FMO
Entrepreneurial Development Bank

PRIVATE-EQUITY FUND EVALUATION (2008 – 2018) – Summary

INTRODUCTION

SCOPE AND METHODOLOGY

This report summarizes the findings and recommendations of a recent evaluation of FMO fund investments.[1] It assessed the development results of mature investments in Private-Equity Funds of vintage years 2008-2013. The evaluation also discussed strategic and investment trends of more recent vintage years 2014-2018 to add a forward-looking perspective to the assessment. The scope of the evaluation excluded the assessment of FMO's direct investments (i.e. co-investments, direct equity).

The scant data available in FMO on jobs, growth, and other fund development impacts did not allow to make meaningful quantitative analyses based on statistically significant samples. Therefore, development impacts were assessed qualitatively and / or based on research available in the literature reviewed.

The assessment centered on general-purpose and sector-purpose funds where FMO committed its own funding i.e. FMO-A (EUR 2.6 billion; 84%; 113 investments), as well as on those smaller funds where FMO committed concessional funding[2] (EUR .5 billion; 16%; 52 investments), hereafter referred to as Government funding i.e. AEF, IDF, and MASSIF funds.

The evaluation methodology is limited to a desk review of FMO’s strategies, project documents (CIP, FP, Annual Reports, Impact Card, Scorecard), and earlier FMO evaluation reports, as well as to interviews of operational staff and of other internal key informants. Therefore, from the outset, the evaluation approach excluded contributions from external key informants and / or consultants.

Though the evaluation was conducted inhouse, its analysis was complemented with a limited literature review of external research and considered findings from external evaluations where relevant (e.g., to triangulate information; when FMO data was not available).

INVESTMENT PROGRAM

Overall, the analysis of commitments and portfolio for both FMO-A and Government funding over the review period points to a decreasing emphasis on fund investments (particularly, on general-purpose funds) (Figure 1), as well as to the switching of the regional focus to Africa and the World.

Annual commitments of FMO-A funding peaked in 2016 and they have decreased since then, with commitments to the Financial Institutions sector experiencing the most significant decline. In 2008-2018, 42% of the FMO-A funding was committed to General-Purpose funds (EUR 1.1 billion), 26% to Financial Institutions funds (EUR 667 million),

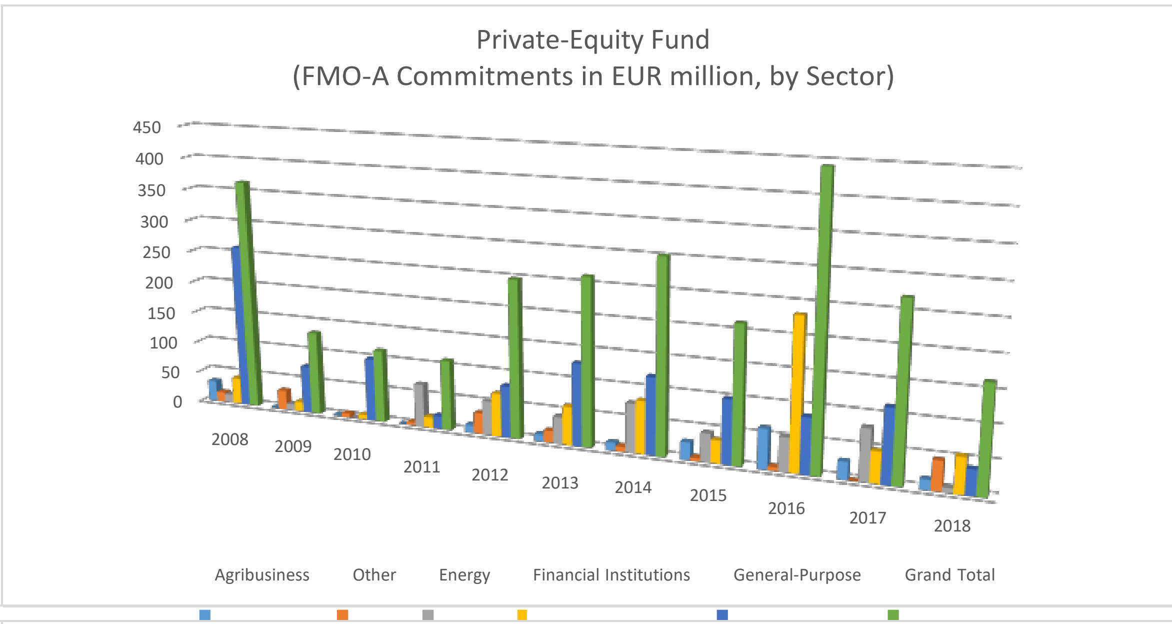
[1] *“Private-Equity Fund Evaluation (2008 – 2018) – Focusing FMO fund investments on the 2030 agenda: The Sustainable Development Goals”*, FMO, June 2019.

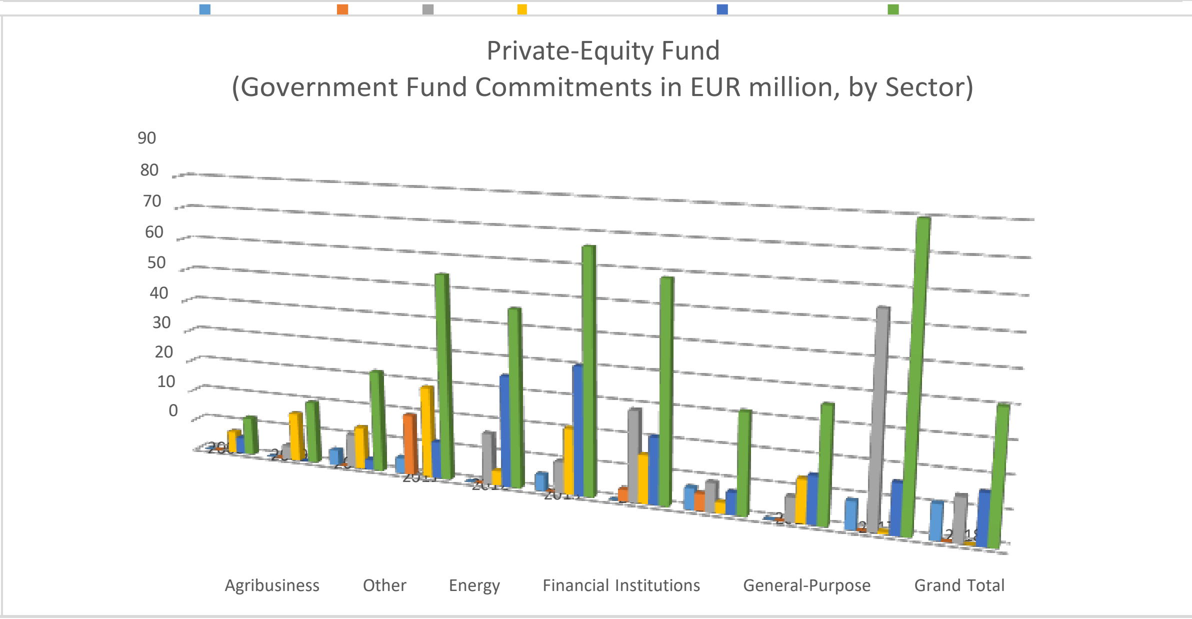
[2] Investment Funds managed by FMO N.V. on behalf of a public entity, such as a government or a (publicly funded) multilateral institution. These funds are expected to bridge a financing gap of young but promising businesses in emerging economies. Commercial and sovereign wealth funds typically find these business to be too risky.

17% to Energy funds (EUR 450 million), 8% to Agribusiness funds (EUR 204 million), and 7% to Other funds (EUR 176 million).

Meanwhile, annual commitments of Government funding peaked in 2017 and they have decreased since then, with commitments to the energy sector experiencing the most significant decline. In 2008-2018, 32% of the Government funding was committed to General-Purpose funds (EUR 169 million), 31% to Energy funds (EUR 165 million), 23% to Financial Institutions funds (EUR 123 million), 8% to Agribusiness funds (EUR 42 million), and 5% to Other funds (EUR 28 million).

Figure 1 - Private-Equity Fund Investment, FMO-A and Government Funding (Commitment, by Sector)





Source: FMO data

Since 2016, the regional focus of the annual commitments of FMO-A funding switched to Africa and the World (from LAC and ECA). Starting from a low base in 2015, ECA was the only region with an upward trend in annual commitments. In 2008-2018, 38% of FMO-A funding was committed to Africa (EUR 1.0 billion), 37% to Asia (EUR .96 billion), 10% to Latam (EUR 266 million), 9% to ECA (EUR 241 million), and 5% to the World (EUR 132 million). Over the same period, 10% of the FMO-A funding was committed to countries in the European Neighborhood.[3]

Since 2015, the regional focus of annual commitments of Government funding has been on Africa and the World, and to a much lower extent also on ECA. In 2008-2018, 43% of Government funding was committed to Africa (EUR 228 million), 25% to the World (EUR 134 million), 19% to Asia (EUR 102 million), 8% to Latam (EUR 43 million), and 4% to ECA (EUR 20 million). No Government funding was committed to countries in the European Neighborhood.

Current trends create expectations of greater potential for Private-Equity Fund investments going forward, including the *"Operating Principles for Impact Management"*.[4] Impact-fund investing has gained prominence as an approach to investment with the intent to contribute measurable positive social or environmental impact, alongside a financial return. While not all fund investments would have equal impact, continued development of the industry would improve the prospects for achieving the Sustainable Development Goals (SDGs). This growing market provides opportunities for FMO to help overcome the uncertainty of non-impact investors on the potential for commercial returns of impact fund investment, build common standards covering what it means to manage for impact, improve the comparability of measured impacts across fund managers, and engage with governments to make the business environment more conducive to such fund investment.

Therefore, the study formulated the following recommendations for FMO.

RECOMMENDATIONS FOR FMO

The three recommendations for FMO (i.e. A.1.- A.3.; B.1. - B.3.; C.1. - C.3.) and the findings that underpin each of them are summarized in the following paragraphs.

A. FORMULATE A STANDALONE STRATEGY FOR FUND INVESTMENT (A.1.; A.2.; A.3.)

> ***A.1.*** ***Formulate a standalone strategy document for funds that reconciles clearly and realistically the directions of the FMO Strategy 2025 with (i) the unique indirect characteristics of fund investments (indirect, sector agnostic), (ii) the development priorities of the target countries of operation, and (iii) the Operating Principles for Impact Management.***

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The evaluation reviewed the strategies formulated by the Private-Equity department. It found that the department strategies discussed indistinctly their three types of investments i.e. funds, co- investments, and direct equity.

[3] I.e. Morocco, Algeria, Tunisia, Libya, Egypt, Jordan, Lebanon, Syria, Turkey, Georgia, Armenia, Azerbaijan, Moldova, Ukraine, Belarus.

[4] To which FMO was one of its first adopters (April 12, 2019) - https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Impact-investing/Principles/

Therefore, and based sometimes on assumptions, the evaluation sought to identify the Private-Equity Fund strategies over the review period:

- Between 2008 and 2016, the fund strategy aligned well with the fund strategies formulated by other bilateral and multilateral Development Finance Institutions (DFIs). Fund investment was described as a contributor of significant multiplier[5] and diversification effects. FMO was expected to play a role as anchor investor, to supply needed financing, to build environmental, social and corporate governance capacity in fund managers (both experienced and first-time managers), and to build capacity in investee companies in low-income and lower-middle-income countries.
- Since 2017, the fund strategy de-emphasized the Financial Institutions sector and articulated more expectations for funds. Among others, it added a distinguishing impact on SDG 8 (Decent Work and Economic Growth), SDG 10 (Reduced Inequalities), and SDG 13 (Climate Action); sector focus on agribusiness and energy; and regional focus on Africa, Asia and the circle around Europe. It also articulated expectations of contributions to capital market development, SDG 2 (Zero Hunger), SDG 5 (Gender Equality), SDG 7 (Affordable and Clean Energy), and SDG 17 (Partnerships for the Goals).

These added strategic expectations are both challenging the traditional role that fund investment has played in FMO and the current organization of its private-equity fund investments, which had been designed to implement the less demanding strategy of 2008-2016.

Moreover, the fund strategies do not yet fully consider the financing challenges of firms in each target country of operations. DFIs have the potential to tailor their strategies to the contexts of the countries on which they focus, so that these firms can continue to compete effectively when new investments are too large and costly to be financed internally.[6]

Additionally, the focus of the strategy since 2017 on the most challenging regions and countries makes the expectation of developing capital markets harder to achieve. It becomes more difficult and often not possible to exit fund investments via initial public offerings (IPO) in these regions and countries. In discussions with colleagues in the Private-Equity department, they agreed ultimately that the strategic expectation may be downgraded to the provision of some support to M&A activities in these countries.

A.2. ***Maximize in this standalone strategy document the potential of funds for increasing FMO's portfolio diversification and multiplier effects, for delivering financial and non-financial additionality, and for achieving development impacts in terms of the SDGs focused by the FMO Strategy 2025 (meanwhile, reconciling the trade-offs intrinsic to these SDGs).***

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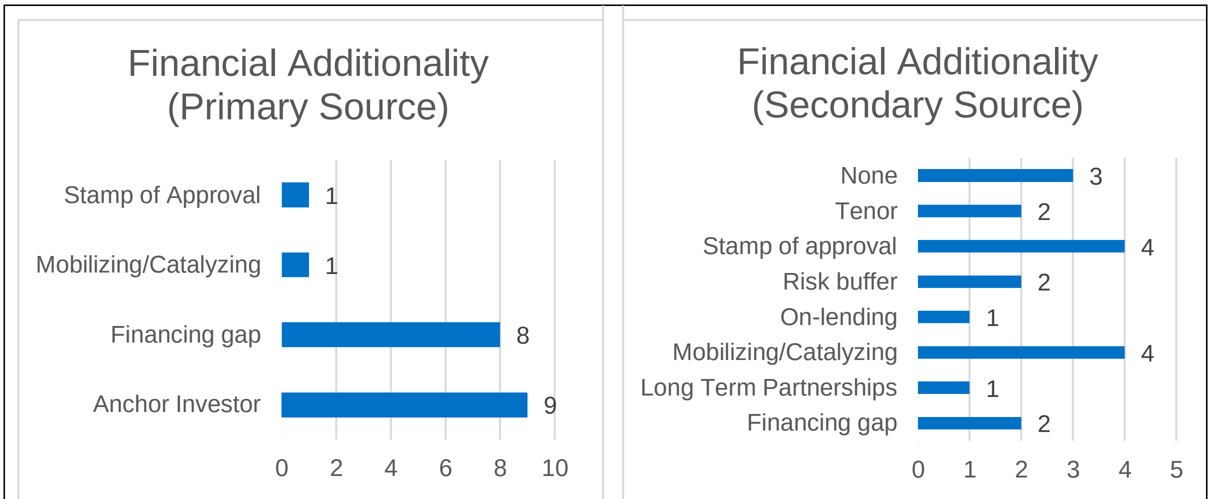
[5] Defined as a fund typically investing in 5-15 companies and enabling them to attract more debt.
[6] I.e. with their own capital.

Going forward, FMO may not be taking full advantage of the multiplier and diversification effects of its traditional investments in general-purpose funds. According to literature reviewed and the fund strategy of the 2008- 2016s, general-purpose funds have helped FMO and other leading DFIs to achieve significant multiplier and diversifying effects. However, the fund strategy since 2017 calls FMO to focus its investments instead on agribusiness and renewable energy. Furthermore, FMO has followed through this strategy by shrinking since then the size of the FMO-A general-purpose fund portfolio.

The ex-ante substantiation of financial additionality was weak in the Financial Proposals (FP) reviewed by the evaluation. The evaluation purposively sampled the most recent investments approved in 2018-2019 to ensure that they represented the current ex-ante focus of FMO on financial additionality. It found that the *"Primary Source"* and *"Secondary Source"* boxes of financial additionality were ex-ante checked systematically in the FPs (Figure 2). However, the evaluation could not find written records of the specific efforts made to demonstrate these additionality claims.

Figure 2 – Financial Additionality (Primary and Secondary Source)



Source: FMO FP data – Sample of 19 fund investments that applied for Green or RI label in Jan 2018 – May 2019. These were purposively sampled to ensure that they represented the current ex-ante focus of FMO on financial additionality.

Like other bilateral and multilateral DFIs, FMO typically plays a larger role than that of a mere Limited Partner (LP) with its investments in Private-Equity Fund Investments (a.k.a. non-financial additionality). FMO claims to build ESG capacity in fund managers and investee companies in all its A and B risk-category investments.

The ESG reports made available by the private-equity team provided evidence that FMO staff jointly with all fund managers of A and B risk-category investments conducted ESG diagnostics, identified areas for improvement,[7] and agreed on plans to address these areas of improvement, including specific actions and timelines.

However, the *"ESG Additionality"* box in the FPs reviewed was checked ex-ante as *"Yes"* in only about 50% of the cases of A and B risk-category-fund investments (Figure 3). This may be due to bad documentation of the FP

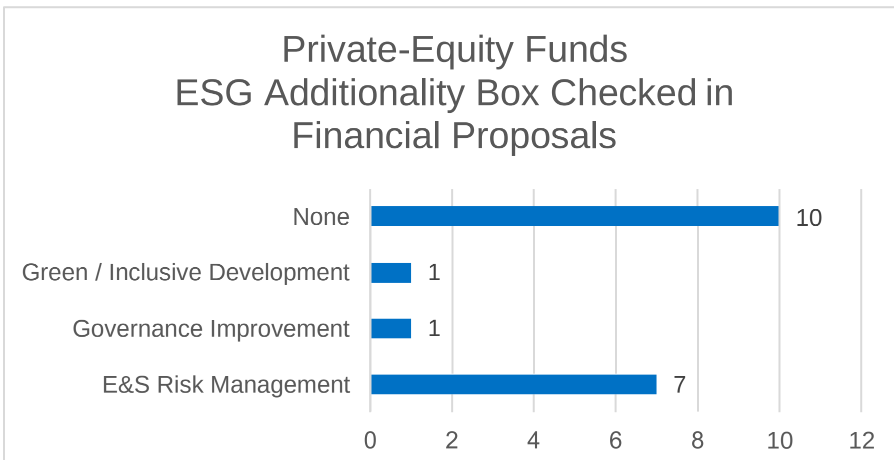
[7] E.g., ESMS, staffing, investee risk categorization, monitoring, training, legal agreements, consultants/staff terms of reference.

deliberations; and / or that ESG aspects are considered only after investment agreements are signed; and / or that current ESG guidance requires further refinement and / or dissemination.

Additionally, according to staff interviewed by the evaluation, FMO built capacity in a limited number of first-time managers. However, the evaluation could not find evidence of these capacity-building efforts, because they were not systematically tracked and reported. Typically, FMO was expected to transfer knowledge and expertise to first-time managers via business interactions with its experienced investment staff, and / or in industry learning events which FMO helps to coordinate.

Nonetheless, earlier FMO evaluations[8] provided mixed views about the potential impact of working with first-time managers. One evaluation recommended engagement with first-time fund managers to increase potential for co-investments and additionality. The other evaluation suggested more focus on experienced fund managers with enough country knowledge and / or on fund managers with local teams and relevant experience in SME fund portfolios.

Figure 3 – Environmental, Social, and Corporate Governance



Source: FMO FP data – Sample of 19 fund investments that applied for Green or RI label in Jan 2018 – May 2019. These were purposively sampled to ensure that they represented the current ex-ante focus of FMO on ESG additionality.

Going forward, the focus on the agribusiness and renewable energy sectors articulated by the strategy since 2017 may hinder the strategy's expectation of achieving distinguishing impact on the SDGs. Literature reviewed for the evaluation provided evidence that private-equity fund investments contribute positively to the SDG 8, SDG 10, and SG 13 when they additionally focus on the following array of sectors and activities:

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[8] *"Going public on FMO's private equity - FMO-A private equity evaluation by IMR"*, J. Horsten, FMO, 2011; *"Evaluation of the performance of FMO's SME Fund portfolio"*, M. Jansen, FMO, 2012.

SDG 8 – Decent Work and Economic Growth:

- **Education, transport infrastructure, and social protection sectors.**
- **Inclusive Business in Food and Beverage, Infrastructure, Healthcare, Education, and Financial Services.**

SDG 10 – Reduced Inequalities:

- **Health, education, water and sanitation, and social protection sectors.**
- **Inclusive Business in Food and Beverage, Infrastructure, Healthcare, Education, and Financial Services.**

SDG 13 – Climate Action:

- **Health, agriculture and food security, energy, water and sanitation, transport infrastructure, telecoms, and ecosystems sectors.**

Likewise, the focus on the agribusiness and renewable energy sectors articulated by the strategy since 2017 may hinder the strategy's expectation of achieving FMO's sector leadership in Zero Hunger (SDG 2), Gender Equality (SDG 5), and Affordable and Clean Energy (SDG 7). The literature reviewed by the evaluation found evidence that private-equity fund investments contribute positively to these SDGs when they additionally focus on the following array of sectors and activities:

SDG 2 – Zero Hunger:

- **Health, agriculture and food security, energy, transport infrastructure, and social protection sectors.**
- **Inclusive Business in Food and Beverage, Healthcare, and Financial Services.**
- **Reducing food waste in value chain; forest ecosystem services; low-income food markets; product reformulation; technology in large-scale and smallholder farms; sustainable aquaculture; restoring degraded land; cattle intensification; and urban agriculture.**

SDG 5 – Gender Equality:

- **Health, education, water and sanitation, and social protection sectors.**
- **Inclusive Business in Healthcare, Education, and Financial Services.**

SDG 7 – Affordable and Clean Energy

- **Health, education, agriculture and food security, and energy sectors.**
- **Inclusive Business in Infrastructure.**
- **Expansion of renewables, energy efficiency in energy intensive and non-energy intensive industries, energy storage systems, energy access, and grid interconnection.**

In addition, and regarding SDG 5, both the unavailability in FMO of comprehensive gender information at investee-company level and the literature reviewed by the evaluation hint of an untapped potential for FMO funds to further support gender impacts. According to a recent report[9], these are further suggested actions that LPs and General Partners (GPs) can implement to advance gender equality in the industry:

- LPs (such as FMO) can adopt standardized due diligence questions on policies and initiatives (e.g., the ones of the Institutional Limited Partners Association Due Diligence guide); establish goals for GPs to provide sex-disaggregated data on women in their funds and portfolio companies; increase the proportion of capital allocated to gender balanced investment teams; and invest only in GPs with gender diverse teams.
- GPs (which FMO can influence) can set and communicate ambitious gender diversity goals to demonstrate commitment; collect the necessary data to assess progress toward gender diversity against short-term targets; make senior leadership accountable for progress towards gender diversity goals and targets; affirm the GPs' commitment to diversity at the time of investment; actively pursue gender-diverse talent for portfolio companies; provide guidance and feedback on best practices in achieving better gender diversity outcomes.

A.3. ***Choose strategic objectives in terms of sectors, fund sizes, and regions / countries in order to optimize the portfolio's additionality and financial / development results. A more transparent strategic approach to fund investing would send clearer signals to the players in the impact-fund market, consequently increasing the FMO's reliability and attractiveness as "preferred partner" of choice.***

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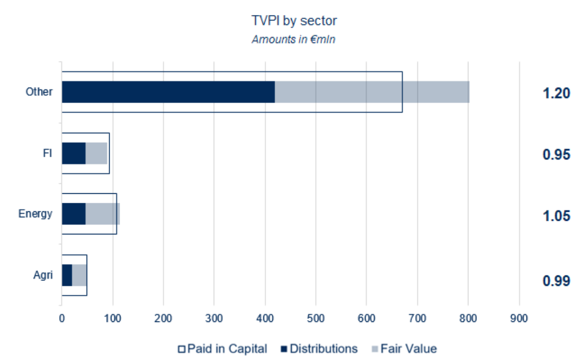
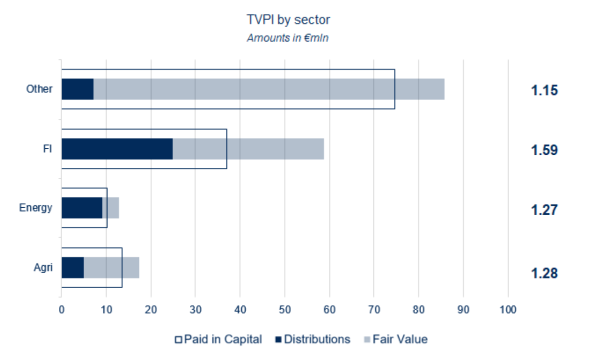
The evaluation discussed financial results in the context of the choices articulated by the strategy since 2017 in terms of sectors, fund sizes, and regions / countries. These choices may constrain the delivery of additionality and development impact going forward.

First, the strategy since 2017 calls FMO to focus its FMO-A funding on the Agribusiness and Energy sectors, which have typically achieved lower TVPIs than general-purpose funds (Figure 4).

[9] *"Moving toward gender balance in private equity and venture capital"*, Oliver Wyman, IFC, 2019.

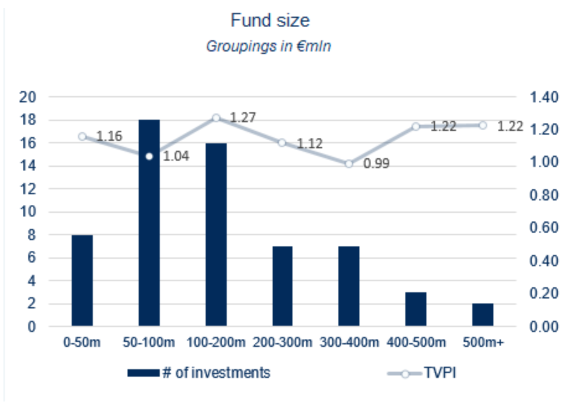
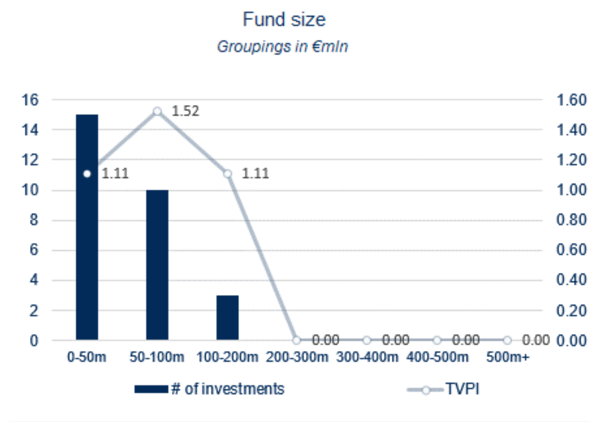
Figure 4 – Private-Equity Funds Profitability, by Sector (2008-2013).

FMO-A Funds	*Government Funds*
	
Source: FMO analysis.	*Source: FMO analysis.*

Second, the strategy since 2017 calls FMO to focus its FMO-A funds in size ranges smaller than EUR 100 million and between EUR 100-500 million. However, over the review period, FMO has traditionally achieved below-average TVPIs in these two fund-size ranges (Figure 5):

- < EUR 100 million (FMO-A funding with first-time managers) (green and inclusive business): These types of funds achieved the lowest financial results in the current portfolio (TVPI of 1.04).
- EUR 100-500 million (FMO-A funding considered "sweet spot" for co-investment): These types of funds achieved average financial results in the current portfolio (TVPI of 0.99-1.27).

Figure 5 – Private-Equity Fund, by Investment Size, Number of Investments, and TVPI (2008-2013)

<table>
<tr><th>FMO-A Funds</th><th>Government Funds</th></tr>
<tr><td>
</td><td>
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<tr><td>Source: FMO analysis.</td><td>Source: FMO analysis.</td></tr>
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Third, the department's assumption of a higher profitability of direct private-equity investments deserves a review. Based on this assumption, the private-equity department strategy sets out to reduce the share of fund investments in the private-equity portfolio from 60% to 40% by 2025. However, the TVPIs as calculated by the Private-Equity department for funds, co-investments, and direct equity are not fully comparable, because they do not always account for all fee and overhead costs involved by each type of investment.

According to the most recent department report, the entire Private-Equity portfolio achieved a TVPI of 1.33, which would mean a TVPI of 1.63 for direct equity, a TVPI of 1.28 for co-investments, and a TVPI of 1.20 for funds. However, these TVPIs were not calculated in the same manner because:

- The TVPI calculated for funds includes fund-managers' fees.
- The TVPI calculated for co-investments includes neither fund-managers' fees nor management costs. This regardless that the recent strategy since 2017 points to a large fund portfolio as the means to obtain co-investment opportunities (i.e. a 10% hit ratio).
- The TVPI calculated for direct equity does not include management costs though it requires substantial investment in talent, governance, and investment processes.

The entire discussion in this section about the financial implications of several strategic choices should be considered with caution. This is because FMO currently has financial data limitations, according to staff interviewed by the evaluation. They have reported that the financial information currently available does not allow FMO to assess the underlying reasons for the performance of the portfolio, as data may not be available about the local currency movements. Therefore, the links between strategic choices and financial results discussed above should be better used as an example of the type of strategic analysis that FMO should conduct to formulate its fund strategy once data limitations are fixed. Therefore, assessing and fixing any financial data limitations should be a priority.[11]

B – ALIGN THE ORGANIZATION WITH THE STANDALONE FUND STRATEGY (B.1.; B.2.: B.3.)

B.1. ***Optimize the allocation of investment, environmental, social, and corporate governance staff to business development and portfolio management, seeking to align it with: (i) the growing demands imposed by the standalone strategy document for fund investment (Recommendation A); and (ii) an aging and low TVPI fund portfolio.***

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The added expectations for the funds articulated by the strategy since 2017 and the aging fund and low TVPI portfolio (which would be expected to demand stronger supervision) challenge FMO's current private-equity organization. This is because it had been designed to implement the less demanding strategy of 2008-2016 and to supervise a younger fund portfolio.

First, the current allocation of staff to managing fund investments is thin. The evaluation triangulated rough estimate points of the ratio of portfolio & pipeline deals to the number of investment staff assigned to manage these deals (Table 1). The estimate points for the Private-Equity department are about 50% higher than those calculated for the Financial Institutions department, and higher than any of the private-equity comparators reviewed. Contrary to the general expectation, these estimates would imply that debt portfolio management would demand more staff than private-equity portfolio management.

Table 1 – Three Estimate Points of the Ratio of Clients and/or Portfolio & Pipeline Deals to the number of Investment and E&S Staff

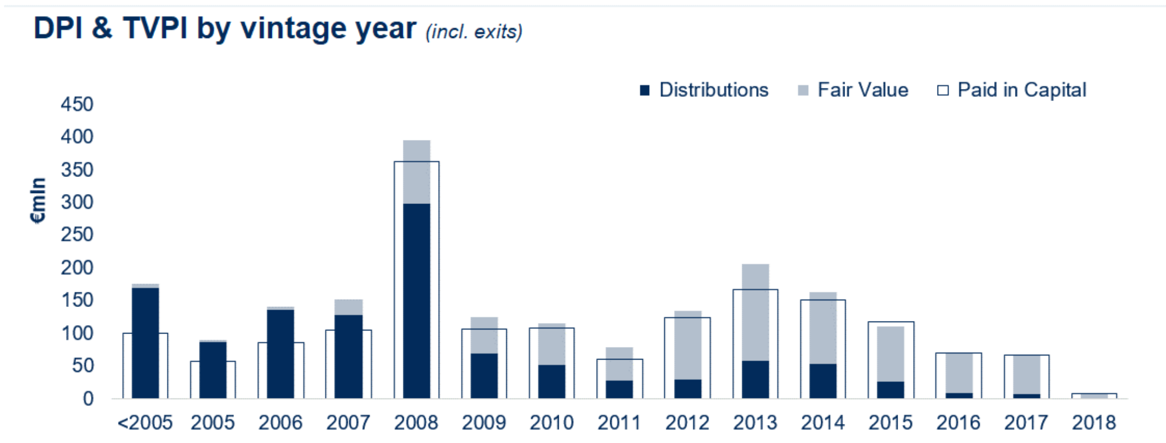
ESTIMATES	***RATIOS***
Joint Analysis Private-Equity and Stakeholder, Strategy and Knowledge Management departments	5.8 - 6.6 clients / total FTEs (*) (7.0 - 8.2 if analysts are excluded).
Two Comparators from Literature Reviewed by the Evaluation (BCG, DFIs)	2 clients / FTE in a typical Private-Equity firm (in addition to business development).
	Typically, 4.5 clients & leads / FTE.
Evaluation Estimate (December 2018)	9 clients & leads per investment staff (*) (16.2 if analysts are excluded, according to Management in the Private-Equity department).
	54 clients & leads / FTE E&S specialist (*)
Note: (*) Assuming that analysts and E&S Specialists support investment staff throughout the entire investment cycle.	

[10] Notwithstanding, the FMO Annual report 2018 presents the *Key Observations* from the external auditor on valuation of equity investments at fair value: *"We are satisfied that the fair value of the equity investments is properly determined and concur with the related disclosures in the financial statements."*

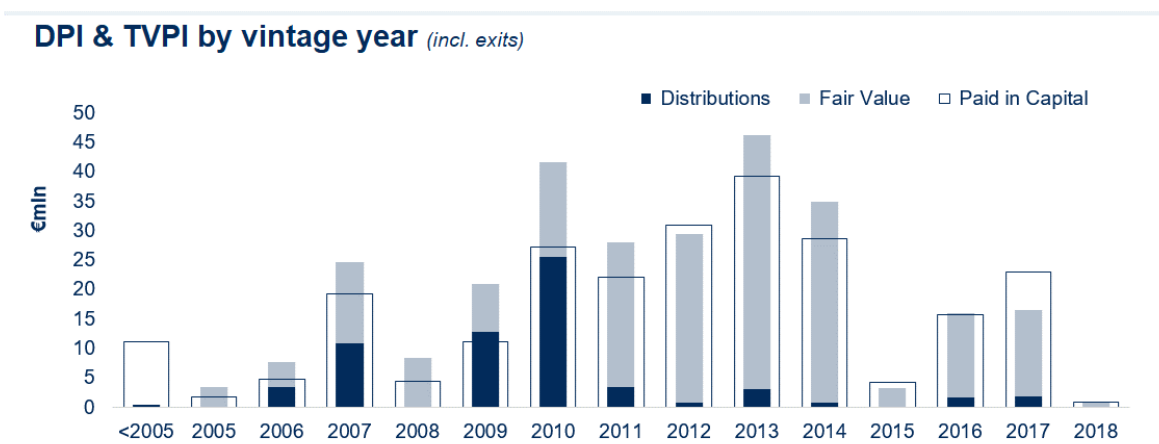
Second, a trend analysis of the multiples Distributions to Paid in Capital (DPI) and Total Value to Paid in (TVPI) of FMO-A and Government funds signals aging FMO-A and the Government portfolios. This aging effect is less significant in the former (84% of commitments) than in the latter (16% of commitments). This happens because of: (i) significant unrealized gains in funds of vintages older than the expected ten-year life; (ii) smaller distributions of funds of vintages older than five years; and (iii) lower TVPI of funds of vintages of 2009 and newer (Figure 6).

Figure 6 – Private-Equity Funds' DPI and TVPI by vintage year (FMO-A and Government Funds)

FMO-A



Government Funds



Source: FMO analysis.

***B.2.* Sustain stronger support for innovation in terms of products (e.g., venture capital), delivery mechanisms (e.g., asset-management company models), and the corporate priorities focused by the FMO Strategy 2025.**

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Innovation in terms of delivery mechanisms and market segments can potentially enhance the FMO capacity to focus equity investments on specific FMO strategic priorities. This capacity is not always available in fund investments, which lend themselves more appropriately to serve as general-purpose investment vehicles.

For example, ARISE may bring useful lessons, though it is not technically a Private-Equity Fund. ARISE is an investment platform jointly owned by Norfund, FMO, and Rabobank which focuses on building strong financial service providers in Africa serving SMEs, the rural sector, and clients who had no earlier access to financial services. Therefore, it allows FMO to channel funding into a specific strategic sector.

Other bilateral and multilateral DFIs have tested other approaches with similar intents. They include several versions of asset-management companies and / or non-banking investment subsidiaries (particularly important in the context of Basel IV), as well as venture capital (or even earlier stage capital) focused on innovation and the new economy (e.g., technology, Fintech, circular economy).[12]

***B.3.* Reconsider risk capital allocation and ex-ante job estimation policies aiming at tailoring them better to the unique characteristics of fund investments, which by nature are an indirect financial vehicle with strong diversification and multiplier potential.**

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The risk and impact factors assigned by FMO appear to penalize fund investments. FMO assigns to fund and direct equity investments the same risk capital allocation factor (i.e. 150%, 8%/100 Euros) and the same job estimation factor (i.e. 200%, Impact Model[13]). This despite the typical rationale for fund investing being diversification and multiplier effect.

Going forward, this may become more critical as the expected change in banking regulation (Basel IV) could potentially lead to risk capital allocation factors in the range of 250-400% (depending on the ultimate definition accepted for debt). For example, the upcoming banking regulation would likely increase the cost of investing in infrastructure assets globally.

C – IMPROVE RESULTS MEASUREMENT AND FEEDBACK LOOPS TO FUND STRATEGY AND OPERATIONS (C.1.; C.2.; C.3.)

***C.1.* Grounded in economic research, develop transmission channels[14] between fund investing and the objectives of the standalone strategy for fund investment (Recommendation A).**

[11] There is also currently a proliferation of products and financing structures that are starting to offer investors greater ability to pick specific types of exposures including secondary funds, longer-term vehicles, and capital call lines of credit.

[12] https://www.fmo.nl/l/library/download/urn:uuid:d85800f8-607a-4118-bb7a-059392b8c869/fmo+impact+model+%26+methodology.pdf

[13] Economic transmission channels are the routes via which funds are likely to contribute to development impact objectives.

***C.2.* To underpin these transmission channels, define scope, assign leadership, and set in motion an initiative aiming at designing and implementing a results framework (e.g., associated to the "look-through" project) including relevant, complete, and good quality metrics, benchmarks with peer DFIs and impact investors, and evaluations at fund and investee-company levels.**

***C. 3.* Ensure that evidence of financial and development results feeds back into fund and corporate strategies.**

FINDINGS

There is not enough information available from FMO on development results to fully substantiate claims that Private-Equity Fund investments contribute to the strategy since 2017; however, the literature reviewed for this evaluation provides evidence that funds positively impact investee companies' growth in terms of jobs supported and of other metrics (e.g., revenues, EBITDA, taxes paid).

The development impact data collected by FMO about jobs and growth from funds and investee companies is work-in-progress, the internal responsibility is perceived as unclear by staff interviewed, and there is no comprehensive evaluation plan in place for funds.

Since late 2016, FMO requests fund managers annually to provide the following investee-company information: direct employment, female employment, taxes, installed capacity, power production, GHG avoided, farmers supported, and area of forest under management. A quick check of the data files available shows that this information is only available for some investees, sometimes for one year, and in fewer cases for two years. Therefore, based on data collected, the evaluation could not draw any findings in terms of jobs and growth. Furthermore, the evaluation could not find evidence that the external auditor checks the quality of the data provided by fund managers, and the enforceability of the reporting requirements is weak at best.

Moreover, the responsibility for results measurement and feedback loops to strategy and operations is perceived by the staff interviewed to lie with five departments i.e. Private-Equity; Impact and ESG; Finance, Impact & Data; Credit, Legal & Special Operations; and Stakeholders, Strategy & Knowledge Management. There is no perceived leadership that ensures the relevance, completeness and quality of the development metrics and data collected. This despite that two FMO evaluations[15] had already found evidence that the development impact of SME funds was not possible to be established, since in most instances fund managers had no reporting requirements on development impact indicators such as employment, tax payments, and turnover.

Additionally, the Reducing Inequalities (RI) and the Green labels[16] do not account accurately for all the investments made by fund managers in investee companies.

- The RI label is approved for fund investments if ex-ante at least 50% of their transactions are expected to be made in an LDC country and / or to involve inclusive businesses. The RI label is never revised ex-post when fund managers make the actual investments in investee companies.

[14] *"Going public on FMO's private equity - FMO-A private equity evaluation by IMR"*, J. Horsten, FMO, 2011; *"Evaluation of the performance of FMO's SME Fund portfolio"*, M. Jansen, FMO, 2012.
[15] FMO's proxies for the SDG 10 Reduced Inequalities, and for the SDG 13 Climate Action.

- The Green label is also approved for fund investments if ex-ante at least 50% of their transactions are expected to follow the FMO's "Green Principles". The Green Label is never revised ex-post when fund managers make the actual investments in the investee companies.

According to the staff interviewed, the private-equity department does not plan to expand the "look-through" project to also encompass development impact data. The project was originally designed with two objectives: (i) to comply with financial regulatory reporting requirements in order to seek lower capital reservation level (e.g., country, sector, currency); and (ii) to respond to NGOs' requests that FMO discloses the names of the investee companies of its fund investments. However, the disclosure of investee-company names may not always be compatible with the confidentiality agreements that link FMO and fund managers. Alternatively, FMO could consider disclosing development impact metrics at fund level, as this information may be more relevant for external disclosure.

Management Response by PE jointly with RISK, IESG, CLS and FID

EVALUATION RECOMMENDATIONS	MANAGEMENT RESPONSE
A1. ***Formulate a standalone strategy document for funds that reconciles clearly and realistically the directions of the FMO Strategy 2025 with (i) the unique indirect characteristics of fund investments (indirect, sector agnostic), (ii) the development priorities of the target countries of operation, and (iii) the Operating Principles for Impact Management.***	**PE: Agree to improve** FMO does invest in Funds. This strategic choice, reasoning and focus is laid down in different strategic documents (word documents and power point presentations) and not laid down in one strategic document. Aside of these documents there is a strong knowledge within the team how to diversify the portfolio such that we have good diversification of funds and investments in FMO's markets. In 2020 PE will lay down its Fund Strategy in a separate Strategic document covering the reasoning for Fund Investments making a clear distinction between the source of Funding available (State Funds – FMO-A) and objectives. In our strategy document we will consider the recommendations made.
A2. ***Maximize in this standalone strategy document the potential of funds for increasing FMO's portfolio diversification and multiplier effects, for delivering financial and non-financial additionality, and for achieving development impacts in terms of the SDGs focused by the FMO Strategy 2025 (meanwhile, reconciling the trade-offs intrinsic to these SDGs).***	**PE**: **Ongoing and help required** Incorporating the *"Operating Principles for Impact Management"* does require us to improve the ex-post impact measurement of our investments made by the Funds which does need further development of data collection. The implementation of *"Look through"* functionality in FIA will contribute to this data collection capability.
A3. ***Choose strategic objectives in terms of sectors, fund sizes, and regions / countries in order to optimize the portfolio's additionality and financial / development results. A more transparent strategic approach to fund investing would send clearer signals to the players in the impact-fund market, consequently increasing the FMO's reliability and attractiveness as "preferred partner" of choice.***	**PE: To be further clarified in the 2020 Fund strategy document.** As for FMO, the PE strategy as formulated in cooperation with BCG is also aiming to do more direct and co-investments (from 40% direct + co-investments to 60% direct + co-investments). We will also formulate a direct equity strategy document. As co-investments are an integral part of our Fund strategy, we will incorporate the co-investment strategy in the Fund Strategy document.
B1. ***Optimize the allocation of investment, environmental, social, and corporate governance staff to business development and portfolio management, seeking to align it with: (i) the growing demands imposed by the standalone strategy document for fund***	**PE: Agree** We do agree and will consider in the upcoming PE fund standalone strategy document. We foresee in that document an overall approach to manage portfolio and new investments. This will include an expectation on portfolio composition (e.g. size, geographies, number of investees), and the capacity of the FMO's organization required (e.g., staff, procedures, systems).

investment (Recommendation A); and (ii) an aging and low TVPI fund portfolio.	**IESG** Over the next couple of months, we would like to run an exercise in the PE E&S team to better put resources to where we feel are the highest risks (or opportunities). We may change a bit the way we organize ourselves around the PE regions, but we are, more importantly, also trying to identify a better risk identification for category B funds. These issues have been long pending and because of the staff constraints there was never an easy possibility to do more.
B2. Sustain stronger support for innovation in terms of products (e.g., venture capital), delivery mechanisms (e.g., asset-management company models), and the corporate priorities focused by the FMO Strategy 2025.	**PE: Agree** We do involve risk in any new projects being developed. The design of the VC program is such that it does help us in maximizing the return taking the higher risk involved in VC investments. **RM** We would very much like to be involved in sound boarding with PE on potential innovative solutions.
B3. Re-consider risk capital allocation and ex-ante job estimation policies aiming at tailoring them better to the unique characteristics of fund investments, which by nature are an indirect financial vehicle with strong diversification and multiplier potential	**PE: Recognize it as an area for improvement – do need help from other departments** We do recognize the fact that our ex-ante way of defining and focusing on impact investing (RI and Green labelling) is not optimal to come to a selection of fund investing and measuring our real impact. We are open to improve on that, however, do need clear guidance from Credit and IMIR. **RM** We also recognize the diversification effect, however unfortunately, in terms of risk weighting, it is not up to us to determine. Risk weights are added based on standardized regulatory requirements. FMO simply needs to follow the regulations. Lobbying efforts are being made to influence the discussion on the 250% / 400%. The current proposed changes to regulations do however not seem to cater for diversifying between type of PE investments. **FID** As FMO is moving towards portfolio steering, we will have to start ex-post labeling (i.e. checking whether a label is applied correctly during the lifetime of a fund) in 2020. Also, we can apply analysis of the past performance of (predecessor) funds on employment, allowing us to identify those fund managers with better-than-average job impact.

C1. Grounded in economic research, develop transmission channels between fund investing and the objectives of the standalone strategy for fund investment (Recommendation A).	**PE: Agree, need help from other departments** Will be included in 2020 Fund strategy document. **IESG** The impact domain project and the ESG tracker 2 should help analyzing the impact we achieve on the ground with our investee companies. While the IT-related system challenges are big, it is the right step to ensure more granularity at client level about not only what we do (the old SUSTRACK system) but how the ESG risk mgmt. performance at investee level will have improved over time and what impact that (and other non-ESG related activities) achieved.
C2. To underpin these transmission channels, define scope, assign leadership, and set in motion an initiative aiming at designing and implementing a results framework (e.g., associated to the "look- through" project) including relevant, complete, and good quality metrics, benchmarks with peer DFIs and impact investors, and evaluations at fund and investee-company levels.	**PE: Agree, need help from other departments** Will be included in 2020 Fund strategy document, partly based on improved FIA/look through data. **FID** This results framework is part of an FMO wide initiative to embed impact more explicitly in the investment process which will allow for PE Fund specific impact measurement. In addition, we are in the process of a global harmonization effort for impact measurement and reporting. Part of this is a new impact model which will include a project in 2020 to start benchmarking for Jobs and Emissions. We are in conversations with look-through project to find synergies and ensure duplication of work is not happening. Note that it will be important to ensure consistency between FMO's overall results framework and the specifics for PE Funds to ensure continued reporting at the aggregate level.
C3. Ensure that evidence of financial and development results feeds back into fund and corporate strategies.	**PE: Agree, need help from other departments** With the further improvements of FIA, better information becomes available which will be fed into the investment decision making process. We are looking forward to the improvements in measuring development impact and ESG interventions to be developed and implemented by IESG and IMIR.