



FMO Development Impact Report 2013/14
Demonstrating FMO's Development Results through Measurement and Evaluation

*FMO Strategy Department
Development Impact Unit
February 2014*

Note to the reader:

FMO's Impact Report 2013/14 is a concise presentation of the findings from project evaluations and other evaluation-related work carried out by FMO's Evaluation Unit (from 1/1/2014: Development Impact Team) in the course of 2013.

Any opinions and conclusions contained in this report are those of FMO's Development Impact Team and are derived from evaluation findings. They do not necessarily coincide with the views of FMO's Management Board.

FMO's Management Board has expressed its views on the report's findings and recommendations in a Management Response, which is included on page 18 of this report.

Interested readers may obtain further background information from FMO: evaluation@fmo.nl

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I Executive Summary

Highlights

Findings from portfolio-wide ex-post project evaluations

- **Importance of FMO's role at the start of the crisis:** When, in 2008, global capital markets were hit by the credit crisis, FMO still continued to serve its clients and nearly doubled new commitments in equity investments. It also responded to clients' needs by providing support to improve business operations. The financial crisis has highlighted the need for long-term committed financiers like FMO, strengthened our additionality to commercially available finance, and helped FMO play a stronger role.
- **Development outcome trend turns positive:** Whereas the previous evaluation report shows a – business cycle driven - declining trend in development results over a five year period, this tendency has turned. The 2008 committed FMO-A investments scored considerably higher than deals committed in 2007. Almost 70% of the projects financed in 2008 led to favorable development outcomes, which is good performance given the difficult post-crisis period. Energy projects most often showed good performance, both financially as well as from an impact perspective.
- As in previous years **investment outcomes and development outcomes remain highly correlated**. There is a strong relation between development impact and projects' financial returns to FMO. The percentage of projects showing favorable financial outcomes combined with weak development outcomes has increased somewhat in the last years. These projects (mostly loan-financed) have been seriously affected by the financial crisis (FMO client banks with shrinking loan portfolios, corporates - especially in Eastern Europe - facing adverse market conditions) who were still able to meet their debt servicing obligations.
- **Investment outcomes for FMO** have been under pressure for projects started in 2008, in particular for private equity investments (primarily private equity funds). They have been affected by the worldwide pressure on market valuations and reduced exit perspectives. However, these funds have been approved five years ago, and are still in FMO's portfolio. They have just completed – and sometimes extended - their investment period. They were evaluated – based on current fair market valuations - too early, and may well have potential to still generate good financial returns.
- Over the years, the **government funds financed projects** less often generated strong financial and development returns. Their financing is highly additional, as they accept risks on projects that would, without the existence of the funds, be unbankable, even by FMO. As a result, especially projects financed by FOM & IDF showed a higher failure rate. MASSIF recorded higher success rates.

Government fund (impact) evaluation plan

- In 2013, we have started to implement the **Government Funds evaluation plan** that we agreed with the government. The traditional FMO evaluations are supplemented by evaluations of development effects on end-users (indirectly financed SMEs, users of our clients' infrastructure services), and making use of a control group approach. These in-depth evaluations also aim to demonstrate that effects can be attributed to the projects financed by the Funds. The studies are managed by FMO, executed by external academic experts, and advice and quality control are provided by an external evaluation panel.
- An **AEF** effectiveness study of two renewable energy projects in Nicaragua demonstrated that these projects resulted in a **significant reduction of GHG emissions**. More efficient renewable energy models enabled the national government to reduce spending on electricity subsidies (and should thus be bankable).
- A **MASSIF** effectiveness study revealed that six MASSIF-supported Financial Institutes **expanded MSME loan portfolios faster than market trends**. It also concluded that investments in SME private equity funds in India were highly relevant due to capital scarcity faced by local SME companies. The field visits also illustrated the perceived value added of capacity development / training provided to our clients.
- Several **Impact studies** were started in 2013. Two long-term impact evaluations for MASSIF took-off. These deal with the financial and social performance of a microfinance institution and of a fund investing in SMEs. For IDF and AEF, two impact studies have also been initiated.

Other developments in impact measurement and evaluative research

- A **new strategic impact measurement and reporting framework** has been developed to facilitate FMO's doubling impact and halving footprint goal. The developed tools to steer on impact (KPIs) will be made operational in 2014. This framework will facilitate FMO to manage its financing more on impact, and also shows achieved impact of projects in the portfolio, facilitating FMO's external accountability.
- A joint EDFI effectiveness study for SME development through financial institutions in Africa showed that **EDFI financing and support helped the banks' financial strength and sustainability**. However, the 'missing middle' of SMEs may be more effectively targeted, via better alignment of strategies and a more tailor-made product offering by EDFIs.
- We cooperated with FMO's Financial Institutions Department on a **study of FMO financial institution clients that defaulted** or, for other reasons, did not produce good development outcomes. The study brought out that bank failures have, in most cases, been crisis related. Bank financials have limited predictive value with respect to financial or developmental failure, but overly rapid growth is one of the clear warning signals, and strong and committed shareholders are our best insurance. Poor development results of FIs were found to have almost always been the result of poor overall performance of banks.

Recommendations

- **Methods to evaluate projects on E&S need to be strengthened.** More insight is needed in the actual E&S performance of clients after five years, also for clients initially categorised as relatively low risk. In addition to assessing clients' compliance with FMO requirements for E&S risk management, evaluations will increasingly also have to look into projects' realized contributions to green and inclusive development. Environmental/green and social/inclusive performance will have to be assessed and rated separately, as they don't necessarily correlate.
- We still have difficulties to **gain more insights in both the developmental as well as the financial returns of private equity (funds) investments**. Evaluating funds' investment outcomes after five years only is too early. And presenting equity investment outcomes in terms of success rates easily gives a distorted picture, as a high number of equity investments with low returns can be made up for by few investments with high returns. We do, however, still not have good equity investment IRR data by vintage year. For a better assessment of PE funds' development outcomes, more impact indicator and performance monitoring at the level of funds' investees remains crucial. This has been signaled before, but still needs further follow-up.

II Introduction

After a year of transition into FMO's new strategy, aiming for FMO to become the leading impact investor by doubling impact and halving footprint, the Evaluation Unit, which had been part of the Investment and Mission Review Department, has per 1 January 2014 been transformed into a Development Impact Team, which is part of a newly formed Strategy Department.

Reporting results of our portfolio-wide evaluation program

As in previous reports, we continue to report the trends and patterns emerging from our annual program of portfolio-wide ex-post evaluations of projects financed five years previously, whether financed for FMO's own accounts and risk (FMO-A), or off-balance, from FMO-managed government funds.

The need for new/additional approaches to accountability and learning

There is increasing demand for, on the one hand, accountability in terms of tangible and measurable results, ideally attributable to FMO's support to its clients/projects and, on the other hand, for more in-depth evaluations of project impacts (including indirect outcomes) on aimed for ultimate beneficiaries (such as users of infrastructure services financed, or MSMEs targeted through support to financial intermediaries). This year, we therefore also report on new developments in these areas, by which FMO seeks to strengthen its results management and evaluation. As of 2014, we will be adopting a new evaluation approach, discontinuing the portfolio-wide evaluation program in favor of a strategy sector based approach. Portfolio-wide results accountability will increasingly be provided by monitoring the realization of a set of strategic impact and footprint indicators. This makes it possible to focus evaluation work on a different sector each year, thereby aiming for greater depth and improved relevance to FMO policy and strategy formulation and implementation.

Results and developments: accountability through indicator measurement

FMO has, for some years now, collected a limited set of portfolio outcome and outreach indicators (employment at clients, number of MSMEs reached through financial intermediaries), our so-called quantitative indicators, under supervision of the Evaluation Unit. We briefly report on the results, and on their value and limitations in providing results accountability.

Learning through in-depth evaluations: developments and findings in 2013

For a better understanding of projects' full results on the ground, we cannot just rely on data from clients, already available within FMO. In-depth evaluative research is needed to assess, for example, the indirect and induced effects of a power generation project, and rigorous scientific methods need to be employed to assess the effects of increased access to microfinance on borrowers. In this year's evaluation report, we therefore report on steps made in this direction in 2013. These include the first effectiveness studies and evaluability studies (preparing the ground for rigorous impact evaluations) carried out in 2013 in the context of the Government Funds Evaluation Plan, managed by FMO and supervised by an advisory panel of independent evaluation experts. We also coordinated a joint study on the effectiveness of support to SME development through African financial institutions, commissioned by the European Development Finance Institutions, EDFI.

The structure of this report

The first chapter of this report provides the highlights and recommendations of the 2013 evaluation report. Subsequently, chapter two provides the background of this year's evaluation activities. In chapter three, evaluation results of FMO-A are given in terms of the portfolio wide evaluation and in-depth studies. Also, the newly developed impact monitoring framework is touched upon. The last chapter focuses on the evaluation of FMO's Government Funds. This includes the portfolio wide analysis, but also deals with the newly initiated effectiveness and impact studies.

FMO-A versus Government Funds

In this evaluation report, we report separately on evaluation findings with respect to projects financed for FMO's own risk and account (referred to as FMO-A), and on the outcomes of projects financed out of special purpose funds that FMO manages for the Dutch government. The government has established these funds in order to support private sector activities that are highly relevant to development, but whose expected risk/return-profile is such that FMO, having to look after its own continuity, cannot prudently take them on by itself. Typically, these projects have risks that make them commercially unbankable. They have a high chance of not succeeding, but *if* successful they may generate very high development returns, and/or may demonstrate the viability of previously untested and unproven business concepts, making them more bankable in future. These characteristics would imply that, all else (including product mix) being equal, these Funds would less frequently show good financial results, and also less often good development outcomes. But the successful ones may more often show excellent development outcomes. Funds are available for infrastructure (Infrastructure Development Fund, IDF and Access to Energy Fund, AEF), for micro, small and medium enterprise development (MASSIF) and financing joint ventures and subsidiaries of Dutch enterprises (Facility Emerging Markets, FOM). We have agreed upon a Government Funds Evaluation Plan that seeks to meet the requirements of the Ministry's Protocol on Results Management and Evaluability in Private Sector Development. We started implementing this Plan in 2013.

III FMO-A

III.1 Findings from the FMO-A portfolio-wide evaluations

The context of the 2013 portfolio-wide evaluation program

We evaluated, in 2013, a stratified random sample of 50% of the projects for which FMO entered into new commitments 5 years earlier, in 2008. In our analysis of the 2013 evaluations, we compare the year's evaluations with foregoing years (trend analysis), or group them together with the two foregoing years to obtain a large enough number of evaluations to analyze outcome patterns.

The proportion of projects producing good results – either in terms of contributions to development, development outcome, or in terms of financial returns on FMO's investment, investment outcome – can be strongly influenced by business cycles or economic crises. In recent evaluation years, we saw that both development outcome and investment outcome success rates had been negatively affected by the fact that clients financed before 2008 were often severely affected by the global effects of the credit crisis.

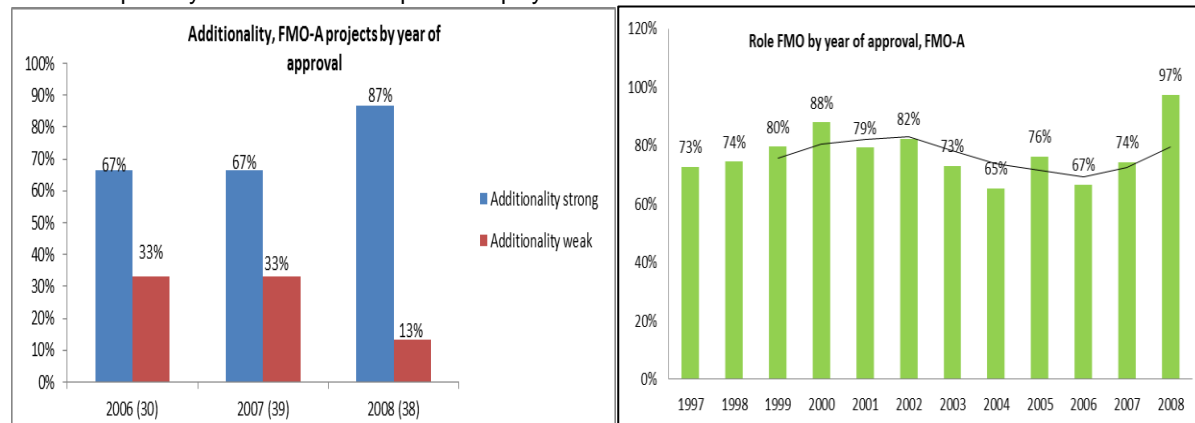
The US subprime crisis had manifested itself in 2007, which, from the latter parts of that year, already had an effect on banks' and investors' liquidity and on their appetite for taking on emerging market risk. Previously high liquidity – which had been putting pressure on DFI additionality – had fully reversed by 2008. We were more needed, and thus had a stronger role to play.

The broader, global economic effects of the crisis made themselves more seriously felt in the latter part of 2008 (fall of Lehman in September, nationalization of ABN AMRO and Fortis in early October). Our 2008 commitments were thus affected in different ways. Outcomes of FI investments early in the year have at times been affected by years of subsequent consolidation and stagnation, while investments later in the year sometimes came to the rescue of clients in an effective manner and produced strong results. Project finance committed in the year has hardly been crisis affected; it has often been disbursed with considerable delays (other investors holding back, leading to implementation delays), and benefitted from post-crisis rebounds. And 2008 PE Fund commitments – steeply peaking as a proportion of FMO's 2008 commitments – were slow to disburse, and have often not generated much of a return for FMO yet. The crisis impact on 2008 FMO commitments has thus been mixed.

Additionality and role of FMO

At the dawn of the crisis when commercial investors were quite reluctant to venture into our markets, FMO did not abandon its clients but continued to provide scarce financings. FMO continued to support clients with sound businesses, but who could not readily meet their (re-)financing requirements, due to the tough market circumstances at the time. This was motivated partly by FMO's desire to retain and increase additionality and consequently a higher degree of development effectiveness, as expressed in FMO's 2009-2012 strategy, formulated in 2008.

The role and contribution of FMO is an overall indicator combining ratings on additionality, catalytic role and the non-financial role of FMO (supporting clients' environmental and social standard setting and improvements). FMO's additionality was evaluated as sufficiently evident in 87% of the evaluated projects approved 2008, compared to 67% in the previous year (fig. 5)¹. This does not come as a surprise as liquidity started to dry up and commercial investors were less willing to invest in developing countries following the onset of the financial crisis. Additionality was still insufficiently evident especially in some follow-on private equity fund investments that were oversubscribed.



¹ Outcomes are reported in terms of numbers and proportions of evaluated projects, and not weighted by volume of commitments. All other results in the report use the same approach. The line in some graphs shows the trend in success rates as a three-year moving average.

(Figure 1)

(Figure 2)

The proportion of FMO's newly committed projects financed with equity (especially private equity fund commitments) increased from 23% in 2007 to 40% in 2008. This was motivated by (a) the wish to better serve our markets and clients with scarcer types of finance (and thus to retain and increase FMO's additionality), and (b) by the fact that FMO's role can be bolstered by such investments. Both objectives have been mostly achieved by the investments made five years ago. We responded to further needs of our clients by providing relevant support for improved business operations, including E&S standard setting and corporate governance. Hence, FMO played a good role in serving its clients in 97% (74% in 2007) of evaluated 2008 approved projects. These improvements illustrate the value of continuing to invest in a crisis period, when commercial banks tend to become more risk averse.

Development Outcome

Whereas the previous evaluation report shows a declining trend in development outcomes success rates over a five year period for FMO-A, this tendency finally seems to have turned. Out of the 2008 committed deals, 68% generated good development returns, compared to 54% of 2007 projects evaluated. Development outcome is assessed against three main indicators: project business success, contribution to economic growth and environmental and social (E&S) outcomes.



(Figure 3)

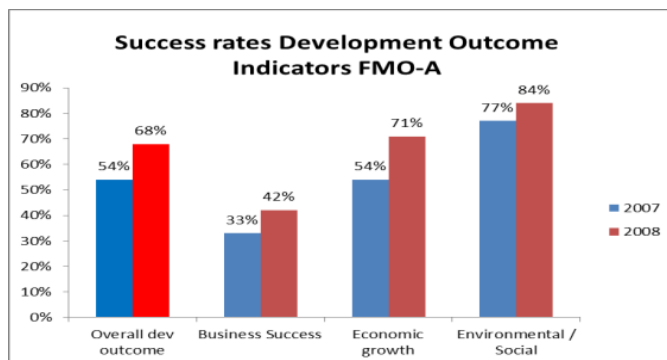
All components of the Development Outcome score improved compared to the previous year. The proportion of projects with strong *Business Success* grew from 33% to 42%, the proportion of those with strong contributions to *Economic Growth* from 54% to 71% and the proportion evaluated as having generated good *E&S Outcomes* from 77% to 84%. The big increase in projects performing well on *Business Success* and *Economic Growth* is probably due to the fact that 2008 investments were still affected by the crisis, but, in recent years, benefitted from the recovery that subsequently took place in many of our markets.

An investment with good business success and good development outcomes

FMO invested in a financial institution in Tajikistan. Our support helped this small bank grow into the number one MSME bank in Northern Tajikistan and to establish a number one position in remittances nationwide. The bank's performance stumbled in 2009 as a result of the financial crisis (which strongly affected Tajikistan's main trading partner and migrant worker recipient Russia and, among others, led to a significant devaluation of the Tajik currency), coupled with a serious case of fraudulent lending at one of the bank's branches. The resulting small loss in that year and the stagnation of the bank's loan portfolio were, however, made good by a quick recovery and the resumption of healthy portfolio growth and profitability in subsequent years. Business success was therefore rated as satisfactory, contribution to economic growth as excellent and E&S outcomes as satisfactory. FMO's investment outcome has been satisfactory. In a high risk and still very poorly developed country we have been highly additional and played a satisfactory role.

Environmental and social outcomes

Of the components of development outcome, E&S outcome is most frequently evaluated positively (see figure below).



(Figure 4)

The high E&S outcome success rate is, in part, due to the fact that FMO screens its clients in advance on E&S risk, and on compliance with FMO's E&S requirements. With clients that are not yet compliant, environmental & social action plans are agreed, whose implementation is monitored.

Evaluations brought out, though, that we currently have limited means for evaluating many projects' E&S outcomes. Our methods, to date, mainly look at whether clients operations, E&S risk management, and environmental and social risk management systems, complied – or have eventually been brought into compliance - with FMO's requirements. Projects assessed as having low E&S risks are almost automatically evaluated as having generated satisfactory E&S outcomes. Going forward, we intend to develop better tools for evaluating environmental/green and social/inclusive outcomes, and make more use of specialist expertise in arriving at evaluative judgements in these areas. Moreover, low E&S risk scores which are assigned before a transaction should not automatically result in positive E&S performance ratings ex-post.

Investment outcome

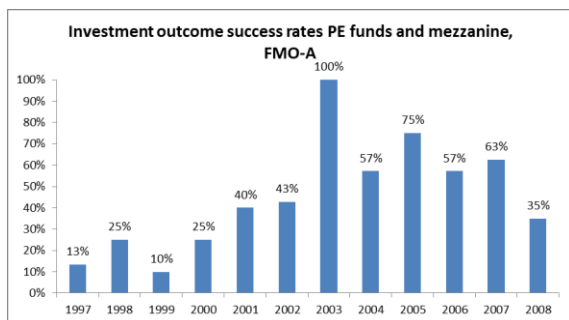
Investment outcomes in 2008 and the trend in the investment outcome success rate were strongly influenced by the fact that, in 2008, FMO sharply increased its equity financing when commercial investors were quite reluctant to do so. The share of FMO's equity investment commitments nearly doubled compared to 2007 (see Figure 7). Typically characterized by high risk, the majority of these equity investments did not show high performance after five years. Also, most equity investments were in private equity funds that typically have an investment period of five years, and mainly generate their profits when investments are exited in years 5 to 10.

Poor economic performance in many of FMO markets following the crisis has led to a challenging private equity industry, with narrow exit opportunities. However, in equity investments a small number of high yielding investments may make up for many investments that generate poor returns. With the current PE monitoring system, however, it is not easy to assess the yield of all 2008 equity investments combined, and it is, thus, not clear to what extent successful investments have compensated for the investments that stay behind.

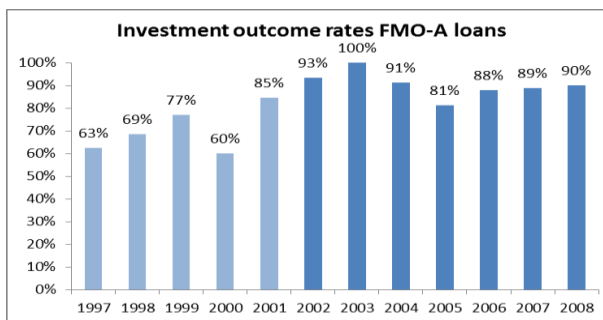
Of the evaluated 2008 equity (16) and mezzanine (4) investments, 35 % (7) were evaluated as producing a good investment outcome for FMO. For evaluations, the hurdle for this was set at an IRR of 8% or more, a minimum return typically demanded by equity investors. It should be borne in mind, though, that most of the 65% less performing equity investments are not loss-making, but are still generating positive returns to FMO².

It could thus well be that FMO's total 2008 PE / mezzanine investments, on aggregate, are still generating a reasonable return to FMO. No firm overall assessment is possible without an improved investment return monitoring system for private equity – just as PE Fund development outcomes cannot be well evaluated without an improved investee level indicator monitoring database.

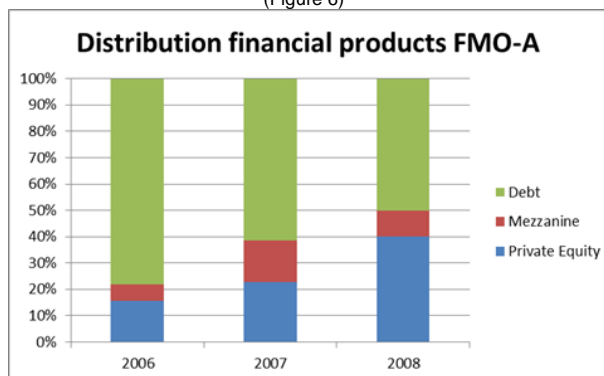
² Of the 16 equity investments only (excluding mezzanine), only 4 (25%) were evaluated as generating a good investment outcome: two as excellent (IRR >15%), two as satisfactory (IRR 8-15%). Of the twelve investments evaluated as having a poor investment outcome, four were partly unsatisfactory (IRR 5-8%), and of the eight that were rated unsatisfactory (IRR <5%), only half were expected to generate negative returns (IRR <0%)



(Figure 5)



(Figure 6)



(Figure 7)

Looking at the combined 2008 private equity, mezzanine and debt investments, FMO generated good investment returns in 63% of projects. Investment outcome success rates declined compared to previous years (83% in 2006 and 77% in 2007). The overall decline is the result of the low equity investment outcome in 2008, combined with 2008's sharp increase in the proportion of equity (fund) investments. Positive outcomes reflect the good returns from loan investments; loans generated good returns to FMO in 90% of the cases. Because of their lower risk, loans often perform as expected, and more often achieve good investment returns than equity investments.

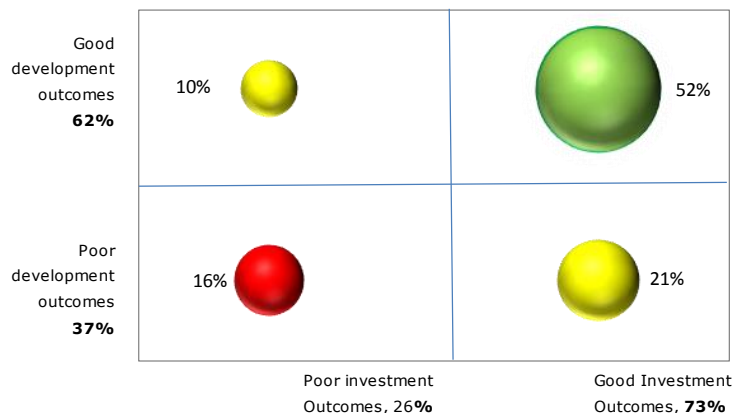
Correlation between development and investment outcomes

Up to two-third of projects committed in 2006-2008 achieved successful development outcomes and 73% of projects generated good investment returns for FMO. The results show that development and investment outcome are correlated in most cases. It reinforces previous findings that whenever projects are selected on their potential for good development impacts as well as financial sustainability (business success), development and investment outcomes go hand in hand. Development and investment outcomes were directly correlated with 68% (2012:73%; 2011:78%) of projects realizing either a win-win (52%) and 16%, or lose-lose outcome, however this correlation has been declining in recent years. i.e. we now observe an increase in the proportion of projects producing good development but poor investment returns and vice versa.

Private equity deals in India and Africa

In 2008 FMO closed sixteen PE fund transactions in total, four of which in India and four in Africa. With the continued influx of capital in India in 2008, funds ended up outbidding each other and paying very high valuations. After the 2013 economic downturn and devaluation, funds are now facing lower valuations and limited exit possibilities. Therefore, it is not surprising that three out of four PEF investments in India had an IRR of less than higher than 8% after five years. The African PEFs (of which four out of six did not perform satisfactorily), tended, after the crisis, to primarily make follow-on investments in existing portfolio companies, especially in South Africa. Pan-African funds also became more popular. While one of the South African funds experienced conflicts in the fund management team, the pan-African funds encountered challenges with their broad geographic mandate, due to limited knowledge of Africa and weaknesses in their business models. Lower outcomes are also attributed to the impact of the low performing pre-crisis equity investments.

**107 investments from FMO-A, approved 2006-2008 :
 Development versus Investment Outcomes**

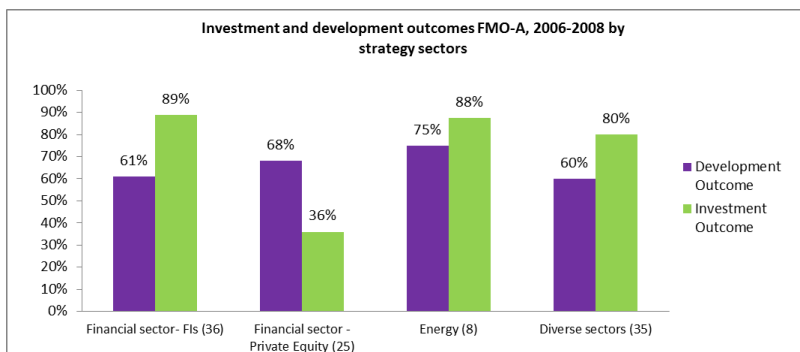


(Figure 8)

Of evaluated projects,, 10% had good development results, but failed to generate good investment returns to FMO. On the other hand, 21% of projects generated disappointing development outcomes (typically due to poor business financial performance), but still managed to meet their obligations towards FMO. These are mostly projects for which FMO provided loan products pre-crisis. Typically, all three non-green quadrants are associated with poor project business performance, which again points to the importance of ensuring that projects are selected simultaneously for their financial sustainability as well as on their development relevance and potential.

Performance per strategy sector

In the 2006-08 commitment years, FMO’s focus sectors were financial institutions (incl. private equity funds) and infrastructure; we also invested in projects outside these sectors. In its current strategy, FMO has expanded its sectors and now invests in financial institutions (including private equity funds), energy and agribusiness³, while still making investments in diverse sectors (previously referred to as ‘other/non-focus’)⁴



(Figure 9)

Previously, evaluations found that projects in FMO’s focus sectors were more frequently successful than non-focus sector projects (Diverse Sectors). This pattern appears to be changing – with only slight differences in relative performance by industry sectors (fig. 3). This may be the result of ensuring that, in sectors where we have built no specific expertise (diverse sectors), we have increasingly sought to rely on partners that have relevant expertise. Observed differences in sector investment outcome success rates appear to mainly reflect product risk (equity vs loan investments).

Energy projects typically outperform the other sectors on development outcomes with three out of every four energy sector projects being evaluated as producing strong development returns. **Financial institutions** witnessed an improvement in development outcomes. This can be ascribed in part to strong business performance of banks (and NBFIs) for which financing was approved at the onset of the crisis. Apart from the inclination towards repeat transactions

³ Agriculture was not considered separately, since only three evaluated projects were in this sector. Therefore no conclusions can be drawn on outcomes. FMO is growing its agriculture portfolio and expects to be able to draw more conclusions on sector outcomes in the coming years
⁴Agribusiness has only become a focus sector in 2011; it was previously part of the ‘other’ (now diverse sector) category.

with existing financial institution clients during the year, improved outcomes are also attributed to results of investments in the microfinance segments in Cambodia and India. Outcomes were negatively affected by poorly performing investments made pre-crisis in ECA and LAC – as a result of the economic upheavals that ensued after FMO’s investments. But, all in all, investment outcome success rates (mostly loans) have held up. The same applies to **Diverse Sectors**.

III.2 Findings from in-depth studies

Effectiveness of EDFI support for SME development through financial institutions in Africa

The members of the association of European Development Finance Institutions, EDFI, have, in 2013, jointly commissioned an evaluation of the effectiveness of EDFI support for SME development through financial institutions in Africa. In the course of 2013, this evaluation has been carried out by Horus Development Finance (Horus). FMO has chaired and coordinated the steering committee that managed the study. The EDFI Board summarized – and commented upon – the study as follows:

“The Horus researchers have explored the effects of financing and technical assistance provided by EDFIs to six financial institutions in Africa, on their provision of credit and other financial services to SMEs, and, ultimately, on the SME clients of these financial intermediaries.

[...]The researchers have been able to show that the effectiveness of EDFI funding for SME financing is influenced by the type of financial intermediary selected, by the types of financing and technical inputs provided to these intermediaries by EDFIs, and by the conduciveness of the sector- and macro-economic environment in which financial intermediaries operate. Moreover, the report illustrated that the financing and support were found to have been highly relevant to these institutions’ needs. The report finds that EDFI support has helped these banks’ financial strength and sustainability, and their ability to serve their clients, including SMEs.

On the other hand, the report notes that, if and when the EDFIs specifically seek to address the SME finance gap (the ‘missing middle’), there is still considerable scope for further improving the effectiveness of their financing. Financial intermediaries may be more critically selected on (and helped with developing) their willingness and capacity to serve SMEs. The funding and assistance provided by EDFIs may be better geared to addressing banks’ constraints with respect to SME banking specifically. And assistance may be better structured, so as to incentivize banks to further develop and expand their SME lending. The study also highlights the need for better data to be collected by and from our financial intermediary clients, so that our clients and the EDFIs themselves can better demonstrate and manage for results in SME outreach. [This] may also help client banks to better appreciate the value that SMEs bring to their business.”

Internal Evaluative Study of Unsuccessful Financial Institutions Projects

In the latter part of 2013, we cooperated with FMO’s Financial Institutions Department on a study of FMO financial institution clients that defaulted or, for other reasons, did not produce good development outcomes. The Department wanted to learn more about the incidence and causes of bank failures – in the past fifteen years or so - that generated losses for FMO, to document cases, and to extract learning material for staff of the department, also to help prevent future losses. We added cases that had not actually led to losses for FMO but that were found, in ex-post project evaluations, to have produced less than satisfactory development outcomes. From the perspective of FMO’s mission, these should also have been seen as failed projects, whose incidence we should seek to minimize. As the study is, at the time of writing of this evaluation report, still being finalized, here we only want to summarize some of the study’s broad findings, as follows:

- Failures of FMO-financed banks have, in most cases, been country crisis related. Crises were identified as the main cause of about 60% of defaults, but often also brought other weaknesses to light that were then seen as main causes.
- FMO’s losses on loans to financial institutions have, over the past fifteen years, and especially in the last ten years, been quite limited. Even though we frequently took – through provisions – relatively big losses after country-, regional and global crises, the bulk of those were actually recovered subsequently.
- Defaults that were not crisis related were seen to be related mainly to overly rapid loan growth and/or by financial institution clients employing a new and untested business model.
- Clients’ financials for the year before defaulting have very limited predictive value with respect to financial or developmental failure. Having strong and committed shareholders is probably the main determinant of whether banks survive hard times and will continue to meet their obligations.
- Where FMO continued to be paid, but development results were poor, FMO often benefitted from a government bail-out or very strong shareholder support while the banks actually failed. In other cases, the banks muddled through, with stagnating or shrinking loan portfolios and commensurately poor development returns, but still being able to service their loans.

A strong crisis-related role for FMO in Georgia

Towards the end of 2008, FMO client banks in Georgia were facing serious difficulties. The global credit crisis reached Georgia through drying up of interbank funding, causing liquidity problems. But the country was also still reeling from the effects of a war with Russia earlier in the year, which contributed to a collapsing real estate sector to which some of the banks were heavily exposed. At one bank, things were made worse by irregularities in related lending to real estate projects. All in all though, fundamentals and prospects in the country and the sector could be considered to be sound. As a result, DFIs – including FMO – were prepared to provide rescue packages that prevented banks – and possibly the country’s entire financial sector – from collapsing. At one major bank, FMO joined EBRD and IFC in putting a rescue package together, that largely consisted of equity and subordinated debt. At another major bank, EBRD and IFC acted in a similar manner. In both cases, the DFIs became substantial shareholders. A third FMO client bank focused on SMEs, and suffered less from (real estate related) NPL increases. To weather the storm, however, it sought to strengthen its capital adequacy, and FMO provided, in December 2008 (!) a tier 2 facility for that purpose. Georgia and its banks recovered relatively well in the ensuing years and, especially from 2010, our client banks showed healthy growth and profitability again. Courageous support to clients – at a time when commercial financiers could not be relied upon – gave us a strong role as DFIs, which was rewarded by solid investment and development returns.

III.3 New strategic impact measurement and reporting framework

Monitoring/QI’s

Development impact is not only assessed at the time of project approval, but also monitored annually for FMO’s existing clients. Since 2010, monitoring includes the collection of a set of Quantitative Indicators (QI’s) that capture part of the development impact of projects. Apart from sector specific QI’s, FMO collects a limited number of QI’s for all clients, in particular on Jobs and Taxes paid. Although these are not necessarily the main development effects of a specific project (and are therefore not targeted), they show impacts of FMO’s investments that can be aggregated over the portfolio. The QI’s are reported on an ‘outreach’ level, adding all jobs and taxes of all clients, irrespective of the share of the company financed by FMO. Despite its serious limitations, this type of reporting is still industry standard. The limitations are that no attribution rules are applied, which makes it impossible to link the FMO financing to the reported figures. This also causes volatility, given the dynamic and heterogeneous character of FMO’s portfolio.

In 2013 FMO has improved its collection of QI’s; coverage increased to almost 95% of clients. Also in 2013, the Development Finance Institutions (DFI’s) have agreed to harmonize their indicators, in order to reduce the reporting burden for clients which receive finance of more than one DFI. This set of indicators is closely aligned with the IRIS-indicators, and hence with the information requirements of impact investors.

Development reach by FMO Sectors	Portfolio, 31 December 2013
<u>Portfolio-wide development indicators:</u>	
Number of employees – all sectors (*mln)	1.37
Contribution to government revenues (*€mln)	1,293
<u>Microfinance loans provided by clients:</u>	
Volume (*€mln)	25,899
Number (*mln)	30.17
<u>SME loans provided by clients:</u>	
Volume (*€mln)	44,595
Number (*mln)	1.42
<u>Customers reached with infrastructure services:</u>	
Number of electricity connections served (*mln)	5.99

FMO's new strategy to become the leading impact investor by doubling impact and halving footprint

In 2012/13 FMO has invested in the development of a new strategic impact measurement and reporting framework, which supports the audacious goals of FMO, as part of FMO's new strategy: becoming the leading impact investor by doubling FMO's impact and halving the footprint by 2020.

The main ambitions of the new impact measurement framework are to:

- Provide better tools to manage for impact in project selection, using impact & footprint targets (integrated approach of sustainability & impact issues) that support FMO in selecting transactions that contribute to inclusive, economic and sustainable development. This is related to the approval phase, and data thus relate to projects' projected impact (i.e. projected # of jobs, or electricity production). In the framework we have chosen for a projection period of 5 years, and we have developed a set of attribution rules, which link impact directly to the financing provided and catalyzed by FMO.
- Improve the reporting of non-financial aspects of FMO, and integrate them in FMO's overall results reporting, including financial reporting (i.e. Integrated Reporting). This will be based on collecting data on actual impacts/results, realized by projects and attributable to FMO. Comparisons of reported realized impacts with original expectations are likely to become the basis of future evaluations and results accountability.

We have selected indicators to measure effects at output and outcome level for each of FMO's strategy sectors (Financial Institutions, Agribusiness, Energy, Diverse Sectors and Private Equity funds). Ultimately, FMO's ambition is to measure the 'doubling the impact, and halving the footprint target in 2020' per industry (via Key Performance Indicators, KPI's) in comparison to a baseline. For Energy we have already selected these KPI's: (a) estimated # of people reached through FMO's financing of energy projects and (b) CO2 emissions avoided through renewable energy projects. For Energy we have taken the energy projects to which FMO committed itself in 2010-12 as the baseline, and looked at the outreach and CO2 emission expectations at the time these projects were approved. On the basis thereof, FMO has set tentative targets for 2014, for both KPI's. With the indicators we apply a set of attribution rules, linking FMO financing to the impact created by the client. This thus deviates from simple reporting on client outreach. Other industries will follow in 2014, and will have impact and footprint targets as of 2015.

The impact and footprint target framework takes into account the catalyzed and mobilized funds, and hence is aligned with the ambition of FMO to become the 'leading impact investor'. FMO also has targets for catalyzed funds, and has started fund management activities. In this context also, FMO needs to report on impact.

Future of Evaluation and Impact Reporting

As of 2014 FMO will start to disclose realizations data of projects financed in previous years (based on KPI's). This will ensure the external accountability of FMO in terms of realized impact, and will ultimately become part of the integrated reporting framework of FMO. Projects will be reviewed annually, so that we can track and report the progress of project impacts. This will also help FMO to build up a database of projections versus realizations of projects, evaluation of which will ultimately help to further professionalize our project selection process, to maximize the realized impact of FMO's financing.

The portfolio wide evaluations (based on a sample of projects approved 5 years ago) as performed over the last 10 years will be replaced by a combination of portfolio wide KPI reporting (both projections and realizations), analysis of what causes differences between the two, and in-depth project and sector evaluations, for learning and a better understanding of impact, direct and indirect, on all relevant dimensions.

IV Government Funds

FMOs Government Funds (GFs) are available (from the Ministry of Development Cooperation) for infrastructure (Infrastructure Development Fund and Access to Energy Fund, AEF), for micro, small and medium enterprise development (MASSIF) and (as a guarantee facility from Economic Affairs) for financing joint ventures and subsidiaries of Dutch enterprises (Facility Emerging Markets, FOM).

The Government Funds (GFs) intend to help FMO support investments that are highly relevant to development, but that are too risky to take on from FMO's own capital. Higher risks can be taken at client level (e.g. in terms of financial strength, track record, business case, sector risks, innovations, etc.) or at the level of the financial product (e.g. subordinated loan instead of a secured loan, equity instead of subordinated debt, start-up capital; longer tenor or grace-period, local currency, etc). Government funds aim to catalyze other financiers or investors to maximize the flow of funding to specific target groups. When government funds invest alongside DFIs or commercial parties, the fund always accepts a higher risk profile in the same project than other parties, acting as a risk buffer to their investments. In this way, government fund investments can also be combined with FMO balance sheet financing. For the Government

Funds, return requirements are less ambitious; they do not seek to grow, but are typically expected to be (largely) revolving.⁵

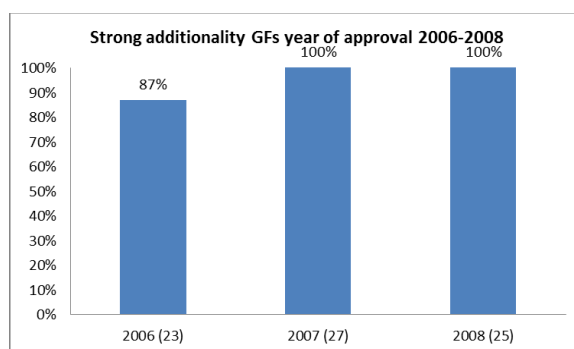
Projects financed out of GFs are included in FMO's annual portfolio-wide evaluation program. However, since 2013 the 'Evaluation Plan for the FMO-managed Government Funds' is also being implemented, to provide more in-depth information on the results of these substantially higher risk investments in emerging markets. These lessons are generated via impact studies that are managed by the FMO Development Impact team and executed by external consultants / researchers. The evaluation plan includes new evaluation methodologies which seek to rigorously demonstrate FMO's contribution to development impact at end-user level. These (ex-post) impact studies do not generate immediate results, but can require a research period of up to four years. Therefore, we also commission effectiveness studies that use different methods and generate insight in project results in a much quicker way. The results of the studies are utilized for accountability, but particularly offer lessons learned which can foster strategy development of FMO and FMO clients. Thus it can facilitate the GFs' efficiency in terms of further enhancing their development impact, while not losing sight of financial performance.

IV.1 Findings from portfolio-wide project evaluations for the Government Funds

Although we have started implementing the GFs' evaluation plan in 2013, projects financed out of GFs have continued to be included in our portfolio wide project evaluation program. The GFs are analyzed separately from the FMO-A results, and this analysis is presented below.

FMO's additionality in GF-financed projects

In terms of additionality, the Government Funds (GFs) investments of 2007 and 2008 scored 100% (see figure 10), in contrast to 2006, when 13% still did not show strong additionality. This positive outcome is not surprising, considering the fact that the GFs focus at high risk profile investments which cannot be taken up by FMO's own balance sheet. MASSIF, FMO's financial sector fund, represents 57% of the 2006 – 2008 GF deals. True risk capital geared towards the lower and bottom-end of the market, local currency financing and seed capital are the distinctive factors of the fund. The Emerging Markets Fund (FOM) (25% of the deals over 2006-2008) matches risk capital provided by Dutch SME's investing in new or expanding companies in emerging markets, including greenfield investments without security. The remaining projects were financed out of one of the two FMO-managed infrastructure funds. The difference in results compared to FMO-A clearly marks the distinction in financing goals of the GFs.



(Figure 10)

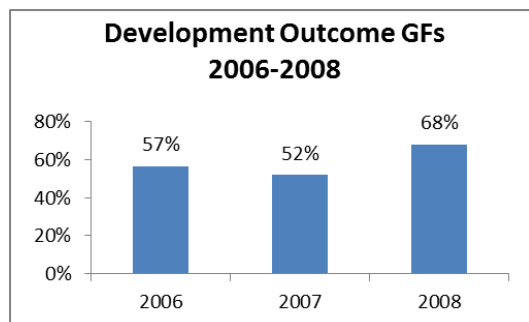
Development outcome

The proportion of developmentally successful GF-financed projects increased from 52% in 2007 to 68% to 2008 (see figure 11). The success rate varies by fund. Looking at the 2006 – 2008 average, MASSIF shows 63% positive development outcomes, followed by FOM with 53%. IDF scores 44% at the time of evaluation; some IDF investments may take longer to mature and generate good development results. Only 4 AEF project were so far evaluated and therefore no conclusions can be drawn for this fund yet.

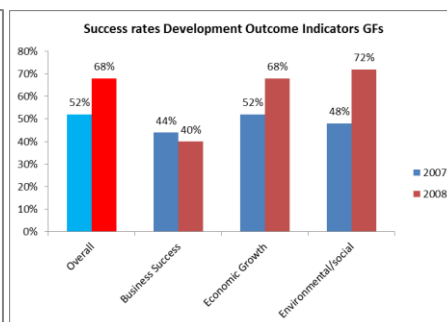
As we saw for FMO-A, we see an increase in developmentally successful GF-financed projects in 2008. Zooming in on the different components of development outcome⁶, we see that, while FMO-A financed projects more often realized good business success, at GF-financed projects the proportion with good contributions to broader growth and with good E&S outcomes improved (see figure 12 compared to figure 4 of FMO-A, page 8).

⁵ Distinction FMO A - Government Funds, 1 September 2009

⁶ See Annex I for insight in components of indicators.



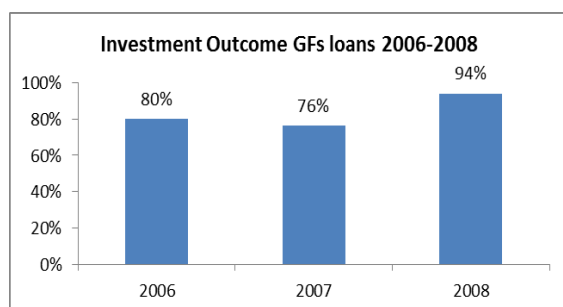
(Figure 11)



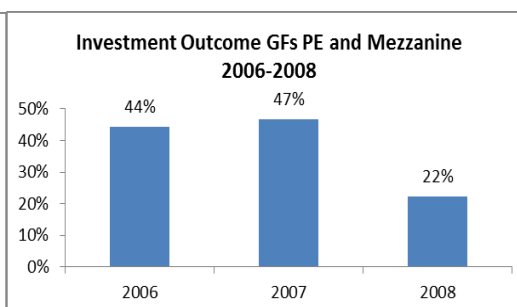
(Figure 12)

Investment outcome

Overall, 67% of 2008 GF projects generated a good investment outcome, which is similar to previous years. However, as with FMO-A, this figure is distorted by the fact that equity and mezzanine investments less frequently generate good returns (and are, effectively, evaluated too early). Therefore, a breakdown is presented in loans (fig 13) and PE & mezzanine (fig 14). We can see that the loan portfolio investment outcome has improved from 76% in 2007 to 94% in 2008. However, PE and mezzanine performance largely fall back from 47% of 2007 investments being successful to 22% for 2008 investments. For FMO-A similar changes were discovered⁷.



(Figure 13)

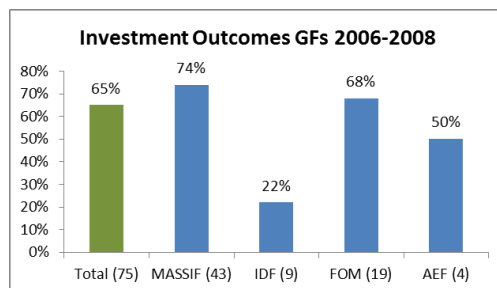


(Figure 14)

Specifically MASSIF (74%) and FOM (68%) perform well on investment outcomes – committed in 2008 (Fig 15). The MASSIF fund, aimed at providing local currency MSME financing for financial institutions (including private equity funds) has been successful in channeling investment LCY financing to MSME clients in a way that less-burdened our clients and their customers with foreign exchange risks. Some of these projects have graduated to FMO-A projects as risk profile have improved. FOM targets relatively small start-up subsidiaries of established Dutch companies, with sponsors and management with little experience in emerging markets. Evaluation results show that two third of the 2008 evaluated projects financed out of FOM have proven to be financially and economically sustainable and are thus likely to make a lasting development impact. The latter demonstrates the role of FOM in effectively helping Dutch SMEs expand their businesses in emerging markets and FMO could not have economically invested in these projects on its own account. The low investment outcome success rate of IDF projects (22%) is caused mainly by projects in telecom, housing and water. Six out of nine IDF transactions were in equity and therefore the financial returns may still improve.

⁷ Looking at the distribution of financial products within the GFs portfolio, only 20% (or 5 deals) is in private equity, while for FMO-A this is 40%. For the GFs, 16% (4 deals) are in mezzanine versus 10% of the FMO-A portfolio. Therefore, for the GFs mainly the very low investment success rate of equity and mezzanine (and to a lesser extent the proportion) influences the overall investment performance result, while for FMO-A it is mainly the increase in the proportion of equity and mezzanine financed projects (and to a lesser extent their low investment success rate).

Three equity deals scored partly unsatisfactory (IRR 5-8%) and two scored unsatisfactory and have been (partly) impaired. Two mezzanine deals were satisfactory, one partly unsatisfactory and one unsatisfactory. The unsatisfactory transaction is not expected to be recovered. Over the GFs equity / mezzanine portfolio six out of nine deals still generate positive financial results, though might not be likely that these results will compensate the probable loss of the other three. Therefore the financial viability of the funds is dependent on the debt portfolio.



(Figure 15)

Correlation between development and investment outcome

Projects financed out of FMO-managed GFs typically make strong contributions to development as well as to the respective funds' specific development objectives. As with FMO-A (figure 8, page 10), the vast majority of GF-financed projects shows either a win-win or a lose-lose outcome, combining good development returns with good financial returns or vice-versa. Given the GFs' higher risk appetite, though, the proportion of projects that is not successful from either perspective is larger (at 25% compared to 16% for FMO-A). GF projects show an improvement in overall development outcome success rate at 58% (2012: 53%) as well as investment outcome success rates at 65% (2012: 64%; 2011: 61%).

IV.2 Findings from in-depth effectiveness studies

FMO agreed with the Dutch government on an ambitious evaluation plan for the Governments Funds that FMO manages on behalf of the government. Part of the plan is to execute ex-post effectiveness studies that focus immediate and intermediate results of investments. At the end of 2013, FMO managed to finalize two effectiveness studies, and had started up a number of studies of longer duration. For details on the latter, see Annex 2.

Effectiveness study of MASSIF investments in Sri Lanka and India

British consultant Oxford Policy Management (OPM) was appointed by FMO to assess MASSIF's support to eight financial intermediaries in Sri Lanka and India and the effect of that support on expanded and/or improved provision of financial services to MSMEs and institutional strengthening. OPM used a theory-based approach setting out the key impact pathways of the MASSIF program and tested if the impacts were consistent with outputs expected.

Sri Lanka has an underdeveloped capital market and raising long-term funds has been difficult. During the period of MASSIF investments, FIs in Sri Lanka also had to cope with limited interest from international investors/DFIs. OPM concluded therefore that there was a strong rationale for the MASSIF support provided to FIs in Sri Lanka during 2004 to 2012. MASSIF funding allowed FIs to expand financing, reduce asset-liability mismatch and attract other (inter)national investors. Promoting MSME growth is also a high national priority especially after the end of the 30-year conflict in Sri Lanka.

MASSIF investments in two Indian small enterprise private equity funds in India were also highly relevant due to capital scarcity and high risk of making institutional investments in unproven fund managers making socially oriented investments.

The provision of finance by MASSIF gave a stimulating push to the FIs to increase the flow of lending to the SME sector. Although there were some data challenges, when comparing trend rates for corresponding periods for FIs supported and all licensed commercial banks in Sri Lanka, four out of six MASSIF-supported FIs expanded their MSME loan portfolios faster than market trends. The growth rate for two out of six FIs was substantially higher than market trends. MASSIF support to two private equity funds in India contributed towards early-stage investments in 35 enterprises. The cumulative effect of successful development of the proof of concept/business model, the performance of some of the investments and some successful exits has led both existing and new investors to make investments in successor funds.

Effectiveness study: Promoting renewable energy in Latin America through AEF

The objective of the evaluation was to validate the ex-ante results expectations and to assess the relevance and effectiveness of two renewable energy projects. Dutch consultant Ecorys developed an evaluation framework based on causal effect relations, i.e. a Theory of Change (ToC), in accordance with the DAC Evaluation Criteria (relevance, efficiency, effectiveness, impact and sustainability).

Ecorys concluded that the relevance of the AEF-funded projects is high, both in view of the energy policies and priorities and needs of the local government and the objectives of the AEF. The main objectives are to increase the share of low-cost renewable energy in the energy mix, increase the capacity and stability of the national electricity system to fulfill the increasing demand, increase the electricity coverage while decreasing its dependence on import of fossil fuels, and reducing GHG emissions.

The funding of the AEF and FMO was evaluated as having been of critical importance for the financing of both projects. The mezzanine funding of the AEF - which can be considered as a type of complementary equity - was necessary in view of high risks (exploration, weak financial position of the off-taker) and for obtaining minimum levels of the debt/equity ratio and therefore in concluding the total financing package.

Both projects were found to have led to significant reduction in GHG emissions, i.e. annually about 300- 400,000 tCO₂. Both projects improved the quality of their environmental management, due to the high international standards that were part of the loan agreements.

The projects contributed to an increased electricity generation capacity (around 7% of total installed capacity in the country) and indirectly also to improved reliability of the electricity system. As the power stations deliver directly to the grid, there is no direct link of the projects with end consumer electricity prices and new connections. However, the increased supply at a substantially lower purchase price compared to electricity generated from fossil fuels enabled the national government to reduce spending on electricity subsidies. The projects also indirectly enabled the increase in access to electricity in the country of 20% that took place between 2006 and 2012. The number of customers connected to the grid in the same period has increased by 50%.

Both projects were the first of their kind in the country. IPP contractual frameworks for these types of renewables projects were developed, and this, as the projects' financial and economic viability is established, is likely to have strong demonstration effects.

Management Response

Perspective

The evaluation methodology employed for portfolio-wide evaluations, although based on DFI best practice, leads to reporting results trends and patterns that are heavily influenced by external conditions and by the timing of evaluations.

The evaluation reports of the last two years showed that the economic crisis was having a serious impact on the financial and developmental success rates of projects contracted in 2006 and, especially, in 2007. This time, we see that the FMO-A 2008 project commitments are, once again, more frequently successful in producing good development results, as they mostly weathered the crisis and benefitted from recovery in more recent years.

This report on internal evaluation activities supplements the report of the recently completed 5 yearly external evaluation by Carnegie Consulting as commissioned by the Government.

Investment outcome

The decline in the investment outcome success rate for 2008 commitments is attributed primarily to the historically high proportion of 2008 investments in private equity funds. PE Funds that started around that time have mostly faced a slow and challenging investment environment for several years, and often had to extend their investment period. That they are mostly on track in generating good development returns is encouraging, while it is not surprising that, after only five years, their investment outcomes are still lagging.

To better account for overall investment returns of FMO's PE investments – also per commitment year – a new financial administrative system will be set up, also to meet the requirements of FMO's fund management ambitions. The system will be designed in such a way that it will enable monitoring of financial and impact indicator data at the level of PE fund investees, and can thus also help strengthen accountability for PE Funds' development results.

Methodology and approach

While it has been helpful for development results accountability, especially by adhering to DFI good practice standards in evaluating a portfolio-wide, representative sample of projects, the light project evaluation methodology employed to date has serious limitations. Outcome assessment methods are light and, as they rely on data and information readily available within FMO or from our clients, only assess direct development effects, generally failing to capture the often more important indirect and induced effects. Methods – including the timing of project evaluations – cannot easily be adjusted to what is most appropriate to the types of projects we do in different sectors. And, finally, the approach no longer produces many new findings that are valuable for internal learning or for strategy formulation and results management.

We have therefore welcomed Development Impact's proposal suggestion to discontinue this approach, and to replace it by annually evaluating the effectiveness of the projects of one of FMO's sector and product departments, particularly now FMO-wide results accountability is being strengthened by measuring, monitoring and evaluating a set of strategy impact and footprint indicators.

The development impact team's new position within the newly formed Strategy Department is expected to strengthen the influence of evaluation findings on policy, strategy and results management. The fact that Strategy also houses the sustainability team should help following up on the recommendation concerning strengthened tools for evaluating E&S and green/inclusive outcomes of projects in the context of the new sector-based evaluations, and to enhance the place of these outcome dimensions in evaluations.

Annex I FMO's ex-post project evaluation methodology

Sampling

Over the past ten years, FMO has evaluated a representative sample of projects that it has invested in. Each year, we have taken a 50% sample of projects for which FMO entered into financing commitments five years before the year of evaluation (as, after five years, projects are typically sufficiently mature to assess their outcomes). We excluded projects/clients whose contracts did not lead to disbursements, repeat transactions with clients that were recently evaluated, and commitments that did not result from autonomous investment decisions (e.g. restructurings, rights issues).

Of the resulting 'net approvals population' we have taken a stratified random sample, seeking to ensure that the composition of projects to be evaluated maximally resembles that of the net approvals population, in terms of source of funding (FMO-A, each of the government funds), sector, region and financing products employed (equity, mezzanine, loan products).

In 2013, we thus evaluated 61 projects, for which financing was committed by FMO in 2008. For the analyses of project outcomes, as reported upon in this evaluation report, these 61 evaluations have often been combined with the evaluations done in 2011 and 2012, giving a total number of 176 evaluations. This number is large enough to meaningfully analyze differences in outcomes between sub-groups of evaluated projects, such as projects in different sectors, financed from different sources, etcetera. Of the 176 projects evaluated in 2011-2013, 107 projects were financed for FMO's own account, and 75 projects were funded out of the FMO-managed Government Funds⁸. These sub-sets of evaluated projects are analyzed separately, as the difference in risk appetite between FMO-A and the funds is likely to result in different outcome patterns and success rates.

Project evaluation approach and framework

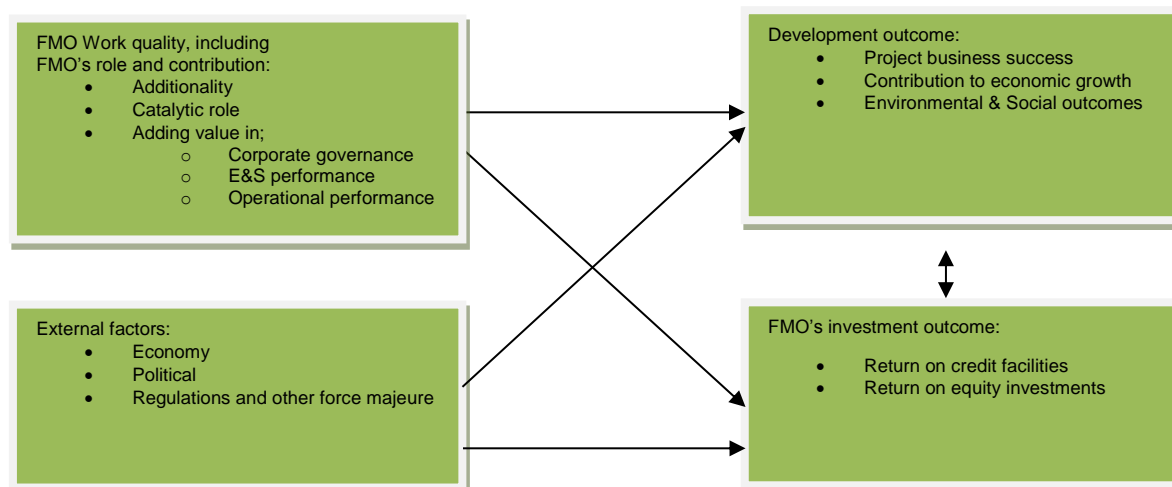
Aiming and managing for good development results, investments are selected not only by applying sound banking principles, but also on the basis of their development relevance and expected development returns. Ex-ante development outcome assessments did, until recently, make use of our Economic Development Impact Score or EDIS. Going forward FMO will, for this purpose, make use of a sector-specific set of strategic impact and footprint indicators. After investments have been made, projects' outcomes are monitored, through annual indicator data collection from clients. Ex-post evaluations are needed to establish whether and to what extent the good development returns expected from projects are indeed realized, as well as to learn, particularly from cases where things did not go as expected.

For our sampling, our evaluation process and our evaluation framework we have, to date, employed an approach that seeks to stay close to the Good Practice Standards (GPS) for Private Sector Evaluation, as formulated by the Multilateral Development Banks' Evaluation Cooperation Group, balancing the GPS requirements against the resource limitations of a smaller bilateral DFI like FMO. We have built our system on the example of IEG/IFC, developing a lighter version.

For projects sampled for evaluation in any given year, investment staff that are managing the client relationship are asked to, in addition to their annual credit review, complete an evaluation annex, called an 'expanded client credit review'. These self-evaluations are based on information that is available within FMO or is easily obtainable from clients. The evaluation form seeks to summarize information on how the project developed since approval, to assess the project's performance in terms of development outcomes and investment returns to FMO, and to assess FMO's role in relation to the project. In the case of Government Fund financed projects, we also assess projects' compliance to the Fund's investment criteria and their contributions to fund-specific development objectives. Finally, the form solicits the formulation of lessons of experience that have been learned in the context of the project. Intersubjectivity of ratings assigned is aimed for, by publishing a set of evaluation guidelines, and by having the self-evaluations critically reviewed by staff of the evaluation unit / development impact team. After this review, evaluation unit staff discusses the project evaluation with submitting front office staff, and finalizes the evaluation.

As shown in the figure below – which illustrates the ex-post evaluation framework, and the relationship between the elements that are assessed in our evaluations - we first assess projects' development outcome. Here we look at (a) the project's business success (which reflects direct value added, but is also a precondition for the project company's economic sustainability), (b) its contributions to broader economic growth and development (including elements like employment generation, and contributing to government revenues) and (c) the project's environmental and social outcomes. Elements are rated on a four point scale, from unsatisfactory to excellent, overall development outcome on a six point scale, from highly unsuccessful to highly successful. For purposes of analysis, we distinguish poor (unsatisfactory and partly unsatisfactory) and good/strong (satisfactory and excellent) outcomes.

⁸ Six projects were, thus, financed from a combination of FMO-A and Government Funds.



Secondly, FMO's investment outcome is looked at. This tends to correlate with projects' development outcome, mainly because a degree of business success is not only needed for a project to produce lasting development contributions, but also to meet debt servicing obligations to FMO, or to generate positive returns to FMO as shareholder. Development outcomes and FMO's investment outcomes are both influenced by factors under FMO's control (project selection, project supervision, and the role played by FMO vis-à-vis the client) as well as by external factors beyond FMO's control. In our evaluations, we no longer systematically assess the quality of FMO's front-end work and supervision (requiring relatively in-depth assessments, better left to sector and thematic studies), but we do evaluate FMO's role as a DFI. According to its mandate, FMO has to be additional to commercial financiers. It should, where possible, try to mobilize further investors and financiers (catalyzing role). And FMO should, where possible, add value to projects, strengthening their social, environmental and operational performance as well as their governance if the client has weaknesses in those areas. A strong and good role as a DFI also correlates with good development and investment results from projects.

Some issues encountered in the 2013 project evaluation cycle – and the way forward

- With a significant increase in **private equity (fund) investments** in 2008 (evaluated in 2013), known problems in evaluating them became more prominent. We effectively do not have enough information to assess the development outcome of PE funds' investments/investees (and then tend to rate funds' development outcome as satisfactory). Furthermore, a five year period is too early to assess funds' outcomes, including their investment outcome, as, after five years, they have just completed their investment period, and their investments' profitability is often still 'too early to call'. Fund investments are better evaluated after 8-10 years, but then they cannot be included in the 'vintage investment year' samples that we have evaluated to date. We would have to depart from portfolio-wide vintage year sampling to resolve this.
- The outcome success rates, in terms of which we report our evaluation findings, are largely driven by **business cycle** (including global crisis) **effects**, as our methods seek to assess projects' development and investment outcome in absolute terms, rather than in comparison with 'the counterfactual', or compared to peers.
- Evaluation methods and data and information limitations do not allow a thorough assessment of projects' **indirect and induced development effects**, which is problematic because these are often much more important than direct effects. Data collection beyond the client – at the level of indirectly financed MSMEs, say, or of users of infrastructure services – would be needed.
- Current tools and methods for **assessing environmental and social outcomes** – increasingly important in view of FMO's strategy – are almost exclusively limited to determining whether clients/projects have been brought into compliance with FMO's E&S (risk management) requirements. We do not have tools available yet for evaluating projects also on their realized social impact (including their inclusiveness) and their environmental footprint or footprint reduction.

None of the above issues can easily be resolved within the current evaluation approach. They are all arguments in support of the change in approach proposed for 2014:

- To increasingly base FMO's future results accountability on the assessment and monitoring of a set of sector-specific strategic impact and footprint indicators. Monitoring realized values and analyzing (the causes of) differences between originally expected and actually realized values is likely to provide improved management for and accountability of development results.
- To increase depth and to enhance the relevance of evaluation work for strategy implementation and learning, evaluation work will investigate outcomes of a different sector/department each year, thus covering the full range of FMO's activities over a period of four to five years. Mixed methods and approaches will be employed, that can be adjusted to the sector-specific intervention logic.

Annex II: Impact (and evaluability) studies initiated in 2013

In 2013 broad impact studies for the GFs became a key component in evaluation. Whereas FMO's traditional approach mainly aimed at accountability at client level over a large sample of transactions, these broader impact studies focus at learning at multiple stakeholder levels from a limited number of projects. The demand for demonstrating achieved results in development cooperation to the Dutch parliament has increased over the years. The Ministry of Foreign Affairs asked FMO to improve Government Funds' results achievement and evaluability by strengthening impact assessment, monitoring and – rigorous - evaluation, to more clearly demonstrate the Funds' contribution to economic development and, in the end, poverty alleviation. First, results analysis needed to be focused more on the end users who are aimed to benefit from projects (rather than at FMO's clients only, who are typically intermediaries in serving the needs of the end users). Secondly, the new evaluation designs needed to show that development results can be attributed to FMO's involvement and that the change would not have happened anyway. Therefore similar projects, which are not subject to FMO financing, are compared to FMO interventions to show differences in development impact.

The use of a) baselines and control groups and b) the focus at relatively large samples of end-users - instead of purely focusing at FMO clients - require special expertise. Therefore the use of an evaluation expert panel and of external researchers that execute the impact studies (also ensuring independency) are essential in the new evaluation set-up. Approximately four times per year, the evaluation panel meets to advise FMO on quality in sample selection, selection of evaluation methodologies and work quality of external evaluation team. The panel also gives access to a network of researchers who can be approached to do the impact evaluations. Several impact studies were initiated in 2013. However the results in terms of accountability and learning will become available over a longer period only. All impact studies are preceded by an evaluability study to verify whether a full impact study is feasible. Desk research and field visits should find out whether sufficient data is available, whether stakeholders are willing to facilitate the process and provide reliable information and whether solid evaluation design could be developed. In 2013 four evaluability studies were started, of which two for the MASSIF fund, one for IDF and one for AEF. First (intermediate) results will become available in 2015. Below, we provide an impression of the studies that have been started in 2013:

MASSIF: PE fund for SMEs in Sub Sahara Africa

The Amsterdam Institute for International Development (AIID) advised FMO how the development impact of a PE fund investing in SMEs in SSA could be evaluated. The fund provides high risk capital finance to fast growing SMEs in four SSA countries which do not have capital access. The evaluation will focus on impact at the end-users level, the SME clients of the fund, and the extent to which they are credit constrained prior to the fund's investment. A control group can be established with SME's which did not pass the last step of the credit selection process or via matching treatment firms with similar companies in the market. Access to alternative sources of financing will be assessed by tracking how successful the SMEs in the control group are in obtaining financing. The study will also assess the catalytic effect of the investment, in attracting other investments to the area. Effects on economic growth will be considered via SME labor productivity and innovations at SME level.

AEF: Solar off-grid electrification in Senegal

FMO contracted Rheinisch-Westfälisches Institute für Wirtschaftsforschung (RWI) Essen for an impact evaluability study on solar rural (off-grid) electrification of 30 villages in Senegal. Whereas most rural electrification projects are subsidized, it can be assessed if the commercial approach of (solar-based) mini grids is a cost recovering viable business model. The proposed evaluation targets end-users on household, micro-enterprise and village level. The study will also investigate whether better returns on investments are reached when the financing is combined with microfinance possibilities for end-users. Control groups can be found in villages which are not electrified or will – within the funding programme - be electrified only in a later stage.

MASSIF: Microfinance fund Bolivia

The feasibility of an impact study of a Bolivian microfinance fund is being investigated by the Rijksuniversiteit Groningen (RUG). Improved development results might be caused by a change in the fund's strategy wherein end-clients are offered a combination of financing, capacity development and market access. The fund seems to differ from peers in that it offers flexible repayment schedules to clients. End-users can be easily targeted in the study as the fund is open to provide much information on its clients. Obtaining a control group (from another bank or MFI) would be difficult. Therefore, FMO-A (which has other goals than GFs) clients are approached to check their interest to provide a control group. Another control group can be constructed among people without access to microfinance, though these are scarce.

IDF: Toll bridge in West-Africa

NORC of the University of Chicago studied the possibilities for an impact analysis of a toll bridge in a city in West-Africa. The bridge aims to relief traffic congestions in different parts of the city and connects a business area with a residential area. It will probably not be feasible to find a control group that is exposed to similar circumstances. End-users of the bridge can be investigated. Moreover, non-bridge-users who experience congestion relief in parts of the city shall also be influenced and might be considered as well. An evaluation design will be presented next year.