crisis that is now also affecting FMO and its markets in various ways, it may almost seem irrelevant to look back, over a longer period, to how FMO's past investments have contributed to development, and how they performed financially. Recently evaluated projects, however, illustrate FMO's effectiveness through projects financed in the wake of another serious recession. The dual functions of evaluation - accountability and learning, external and internal – retain their importance in both good and bad times, and do offer direction also in the present times.

Through an annual program of project evaluations, each year we assess the development outcomes and the investment outcomes (for FMO) of investments approved five years earlier, as well as the quality of FMO's work in relation to these investments[1]. In 2008, we started to only evaluate a stratified random sample of 50% of the approvals, as the increased number of projects no longer warranted a 100% coverage. The individual project evaluations generated many specific lessons of experience. We include these in our lessons database, to help ensure that new investments can avoid past mistakes and emulate good practice examples. The body of evaluations taken together reveals patterns on which we report in this annual review. It accounts for the results achieved by FMO and its clients, brings out success factors, assists policy and strategy formulation and offers guidance on the way forward.

Setting the scene

In 2008, we evaluated projects for which financing was approved in 2003. The context in which these investments were made is well described in the introduction to FMO's 2003 Annual Report: "After a period of deep recession, the world economy is recovering slowly. … Investors are still very selective and their risk tolerance is low." In the period, FMO was thus able to select clients with good fundamentals that were able to benefit from the ensuing upswing in the emerging markets business cycle. Also, FMO was typically highly additional, as private capital flows into its markets had strongly contracted. The 2003 approvals were generally evaluated before the effects of the present global credit crisis could translate into worsened business and development outcomes or into losses (provisions) for FMO.

Outline and structure of the report

The report starts with a description of trends in project development and investment outcome success rates, and an analysis of the interrelationships between development outcomes[2], investment outcomes and FMO's work quality, including FMO's role in relation to the projects. We look separately at projects financed for FMO's own account and at those financed out of FMO-managed government funds, since the investment rationale differs and leads to different outcome patterns.

In the second part of the report, 'Implications for policy and strategy', we first look at evaluation findings in relation to FMO's strategy for 2009-2012. On the whole, it is shown that choices made are supported by evaluations, and are expected to contribute to improved development effectiveness. Next, we see what evaluation findings (both our own and those of IFC) imply for desired FMO action in response to the present global crisis. It is concluded that the crisis is not just a threat, but also offers important opportunities, provided that we can play a good countercyclical role. Finally, we have a look at recently introduced improvements in development effectiveness assessment, monitoring and evaluation at FMO. These are expected to strengthen FMO's ability to manage for greater effectiveness.

[1] An outline of FMO's evaluation framework is provided in Annex 1.
[2] A project's business success, its contribution to economic growth, sustainability outcomes and contribution to broader private sector development.

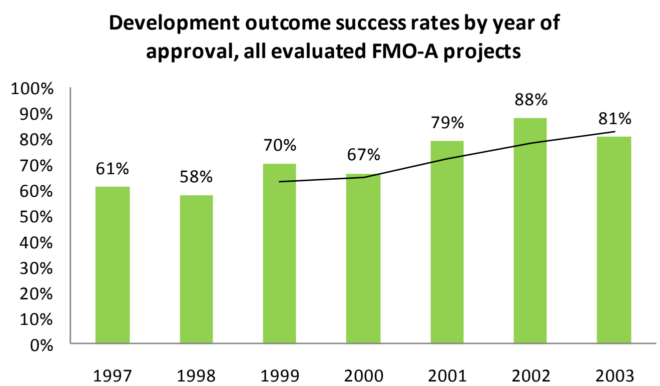
2. Evaluation results: outcome trends and patterns

2.1 Investments for FMO's own account, FMO-A

The vast majority of FMO-A financed projects evaluated in the past three years have generated both good development outcomes (83%) and good financial outcomes for FMO (79%). Development outcomes and investment outcomes remain closely correlated. While FMO's work quality played an important part, good results were much helped by favorable economic developments in our markets in the years leading up to 2008.
While generally meeting professional standards, there is room for improvement in the quality of FMO's work in relation to its projects. In particular, the quality of monitoring and supervision has suffered when staff responsible for clients frequently changed, transfers of responsibility were poorly handled, and new production was incentivized at a cost to supervision quality.

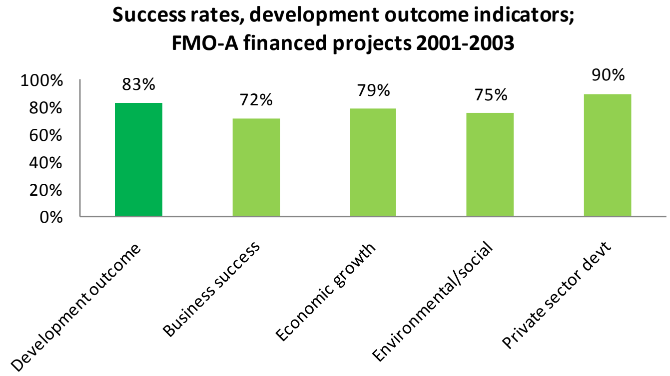
Development outcome

FMO-A financed projects evaluated last year – projects for which financing was approved in 2003 – once again showed a high success rate in terms of development outcome. Of the evaluated sample of 2003 approvals, 81% was evaluated as having produced good (i.e.: satisfactory or excellent) development outcomes. Looking at the three year moving average[3] (the line in the graph below), 83% of the projects approved in 2001-2003 (together responsible for 87% of the Euros disbursed) were developmentally successful.



The overall development outcome rating is the result of evaluating various dimensions/indicators of development outcome: the project's business success (was it sufficiently profitable for its shareholders and financiers, and thus financially sustainable), its contribution to economic growth, the environmental and social outcomes and the contribution to broader private sector development beyond the project company itself. The proportion of 2001-2003 evaluations scoring positively on each of the determinants of overall development outcome is illustrated hereafter:

[3] In this and subsequent analyses, we look at the combined results of three years of evaluations. While all 2001 and 2002 approvals were evaluated, as from 2003 we started to only evaluate a stratified random sample of 50%. In the combined analyses, we have chosen to simply look at all evaluated investments, rather than to give the 2003 evaluations a higher weight. Analyses of outcome patterns are hardly affected, as 2003 outcome success rates on all dimensions and (sub-)indicators only differ a few percentage points from those for 2001 and 2002 combined, The only major difference relates to equity investment outcome: a 100% investment outcome success rate for 2003 approvals (3 evaluated FMO A equity investments only), versus 45% for 2001 and 2002 combined.

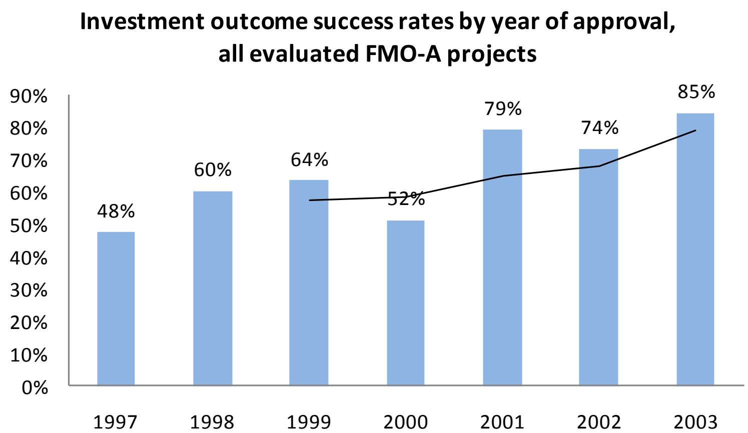


Business success has the strongest correlation with other development outcome indicators and, indeed, with projects' investment outcome for FMO. A project needs to generate reasonable profits for its shareholders and financiers in order to be financially sustainable, needed for it to make a lasting contribution to economic growth and to broader private sector development; it also enables it to devote adequate attention to environmental and social aspects. The 2001-2003 approvals have more frequently achieved good business results than earlier approval years, which largely explains the high success rates on other dimensions.

As in last year's report, we can conclude that the FMO-A investments approved in 2001-2003 have fully benefitted from strong economic growth in FMO's markets in the years between approval and evaluation. As we will see when discussing the evaluation of FMO's work quality, professionalization, strengthened credit approval procedures and building up expertise in selected focus areas also helped.

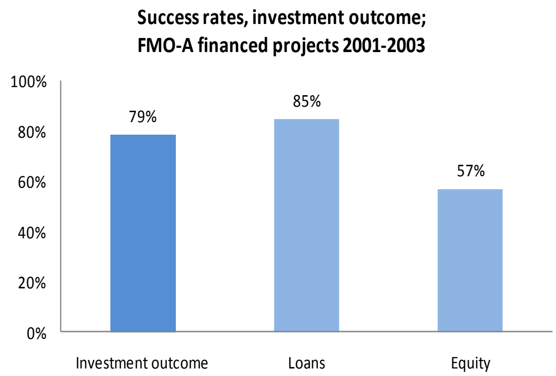
Investment outcome

For investment outcomes (whether or not investments generated good returns to FMO) we observe a similar trend as shown for development outcomes. The 2003 success rate – as well as the three year moving average – is higher than ever recorded before.



Of the evaluated 2001-2003 investments (see trend line), 79% generated good returns for FMO (84% of measured in terms of amounts disbursed). None of the evaluated 2003 approvals generated an entirely unsatisfactory investment return, while a record 12% generated excellent returns.

As can be seen below, equity investments tend to have a lower investment outcome success rate (57% of the 2001-2003 approvals) than loans, as they are more risky. They also are much more cyclical: equity investment outcome success rates were much higher for the 2001-2003 approval years than they were before. Most financially successful equity investments evaluated in recent years generated excellent returns, more than compensating for the losses (or less than adequate returns) on unsuccessful equity investments.



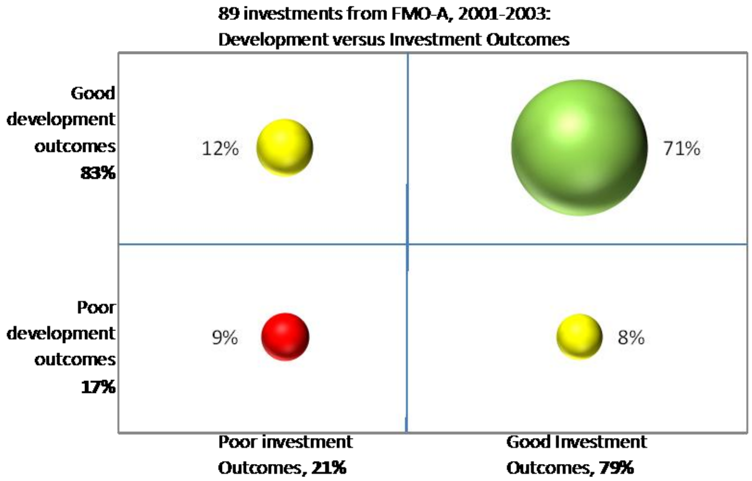
As mentioned in the introduction, recently evaluated investments were made when the emerging market climate was depressed and FMO could invest selectively. The recovery and good years that followed helped clients' results, and thus their equity performance and loan servicing ability. To the extent that clients are going to be affected by the current crisis, their business success ratings will slip, as will their ability to generate wider developmental benefits and to generate a good return on FMO's investments.

Interrelations and the influence of FMO's work quality

Having described the development of evaluated projects' development and investment outcome success rates, we now turn our attention to the interrelation of the two. As illustrated in the evaluation framework (described in Annex 1), development and investment outcomes are determined, on the one hand, by FMO's own work quality in relation to the project[4] and, on the other, by factors beyond FMO's control. Therefore, we also analyze the influence of FMO's work quality on outcomes, and the scope for improving outcomes by improving FMO's work quality.

Of the evaluated projects approved in 2001-2003, 80% had either win-win (both good development and investment outcomes) or lose-lose outcomes. In recent years, the proportion of projects with poor outcomes on both dimension has shrunk drastically to 9% (and even more dramatically to just 5% in terms of amounts disbursed). There hardly ever is a trade-off between good development results and good returns for FMO, provided that projects are selected on their potential for good contributions to development as well as on financial sustainability. If this is the case, projects that succeed in reaching their expressed business objectives both contribute to development and are able to meet their financial obligations to FMO.

[4] Under FMO work quality, project evaluations assess (1) the quality of FMO's front end work (project selection, due diligence and structuring / risk mitigation), (2) project supervision and (3) FMO's role (being additional to commercial finance, being catalytic and bringing added value to the client).



Compared to recent years' analyses, we note an increase in the category where poor development outcomes are combined with an adequate return on FMO's investment. Among evaluated 2003 FMO-A approvals, there were a few projects with poor business and poor overall development outcomes that nevertheless correctly serviced their FMO loans. In the opposite corner we find clients with adequate development results who generated an inadequate return on equity investments, as well as loan financed clients who prepaid after a short period and thus did not give FMO a return that sufficiently compensated for the risk initially taken.

Development and investment outcomes are determined both by factors beyond FMO's control (positive economic developments in our markets clearly helped outcomes in recent evaluation years) and by FMO's own work in relation to the project. Projects where serious shortcomings were noted in FMO's overall work quality produced disappointing development outcomes three times more frequently than projects where FMO's work quality generally was up to standards. A similar picture emerges if we look at investment outcome and work quality.

Maintaining a high work quality in relation to all projects thus offers potential for increasing outcome success rates.

In recent evaluation years, work quality ratings give reason for some concern, as may be seen in the chart below. The proportion of projects with a satisfactory or better overall work quality rating reached a peak for the 2001 approvals, remained at a high level for the next approval year, and shows a marked decline in the last year of evaluations:

Electronics/ICT in East Asia

Development outcome: unsuccessful

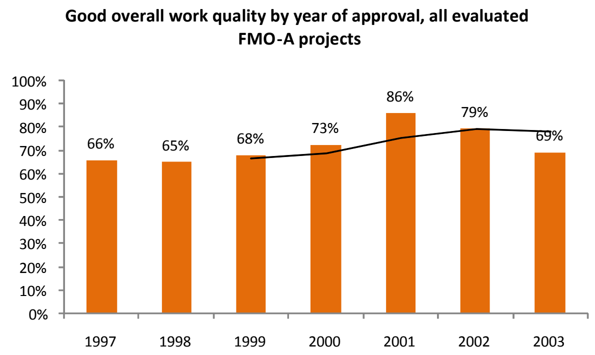
Investment outcome: satisfactory

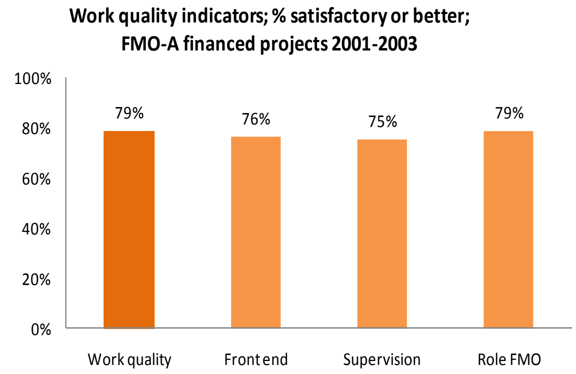
FMO work quality: partly unsatisfactory

In 2003, FMO provided mezzanine finance to meet the high working capital requirements of a promising, relatively young and fast growing producer of equipment for ict networks. Customers were to benefit from the presence of a low cost competitor, and good employment effects were foreseen.

Having stood up to various problems and challenges, the company eventually was not able to withstand opposition from its larger, more established competitors, and had to sell off its business activities. FMO has poorly assessed the business case, presenting it over-optimistically and downplaying the weaknesses.
Expected development benefits were not realized and job creation was not sustained.

As the company was hardly leveraged, it was still able to meet its obligations to FMO from the proceeds of its liquidation.





Of the work quality aspects evaluated (front-end work, supervision and FMO's role), front-end work quality – which has the strongest correlation with project outcomes – still showed improvements in recent evaluation years: improved sector expertise, increased attention to good banking practice and a strengthened credit approval process led to better selection, structuring and risk mitigation.

In recent evaluations we have, on the other hand, more frequently noted shortcomings in supervision. For some years, the proportion of well-supervised investments improved, thanks to the formation of dedicated portfolio management teams within the investment departments. More recently, however, the quality of supervision once more declined. Contributing factors were (a) the fact that the new portfolio management units also started to pay relatively less attention to monitoring after having been given production targets for repeat business, and (b) frequent handing over of responsibility for individual clients. The latter resulted in diminished knowledge about clients and contractual arrangements, decreasing quality of annual credit reviews, less follow-up on improvement trajectories agreed with clients, and less attention to operational, development outcome and sustainability reporting. Project evaluations showed that monitoring quality could have been improved if outstanding issues and points of attention had been properly documented in transfer memos, and if newly responsible staff members had been better introduced to clients, for example during joint client monitoring visits.

Such shortcomings are particularly worrying in view of the onset of the present global credit crisis, when close supervision of clients is of the essence, and clients' business has to be well understood for FMO to be able to assist them appropriately and in a timely manner. Timely receipt and review of both operational and financial reporting is all the more essential to receive early warning of potentially emerging problems. The late 2008 reorganization of the investment departments has fortunately been done in a way that minimized the number of transfers of client responsibilities. Still, responsibility for about half of FMO's clients had to be transferred.

In the newly formed investment departments, new business and portfolio management have, once again, been combined. This eliminates a point of transfer of responsibility, thus reducing the risk of client knowledge being lost. This may also be expected to reinforce continuity in client relationships, and thus help better supervision, provided that monitoring and supervision gets sufficient priority, is supported by adequate staffing and is properly incentivized. Strengthened credit inspection and more feedback from credit analysis to managers may help achieve this.

Among the 2003 evaluations, we also saw an increase in the proportion of projects where FMO's role as a DFI was judged to have been less than satisfactory. While additionality had hardly been an issue in 2001-2002 (when capital flows to our markets had sharply declined), among 2003 approvals we saw a few cases where additionality was insufficiently plausible / proven (including the case of a credit line to a bank in a Central European country about to join the EU, and a project in Southern Africa that effectively amounted to corporate finance to a multinational). In various cases also, FMO did not deliver on expressed intentions to contribute to improving environmental, social and/or governance performance. In some other projects, particularly in the energy focus sector, FMO played an excellent role, leading other DFIs in the transaction and bringing real added value to developmentally (very) good projects (see box). The new development effectiveness framework introduced in the context of the 2009-2012 strategy (see final section of this report) is expected to improve attention to FMO's additionality, and to its catalytic and non-financial roles, as these are now captured in an indicator that will be monitored and for which targets will be set.

Strong FMO Role helps Latin American renewable energy project

Development outcome: highly successful

Investment outcome: satisfactory

FMO work quality: satisfactory

When co-financing a set of small to medium scale hydro projects in Latin America, initiated by local investors and a US investor group, FMO played a strong financial role. Power finance had become particularly scarce in the wake of a recession, while multinational developers faced hard times, particularly after Enron.

Hydro development on a small and local scale increased access to energy at competitive prices. The availability of additional and relatively cheap energy had positive direct and indirect social and economic effects, and also contribute to government revenues.

Apart from being highly successful developmentally, the project was also a business success. The initiators could, upon completion, sell off to a major international player.

2.2 Investments from FMO-managed government funds

Although government fund financed projects are more risky and have a higher chance of failing, they very frequently produced good to excellent development outcomes (71% of evaluated projects). Government funds have enabled FMO to not just stretch the boundaries of commercially available finance, but to actually cross them. Funds allowed FMO to support activities with a high development potential, where risks are too high – not just for commercial finance, but even for DFIs that need to guard their continuity.

Introduction

In addition to investments for its own account, FMO has, for many years, managed a number of funds and programs for the Netherlands government. These funds have specific objectives and reflect government priorities in private sector development. They enable FMO to engage with clients and/or offer products that have a high development impact potential, but carry risks that cannot be prudently borne even by a development bank. While regular DFI finance moves frontiers (being one or more steps ahead of what commercial banks and investors are prepared to risk), government funds allow us to cross frontiers, into activities that are otherwise unbankable, even by DFIs.

Until 2002, the funds included the Seed Capital Program (SC) and the Small Enterprise Fund (SEF), who were, along with the Balkan Fund, merged into the present MASSIF fund in 2005. In 2002, the first commitments from the Least Developed Countries Infrastructure Fund (LDC Fund) and the Netherlands Investment matching Fund (NIMF, absorbed by FMO-A in 2008) were made. In 2003, FMO was also mandated (by the Ministry for Economic Affairs) to manage the Investment Facility for Emerging Markets (IFOM, later FOM)[5].

Starting with 2001 approvals, we have, in addition to FMO-A financed projects, also evaluated projects financed out of government funds. Over the last three years, 51 government fund financed projects[6] have thus been evaluated, now providing a sufficient basis to compare their outcome patterns with those of projects financed from FMO-A. For government fund financed projects, we have added two additional evaluation dimensions: (1) the project's contribution to the specifically expressed objectives of the fund, and (2) compliance with fund-specific investment criteria.

Development and investment outcome

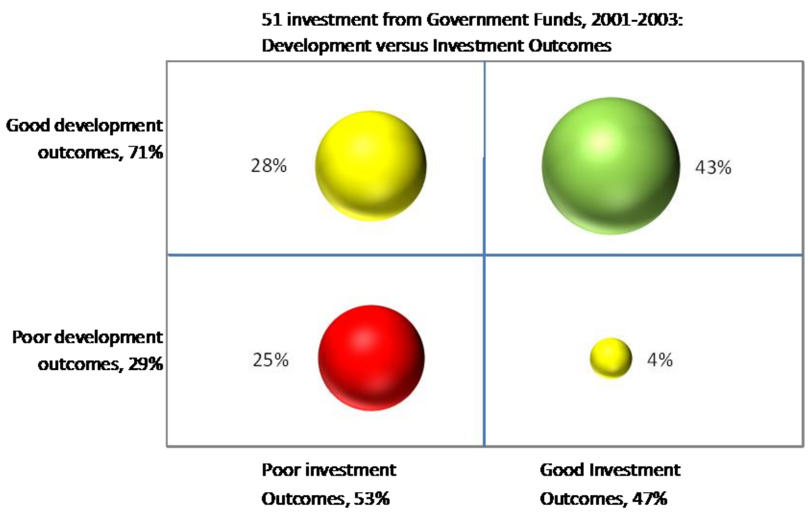
The development and investment outcome pattern for evaluated government fund investments shown in the chart below confirms the special nature of these investments, especially if confronted with the outcome pattern for FMO-A investments shown in the previous section.

Given the higher risks involved – and the fact that clients' financial sustainability is typically much less assured – the most surprising outcome is perhaps the fact that as many as 71% of financed projects achieved good development outcomes, a success rate that has only been surpassed by FMO-A investments evaluated in the last three years. The fact that an institution like FMO could not prudently have made these investments for its own account is confirmed by the fact that less than half of the evaluated government fund investments generated a good investment outcome[7] (compared to 79% for FMO-A investments).

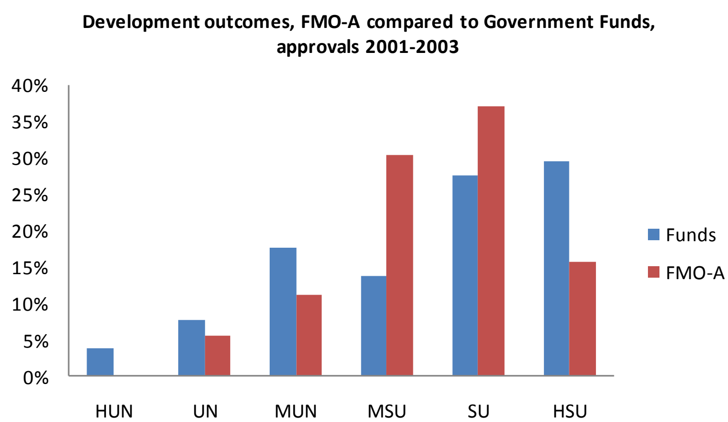
[5] The ***Seed Capital Fund*** aimed to provide risk-bearing start-up capital to new, promising enterprises, mainly in Africa and primarily through intermediary financial institutions. Success in terms of the program objective was interpreted as the degree to which the investees have outgrown their start-up character and gained broader access to funding.
The ***Small Enterprise Fund*** aimed to stimulate small enterprise development by providing – mainly local currency – finance through local financial intermediaries. Here, success in terms of program objectives is measured by the extent to which the financial intermediaries have successfully expanded their small enterprise lending in a sustainable manner.
The ***LDC Infrastructure Fund*** aims to stimulate (semi-)private infrastructure development in least developed countries, by providing catalytic finance (deeply subordinated loans, equity and development grants).
NIMF was established to provide high risk (equity and quasi-equity) finance, unacceptably risky even for DFIs, to match investments by – initially Dutch, later untied - private enterprise.
(I)FOM assists Dutch entrepreneurs who wish to set up business in emerging markets, primarily by providing subordinated loans (that are largely guaranteed by the government).

[6] To date, we evaluated 15 investments from the SC Program, 28 investments from the SEF, three investments each from the LDC Fund and (I)FOM, and two from NIMF.

[7] In the case of government fund investments, their investment outcome is judged as having been good if the return, in Euro-terms, has been positive and has more than compensated the management fees paid by the government to FMO. Investments with good investment outcomes have thus contributed to growth of the (revolving) funds, investments with poor outcomes have caused the funds to shrink.



A more detailed comparison of development outcome ratings, as provided below, illustrates the fact that government fund financed investments generally have the potential for high development impact. If development outcome is rated on a six-point scale, from highly unsuccessful (HUN) to highly successful (HSU), FMO-A financed projects are concentrated in the moderately successful classes. Government fund financed projects more often fail – which is understandable given their higher risk appetite -, but they also are much more frequently highly successful developmentally.



A final point to be noted when comparing the outcome matrices for FMO-A and government funds is the fact that mixed results – particularly the combination of (very) good development outcomes and poor financial outcomes – are much more common among government fund investments. Two types of projects have typically ended up in this category: (1) equity-financed SC Program projects with fair to good business results, that have so far been unable to generate a good return for shareholders, and (2) SEF-financed clients that typically did very well developmentally, but where local currency loans caused losses to the fund as a result of depreciation of the local currency.

In addition to the general evaluation dimensions, government fund investments were also evaluated in terms of the contribution that they made to the fund's specific objective: creating sustainable companies and financial institutions for the seed capital fund, providing investment finance to small enterprise for SEF, etc.. With few exceptions, projects that were developmentally successful also contributed clearly to the funds' expressed objectives. Exceptions are a seed capital client whose financial sustainability is, after five years, still insufficiently assured, and three SEF clients where we found insufficient evidence that FMO's funding had benefitted SME-development, but who otherwise made good contributions to development. In all other cases where program objectives were not or insufficiently achieved, this was associated with poor business performance (predominantly SC projects).

Looking at the results on a fund by fund basis, the former **SC Program** almost universally produced disappointing investment outcomes, and also had the lowest success rate in terms of development outcome. Clearly, fledgling financial institutions (the program's main target group), often starting from scratch, pose a high risk and may require a longer time than the five year evaluation period to take root. It also appears that FMO frequently overestimated its abilities to bring such institutions to fruition; a majority showed significant shortcomings in front-end work, as well as in monitoring and supervision (see box). While FMO's role in general was judged as satisfactory or better, it was still frequently noted that FMO insufficiently delivered on contributions (for example through capacity development, active board membership) that these clients may reasonably have expected. FMO's effectiveness towards such clients was hampered by the fact that it lacks a local presence. The small investment size also made it hard to warrant the provision of enough supervision, guidance and support. Under MASSIF, FMO more often serves this type of clients through partnerships and, for example, microfinance funds and holdings. These do have dedicated staff, are typically closer to the clients and often have access to substantial technical assistance funds. As this addresses most of the observed weaknesses of the SC Program, MASSIF's future results may be expected to be better.

Unsuccessful support to mortgage origination in Asia

Development outcome: highly unsuccessful ☹

Investment outcome: unsatisfactory ☹

FMO work quality: partly unsatisfactory ☹

With funds from the Seed Capital program, FMO supported the setting up of a financial services company, aiming to act as an intermediary between prospective home owners and banks providing mortgage loans. It also aimed to assist banks in selling mortgages in the secondary market.

From hindsight, the business case was poorly analyzed. The potential market in the country for these services was very much overestimated. Banks providing home construction finance and mortgage loans preferred not to make use of independent originators/servicers, but rather to work with developers, replacing construction finance by take-out mortgage finance. A secondary mortgage market was also not yet developing. The company was wound up after just two years.

The story of the **Small Enterprise Fund** is quite different. The development outcome success rates are very high in all areas, as, generally, is the case for FMO's work quality. FMO's role was universally judged to have been good. The only areas where shortcomings were relatively often noted were E&S outcomes and client monitoring and supervision. E&S reporting had often not been obtained, and monitoring often fell short on development impact and the use of SEF funds, as monitoring was too often limited to client financial risk and performance. The high success rates are clearly related to the fund's rationale: to select relatively strong financial institutions that could act as efficient channels for financing small enterprise. The fund was unique in that it provided local currency loans, so that neither the financial institution nor its SME-clients without foreign currency earnings were burdened with inappropriate foreign exchange risk. As more means have, in recent years, become available to hedge exchange risk – particularly the currency exchange fund, TCX – many former SEF clients now qualify for FMO-A financing. MASSIF will thus deal with clients with a higher risk profile – as institutions or because they operate in high risk countries whose currencies still cannot be hedged. Going forward, the fund will thus acquire a higher client risk profile, while maintaining its development relevance.

For **other funds**, the number of evaluations is still too small to generalize findings. However, the three **LDC Fund** projects evaluated to date have all been seen to make strong contributions to development, while accepting high risk. On **(I)FOM**, we refer to last year's report, which discussed the outcomes of an internal review of the fund. It was noted that the program's target investments are typically characterized by a clustering of risk factors that easily leads to many of the projects generating poor development and investment outcomes. The two FOM projects evaluated last year (manufacturing ventures in Russia and in the Czech Republic) did, however, generate positive outcomes. They demonstrate that good project and promoter selection, coupled with good deal structuring, can be good for development, and that the fund can also effectively help Dutch SMEs strengthen their business by investing in emerging markets.

Government funds enabled FMO to effectively support successful development of crisis-resilient MFIs in Latin America

Development outcome: highly successful

Investment outcome: satisfactory

FMO work quality: satisfactory

The Small Enterprise Fund was, in 2003, the only facility offered by any DFI that could provide term loans in local currency to financial institutions. Regulated MFIs were weathering the country's financial sector crisis nicely, experiencing a 'flight to quality' from depositors, but lacked longer term finance needed to expand their product range.

Neither the MFIs nor their clients could prudently take on foreign exchange risk, so local currency loans from FMO offered an ideal solution. During the time of FMO's involvement, the sector saw further rapid growth – now serving more depositors and borrowers than the country's banks and representing a significant part of the country's financial sector assets – and expanded their product range with medium term investment finance and home improvement and mortgage loans. Thanks to good regulation and a professional approach, the country's MFI sector became the most efficient in Latin America, offering microfinance at lower interest rates than anywhere else.

Natural gas development provides cheap power and saves foreign exchange in East Africa

Development outcome: successful

Investment outcome: partly unsatisfactory

FMO work quality: satisfactory

With funds from the LDC Infrastructure Fund, FMO contributed to the financing of an integrated natural gas to power project in East Africa. The project made a major contribution to reducing the country's power shortages. Using locally available natural resources led to a low cost of energy generation, and to substantial savings of foreign exchange spending on imported fuel. Environmental and social effects have been assessed as excellent. Not only does the project offer a relatively clean source of energy, but is has been carried out in a manner that demonstrates exemplary environmental and social management practices.

FMO's role was judged to have been just satisfactory. Although an envisaged catalytic role did not materialize and the investment had a refinancing character, FMO's presence was still seen to be essential, acting as a broker between government and private sector interests. FMO played an active role also in the project company's board.

FMO's investment outcome has been judged as partly unsatisfactory, as we had to make a provision on our investment because of payment arrears caused by regulatory disputes. The latter illustrates the high risk nature of the project.

3. Evaluation implications for policy and strategy

In 2008, FMO developed a new strategy for the 2009-2012 period: ‘Moving Frontiers’. The strategy is designed to retain and enhance FMO’s overall development effectiveness. Three focus sectors (Access to Finance, Access to Energy, Access to Housing) have been selected in which FMO intends to play a leading role. Other sectors can still be served in co-operation with partners who have appropriate expertise. Increased attention to opportunities in sustainability is a further thread, as is the explicit intention to strengthen FMO’s catalytic role, notably through fund management. Furthermore, FMO has set targets to increase its activities in low income countries (and particularly Africa), while adopting an exit-strategy for several upper middle income countries. A development effectiveness framework has been adopted and translated into a revised scorecard. The framework is meant to guide project selection, and to help bring it in line with monitoring and evaluation of project outcomes and of the role played by FMO.

This chapter sets out to (1) present evaluation findings in the context of strategic choices made, (2) to explore what policy guidance evaluation findings may offer in the context of the current global crisis, and (3) to inform the reader about developments in effectiveness assessment, monitoring and evaluation at FMO, and how these are designed to strengthen effectiveness and accountability for results throughout the project cycle.

3.1 Evaluation outcomes and FMO’s 2009-2012 strategy

As evaluation findings were used as inputs in the strategy formulation process, it is not surprising that the latest evaluation outcomes keep supporting many of the strategic choices made last year, such as the adoption of focus sectors, using the strengths of partners in other sectors, and the increased focus on sustainability. The same goes for shifting the portfolio away from upper middle income countries, and to increase the share of low income countries. Thematic evaluations will we undertaken for increased relevance of evaluations to the strategy’s implementation.

Last year’s evaluation review shed light on many of the questions that FMO was facing when designing its new strategy, and thus helped to inform many of the choices to be made. Evaluation findings demonstrated, for example, that FMO much more frequently achieved good development and investment outcomes in **sectors** on which it had focused, and in which it had developed expertise. These findings and this conclusion still hold and are once again confirmed.

The strategy focus on **housing** (both mortgage finance and affordable housing development) is a new one. Among evaluated projects, we have, so far, only evaluated a number of loans to financial institutions, earmarked for the provision of **mortgage finance**. From these, we have been able to draw a number of lessons. For one, to date our monitoring of the utilization of mortgage finance lines was often poor. Monitoring was often limited to credit risk of the financial institution to which financing was provided, and information on these institutions’ overall mortgage finance activities, their development effects and the income groups reached was often poor or non-existent. A dedicated focus should help remedy this. On the other hand, evaluations confirmed that FMO typically played a good role with such facilities, being highly additional: this is clearly an activity for which long term finance, preferably in local currency, is required, and this remains extremely scarce in our markets. Projects dealing with the supply side, in **housing development** and construction, have only been embarked upon in the last three or four years, and have thus not yet come up in the regular evaluation program. To enhance relevance of evaluation to the strategy, to support front office initiatives and to fill gaps in our lessons learned database, we therefore intend to undertake early evaluations or mid-term reviews of a number of these projects in 2009.

The desirability of the strategy's emphasis on **sustainability** is also supported by evaluation outcomes. FMO's work quality – in particular with regard to project monitoring and supervision – is strongly related with projects' environmental and social outcomes, which in turn are correlated with clients' business performance. Good management and governance positively affect financial results; both strong overall management and good financial performance help clients deal adequately with environmental and social issues. Conversely, paying proper attention to sustainability is also likely to be good for business.

As we saw in the discussion of FMO-A development outcome patterns, sustainability outcomes still fall short in about a quarter of our investments. This is rarely so because these projects are evidently environmentally or socially harmful. Outcomes that are scored (partly) unsatisfactory are generally the result of clients not having complied with FMO's requirements to develop and adopt E&S policies and an adequate environmental and social management system (ESMS) to manage their E&S risks, and to report thereon. Particularly from its financial institution clients, FMO has, for quite some years, demanded that they implement an ESMS, so that E&S risks in their portfolio will be adequately dealt with. Despite considerable efforts having been made, including the organization of E&S training courses for financial institution clients, results have often been disappointing. In 2009, we will carry out an evaluative study of the effectiveness of our E&S policies for financial institutions, with a view to helping develop more effective policies, procedures and support.

The most recent evaluations also show that FMO can successfully stimulate investments with strong positive E&S effects, if it selects projects and clients that have the potential for strong positive environmental and social impacts. Excellent sustainability outcomes were achieved in financing renewable energy (e.g. in Central America), in helping natural gas based power development (in East Africa and South Asia through the LDC Fund), in microfinance, and by stimulating low income mortgage and home improvement lending. These projects have generally also turned out well from an economic growth and a banking perspective. The new strategy encourages investment staff to identify such opportunities. Instruments have been introduced to target a higher sustainability impact, both through strengthening E&S risk management performance and by incentivizing the selection of projects that directly contribute to FMO's sustainability priorities (see final section).

Evaluation outcomes by **country income** category keep supporting the strategic choice for reduced investments in upper middle income countries and for investing more in low income countries. Development outcome success rates do not differ significantly between country income classes, but the investment outcome success rate is clearly best in low income countries and worst in upper middle income countries. While this is partly explained by the fact that relatively more (risky) equity investments were made in upper middle income countries, this outcome pattern also holds for loan and equity investments separately. This makes sense if one considers the fact that in the relatively more advanced countries the financial sector is typically also more developed. Outcomes of investments in the relatively more advanced countries have also been seen to be more sensitive to economic crises.

3.2 Evaluation findings and the current crisis

While crises can seriously affect projects' development and investment outcomes, they also offer opportunities to DFIs. Post-crisis investments have typically generated very good outcomes. At such times, we made important contributions to mitigating the impact of crises, and to support economic recovery. Post-crisis interventions also offer good opportunities to get rewarded for risks taken.

FMO should, as much as possible, invest counter-cyclically. In the years leading up to 2008, could have better guarded its development effectiveness by building up its solvency when liquidity in its markets increased. Looking forward, evaluation findings support the case for further injections into FMO-managed government funds, so that we may optimally to respond to clients' needs in difficult times.

Past evaluations have demonstrated that FMO's investment and development outcomes can be badly affected by economic and financial sector crises in its markets. They also show that FMO has been able to achieve some of its best results and to play its role most effectively in post-crisis situations, when liquidity in our markets had dried up.

DFIs should ideally play a countercyclical role, exercising restraint and withdrawing from markets and market segments when these are increasingly served by commercial finance, and stepping up their activities when and where commercial financiers withdraw. This follows directly from the additionality principle. At the start of 2008, when advising on FMO's strategic directions, we wrote that 'FMO may want to consider consciously and deliberately lowering its investment volumes at times when market liquidity is high (as evidenced, for example, by region-wide pressure on margins or by rapid growth in emerging markets private equity fund raising), to be all the more able to respond when the market reverses, liquidity dries up and FMO is optimally additional'.

The new strategy – moving frontiers – was indeed designed to retain additionality and to keep playing our proper developmental role in both good and bad times. It responded to the fact that financial markets had seen substantial deepening in many of the countries where we work, particularly in the more advanced ones. The strategic choices that were eventually made implied that FMO was to become more selective, and opted for fields of activity where it can make good contributions while staying well ahead of commercially available finance. With the benefit of hindsight, one can say that FMO had not optimally prepared itself for the storm that erupted in full force in the latter part of 2008: in the preceding period, when capital flows to emerging markets were still strong, we entered into record levels of new commitments and saw unprecedented portfolio growth. Especially in 2007, we experienced substantial prepayments, as clients had the opportunity to refinance FMO loans that had become relatively expensive. However, as we saw in quite some evaluations, FMO not always withdrew when it no longer fulfilled an essential role: rather than stimulating prepayments whenever our loans could be refinanced from commercial sources, we acceded to requests for margin reductions in order to retain business and to hold on to reliable sources of income.

What can evaluations tell us about the best way forward under the present circumstances?

Starting off in the second half of 2007 as a credit crisis affecting the US economy, the crisis spread initially to the rest of the developed world as internationally operating financial institutions were being hit. Meanwhile, developing countries have also become affected, through a variety of means, and to varying degrees. While countries like China are affected by reduced demand for manufactured exports, many others are hit primarily by much lower commodity prices, and in still others (relying extensively on external finance) the stability of the financial sector is seriously undermined. Capital flows to emerging markets are drying up, and commercial financial institutions are reducing their available limits.

DFIs have extensive experience with crises, whether at country level or at the level of entire regions, although not on the present global scale[8]. They have learned that crises offer opportunities as well, if their response is correct. In December 2008, the World Bank Group's Independent Evaluation Group published lessons from its responses to past financial crises, of which IFC's lessons – largely also reflected in our own past experience – are particularly relevant to FMO[9]. Translated to FMO's context and operations, the most important are:

- While the flow of new investments tends to fall sharply in the immediate wake of a crisis, a relatively quick response thereafter generates investments that are much more often developmentally successful than projects approved pre-crisis.
- Key interventions can help restore confidence. New clients, previously served by commercial finance, come into reach. As commercial finance dries up, strong additionality helps to make clients accept the necessity to improve governance or environmental and social performance. It also helps ensure that DFIs can reap the rewards for the risk they are prepared to take: performance-related returns can be negotiated, so that DFIs share in the returns when their crucial and high risk support helps the client to overcome the crisis, to emerge all the stronger from it.
- There is a risk that opportunities are missed, because staff capacity is fully absorbed by efforts to resolve existing clients' problems. Timely transfer of serious problem cases to Special Operations can help. IFC noted that timely loss provisioning also helped restructuring, by focusing staff attention on improving portfolio quality, and by creating more room and flexibility for negotiations with clients. Within investment departments, it may also help to devote staff separately to, on the one hand, intensified monitoring of existing clients and limited scale work-outs (e.g. rescheduling) and, on the other, to new business opportunities.

For the newly created sector departments at FMO, the following appear relevant:

For **Financial Institutions**, experience shows that financial intermediaries focusing on micro-enterprises are relatively crisis-resilient. Regulated MFIs, with access to deposits, may even benefit from a 'flight to quality' from depositors whose confidence in commercial banks is eroded (as we saw in some Latin American countries in the past). Institutions serving SMEs are likely to see demand increase, as their target clients are affected by generally tightened liquidity. SMEs, especially if borrowing in local currency and producing for and selling in the local market, would be less crisis-sensitive. Assisting SME financiers thus offers good developmental and business opportunities. Larger financial institutions mainly lending to corporate clients, and more open to the vagaries of global financial markets, are more likely to face distress. As FMO also saw after the Asia crisis, this can create opportunities to take part in constructive rescue operations. This may be most effective if acting in consort with EBRD, or with IFC, who (as a member of and in conjunction with the rest of the World Bank group) is better placed to address overall sector weaknesses.

In earlier crises, FMO has also been highly developmentally effective by providing **export finance**, when even for this purpose liquidity dried up in crisis-affected countries. Assisting exporters in this way clearly helped to mitigate the impact of country crises. Under present conditions, it would have to be clearly established that liquidity is the key problem, rather than reduced export demand and prices. The relatively low claim on capital of trade finance would be a further incentive to pursue these activities at the present time.

[8] See earlier FMO Annual Evaluation Reviews on the effects of and opportunities offered by, among others, the 1997 Asia crisis, the 1998 Russia crisis, Turkey around 2000 and Argentina around 2001.

[9] 'Lessons from World Bank Group Responses to Past Financial Crises'; Independent Evaluation Group World Bank / IFC / MIGA, Washington, December 2008.

In **Energy and Housing**, it is likely that many early-stage projects will be shelved or delayed as both project sponsors and commercial financiers adopt a wait-and-see attitude, find it more difficult to bring transactions to financial close, or feel a need to reassess the market. On the other hand, particularly in the power sector, there is a high likelihood that international commercial financiers will withdraw soft commitments or even find excuses for getting out of actual commitments as their institutions reduce country limits, or seek to reduce relatively riskier and longer term commitments.

FMO evaluations of power projects in which we became involved around the 2001/2002 recession (which was accompanied by the Enron debacle and the ensuing problems of other power operators) demonstrate that, in those conditions, we were able to fill gaps left by commercial financiers, be highly additional – at least for a while – and select projects with a high relevance to economic development. Several of these were also environmentally beneficial, such as relatively clean natural gas-fired plants in Bangladesh and Tanzania, and hydro-power projects in Central America.

The **Global Partners** department has been established to allow FMO a continued role in developmentally relevant projects outside our primary sectors of expertise, where selected partner-DFIs and partner-banks with relevant expertise take the lead. The effect of the crisis is likely to be a sharp increase in these partners' demand for FMO co-financing, as commercial co-financiers no longer have the appetite or financing capabilities that they had in recent years.

The opportunity here is the chance to respond selectively, making choices both in terms of risk/return and where development effectiveness is concerned. As stated above, increased additionality will often lead to opportunities for innovative structuring and building in an upside. On the other hand, high demand from partners should help the department in selecting projects that strongly contribute to economic growth and to sustainable development, and where FMO has a strong role to play as a DFI in terms of additionality and catalytic effects. Under the circumstances, partners may tend to pass off commitments and risks that they prefer to get off their books. FMO should, therefore, maintain high standards of independent assessment and due diligence also for partner transactions.

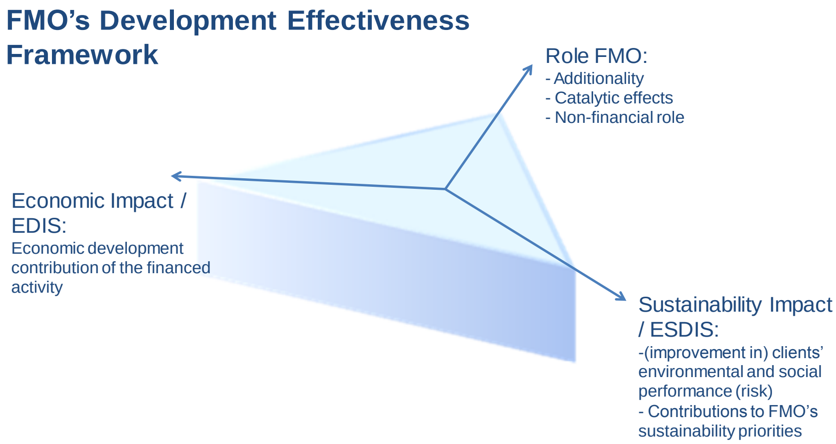
The **Equity** department is confronting the fact that the recent explosion of private equity inflows into our markets now shows a sharp reversal. Fair values of existing investments are, in many cases, adjusted downwards. Being the FMO activity that is most sensitive to the economic cycle, it is affected hardest by the crisis. Both direct equity investments and investments in private equity funds have to deal with much reduced exit opportunities and lower exit valuations. On the other hand, the more recent vintage years of equity funds in which we have participated are still far from being fully invested. Particularly now, these should be able to benefit from low (or: more realistic) entry valuations, from reduced competition and from increased leverage on their investees.

All in all, we conclude that the current crisis, while affecting our existing clients' business performance and their ability to generate good development outcomes and good returns for FMO, also offers good opportunities if lessons from past crisis experience are taken into account.

3.3 Development effectiveness measurement at FMO

The formulation of a new FMO strategy in 2008 has triggered the elaboration of an improved development effectiveness framework. The framework, embodied in a new scorecard tool and helped by strengthened procedures, leads to greater consistency in ex-ante assessment, monitoring and ex-post evaluation of the contributions to development made by FMO and by the projects it supports. Together with increased attention to economic capital, the framework helps to optimize development effectiveness throughout the project cycle, and thus development and investment outcomes.

The elaboration of FMO's new strategy for the 2009-2012 period in 2008 provided a major stimulus to further develop the tools and processes through which FMO assesses its development effectiveness at approval (steering investment selection) and subsequently monitors and evaluates outcomes.
In the past strategy period, the Development Impact Indicator (defined as the product of projects' economic development impact score, EDIS, and the amount committed) served as the leading indicator and production target setting mechanism. Investment departments were incentivized to (i) improve the average economic development relevance of investments supported and to (ii) further FMO's impact by aiming for high commitment levels. We were aware that this left out major elements of development effectiveness, and bore only a partial relationship with the dimensions on which a project's outcomes are eventually evaluated. In 2008, we remedied this by introducing a multi-dimensional development effectiveness framework, illustrated below.



In addition to the existing indicator for expected **economic impact** (EDIS, designed as a proxy for an investment's economic rate of return), we developed a new indicator for **environmental and social development impact** (ESDIS) and an improved and more objective indicator for FMO's role as a DFI. These are incorporated in a new scorecard that was launched at the start of 2009[10]. Projects score ESDIS points for (1) the gap between their current and their committed levels of E&S risk management[11] and (2) for inherently contributing to sustainability objectives (e.g. a renewable energy project making a contribution to fighting climate change, or a micro-finance institution with a strong social development orientation). Sub-scores for the gap between current and committed levels of risk management have been brought fully in line with the Performance Standards and are monitored annually, so that progress towards compliance can be tracked and managed.

[10] The new scorecard is also used to assess and monitor client and product risk and utilization of economic capital, as well as to record a number of quantifiable development outcomes (both portfolio-wide, such as employment effects and government revenues generated, and sector-specific, such as the number of households expected to benefit from new electricity connections).
[11] Or for maintaining high or exemplary standards of E&S risk management.

On **FMO's role as a DFI**, the indicators have been made more objective and detailed. Scoring elements for additionality are derived from the assessment of product risk, client risk and country risk. Catalytic effects now have to be quantified, so that a leverage factor for FMO's investments can be calculated. And a non-financial role in improving a client's ESG and/or operational performance is now only scored if FMO makes substantial efforts and contributions in those areas. Moreover, all scoring elements have to be commented upon in investment proposals, so that not only the investment's rationale but also FMO's role as a DFI is properly documented from the start, providing a solid basis for subsequent monitoring and evaluation.

While our methods and tools for assessing investments' expected economic development effects (EDIS) remain unchanged, the basis for outcome reporting and future evaluations has been strengthened by also assessing a number of **quantitative outcome indicators** (employment effects, government revenues, balance of payments effects, and sector-specific indicators). As the latter are only introduced for new commitments in 2009, the year will be used to gain experience and to fine-tune the set of indicators. We aim to align these indicators as much as possible with those used by DEG and other EDFI-members (DEG's GPR approach) and those used by multilateral development banks (IFC's Development Outcome Tracking System, DOTS). To this end, we will liaise and consult with our sister institutions.

While commitment volumes played a major role in past steering, FMO is preparing to let its investment decisions be guided increasingly by **economic capital** allocation and return. We expect this to help focus the organization on optimizing both financial and development outcomes. With increased attention on all relevant dimensions of effectiveness (economic outcomes, sustainability outcomes and FMO's additionality and catalytic role), efficient allocation of capital should optimize FMO's contributions to development. Past incentives to pursue volume-driven deals with a limited FMO role would basically disappear.

Front-end assessment and monitoring tools thus have been strengthened and brought much more in line with the dimensions on which we also evaluate our projects ex-post. This will thus also benefit the soundness of future evaluations. On the ex-post evaluation side, the improved tools give further guidance to rating outcomes and work quality, and help to more efficiently evaluate the relatively straightforward projects. This creates capacity to do more in-depth (and on the ground) evaluations of projects that are rich in lessons of experience, or that are highly relevant to FMO's strategic focus. For improved strategy relevance, we will also carry out evaluative studies in areas that have remained relatively underexposed in our regular program of project evaluations, but that are of special interest for current business. Examples are the effectiveness of FMO's efforts in the area of sustainability, and projects relating to housing development, a new strategy focus sector in which FMO only has limited and relatively recent past experience.

Response of FMO's Management Board

To : Supervisory Board

From : Management Board

Re : Management Board Reaction to the Annual Evaluation Review

We are pleased to present you the report “Good Times, Bad Times and Development Effectiveness” – the Annual Evaluation Review 2008/9 – from our internal Evaluation Unit. The report presents the evaluation findings of the 2003 vintage of investments financed by FMO. As Management Board, we welcome the conclusions and findings, which show that both development and financial outcomes continue to be strong. This and other Review findings are very encouraging and provide support for the choices that were made last year when formulating the new strategy for the period 2009 – 2012, in particular the focus on the financial, energy and housing sectors, sustainability and low income countries. At the same time, it should be recognized that the long running positive economic cycle in emerging markets has also been a major contributing factor to the good results. As we all know this has abruptly changed in the second half of 2008 and will become visible in both development and financial outcomes in future Reviews.

It is very gratifying to see that the 2003 vintage of projects financed by FMO for its own account, has generated again a high 83% success score in terms of development impact and the highest financial outcome success rate ever with 85%. Furthermore, it is noteworthy that of the 2003 projects none scored an entirely unsatisfactory investment return, while a record 12% generated excellent returns. Another interesting finding of the Review is that evaluation of Government fund financed projects over the period 2001 - 2003 confirm our ex ante assessment that their failure rate is much higher than for FMO financed projects, but at the same time the proportion of highly developmentally successful projects is higher than for FMO. FMO financed projects are typically more concentrated in the moderately successful classes of development outcome. In terms of investment outcome, less than 50% of Government fund investments were evaluated as having a good result, underscoring that the risk profile of these investments is such that they are not normally bankable projects.

One important critical note in the Review concerns the finding that there is room for improvement in the quality of FMO's work, in particular credit monitoring and follow up on sustainability improvement plans with clients. Especially in the present economic downturn, credit monitoring is crucial and steps have already been taken by management during the second half of 2008 to intensify attention to existing clients when it became clear that the crisis was spreading to emerging markets. With respect to sustainability, the new strategy has made this a focal point for the years to come, so that progress in this area should also be forthcoming.

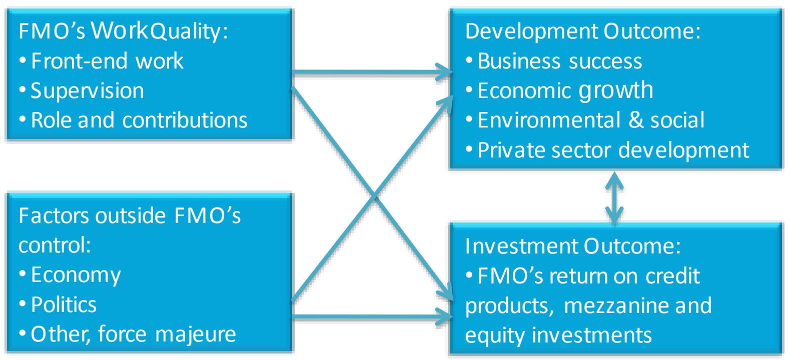
With respect to the current global economic crisis, we concur with the Review's conclusion that DFI's like FMO have a special role to play to keep financial flows to developing countries going where commercial parties are withdrawing. At times like this, DFI's are very additional and through careful selection can finance clients that generate high development returns. It also makes it possible for DFI's to improve their risk reward profile by negotiating performance related rewards with clients, thereby sharing in the returns when their crucial and high risk support help clients to overcome the crisis, and emerge all the stronger from it.

When reading and interpreting the findings of the Evaluation Review, it should be kept in mind that these are based on individual project findings and a specific evaluation methodology, that do not necessarily cover all relevant aspects of our operations. For example, when calculating the financial returns for FMO, transaction costs are not taken into account, creating to a certain extent a relative bias. Furthermore, important portfolio aspects such as risk diversification and dynamics over time, are not taken into account.

Next to enabling us to being accountable to our stakeholders, our Annual Evaluations remain an important source of knowledge for a continuous learning organization such as FMO. For that we very much appreciate the work of our independent Evaluation Unit.

Annex 1: FMO's evaluation framework and approach

Project evaluations are essential to FMO's being able to account for its development achievements. While expected outcomes receive increased attention in the project selection and approval proves (see section 3.3 of this report), ex-ante assessments need to be supplemented by ex-post evaluations. Projects are evaluated five years after approval (or earlier when terminated before then). In 2008, we evaluated a 50% representative stratified sample of projects for which financing was approved in 2003.
FMO's evaluations follow – to the extent feasible for an institution of FMO's size - the methodology prescribed by the Good-Practice Standards for Evaluation of Private Sector Investment Operations (developed by the Multilateral Development Banks' Evaluation Cooperation Group – MDB-ECG). As illustrated below, FMO's project evaluations assess (1) projects' development outcome, (2) FMO's investment outcome and (3) the quality of FMO's work in relation to the project.



Under development outcome, we separately assess the financed activity's business success (direct value added generated), its contribution to economic growth and improvement of living standards, its sustainability outcomes, and its contribution to broader private sector development. Under investment outcome, the project's contribution to FMO's (or a government fund's) financial continuity is assessed. Finally, we evaluate the quality of FMO's work in relation to the project, in terms of front-end work (was the project well conceived and structured), monitoring and supervision, and in terms of FMO's role (additionality, catalytic effects and contributions to the client's performance). For all three dimensions, sub-elements are scored on a four-point scale (from unsatisfactory to excellent). The overall development outcome is rated on a six-point scale (from highly unsuccessful to highly successful).

Draft project evaluations are prepared by investment staff who best know the client and the project. The draft evaluations are assessed critically and independently by staff of the evaluation unit, who finalize the evaluations after discussing them with relevant investment staff members.

Objectivity is strengthened by the use of evaluation guidelines, indicating when to apply which evaluation scores. These guidelines may be obtained from the evaluation unit (evaluation@fmo.nl). The evaluation unit assesses draft evaluations after studying the project and its history. In most cases, this involves desk research of the project file (approval and monitoring documents, etc.) and consultation of secondary sources (internet search, sector studies, etc.). In some instances, on-site evaluations are carried out.