



Corporate Evaluation

Opportunities for the Majority Initiative



ABSTRACT

The Opportunities for the Majority Initiative (OMJ) was originally set up for three years as a time-bound pilot initiative. The OMJ team has worked diligently to test the Base of the Pyramid model and develop the OMJ portfolio, and from that standpoint the initiative has been successful. Regarding OMJ's operational objectives, its achievements on targeting, innovation, learning, and replication have been mixed. OMJ has not found a unique market niche that cannot be served by another IDB Group private sector window with significant operational advantages over OMJ.

In light of the findings, the IDB should strengthen OMJ's operations; improve the evaluability, monitoring and evaluation of projects; and adapt risk management, pricing, and legal procedures to facilitate interactions with lower-income clients. The IDB should consider options for consolidating OMJ activities and those of other IDB Group private sector windows.

Evaluation of the
**Opportunities
for the Majority
Initiative**

OFFICE OF EVALUATION AND OVERSIGHT, OVE



Inter-American Development Bank

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ACRONYMS

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ACRONYMS

ANDA	Administración Nacional de Acueductos y Alcantarillados
BCI	Banco de Crédito e Inversiones
BMI	Banco Multisectorial de Inversiones
BoP	Base of the Pyramid
DIAS	Development Impact and Additionality Scoring System
ECD	Early Child Development
EPM	Empresas Públicas de Medellín
ERR	Economic Rate of Return
FCR	Financial Contribution Rating
FEDECREDITO	Federación de Cajas de Crédito y de Bancos de los Trabajadores
FIHIDROS	Financing for the Salvadoran Water and Sanitation System Access Fund
FONAVIPO	Fondo Nacional De Vivienda Popular
FOPEPRO	Fondo para los Pequeños Productores en América Latina
FRR	Financial Rate of Return
GDP	Gross Domestic Product
GIIN	Global Impact Investing Network
GP	Global Partnership
HEFF	Higher Education Financing for Low-income Students
IDB	Inter-American Development Bank
IDEPRO	Instituto para el Desarrollo de la Pequeña Unidad Productiva
IIC	Inter-American Investment Corporation
IRR	Internal Rate of Return
LAC	Latin America and Caribbean
LOCFUND	Local Currency Fund
M&E	Monitoring & Evaluation
MFI	Microfinance Institutions
MIF	Multilateral Investment Fund
MNC	Multinational Companies
MSME	Micro Small and Medium Enterprise
NGO	Non Government Organization
NSG	Non Sovereign Guaranteed
OMJ	Opportunities for the Majority Initiative
OVE	Office of Evaluation and Oversight
NSG	Non-Sovereign Guaranteed
NYL	New York Law
OLPES	Local Small-Scale Community Operators
ORP	Outreach and Partnerships
PCG	Partial Credit Guarantee
PMU	Project Management Unit
PRONADERS	Programa Nacional de Desarrollo Rural y Urbano Sostenible
PSR	Project Supervision Report
RC	Risk Classification
RGM	Risk and Management Unit
ROIC	Return on Investment Capital
SCF	Structured and Corporate Finance Department
SEP	Social Entrepreneur Program
SME	Small and Medium Enterprise
SYN	Syndication
TC	Technical Cooperation

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Sunflower field that belongs to Sabritas-MX, an agriculture project sponsored by PEPSICO in Mexico, which received a PCG to provide working capital and technical assistance to farmers switching from palm to sunflower cultivation.
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Executive Summary

The Opportunities for the Majority Initiative (OMJ) was approved by IDB’s Board of Executive Directors in March 2007. At that time it was envisioned to be in operation for a period of three years, at which time it was expected to be “integrate[d] with Bank activities ... and disbande[d].” The Board approved a three-phase implementation process for the initiative. The “incubation” phase took approximately one year, and the subsequent two phases were implemented over the 2008-11 period. In July 2011 Management reported to the Board on progress under the Initiative.

OMJ’s mission is to promote the inclusion through market-oriented initiatives of the “Majority” or the “Bottom of the Pyramid” (BoP) – defined as people with annual income less than US\$3,260 at 2005 purchasing power parity (estimated in 2007 to encompass 70% of the LAC population). In doing so OMJ should identify the market failures that impede the inclusion of the BoP and should support replicable, profitable, and innovative business models to address those market failures.

This evaluation, prepared in response to a request by the Board of Executive Directors, focuses on OMJ’s project lending and assesses to what extent OMJ’s objectives are being achieved, recognizing that OMJ projects are generally still in early stages of implementation. To gather evidence the evaluation team reviewed the documents provided by the Bank, made field visits to all OMJ projects approved up to February 2012, and conducted structured interviews with counterparts, beneficiaries, and Bank staff at headquarters and in country offices. The evaluation does not cover internal management issues or non-project outreach efforts in depth.



In general, the companies supported by OMJ in the agriculture sector provide micro-loans, working capital and/or technical assistance.

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FINDINGS

The effectiveness of the OMJ Initiative in meeting its core objectives appears mixed to date. The OMJ team has worked hard to bring the program to life, to mobilize impact investors and the BoP community, to introduce financial and legal innovations within IDB, and to build a robust and varied portfolio. The evaluation recognizes these achievements while also finding significant challenges, as outlined below.

Business Development. The OMJ team has worked diligently to identify a market niche in which solutions for the Bottom of the Pyramid (BoP) can be tested. Even using internal procedures more adequate to sophisticated clients, OMJ has been able to build up a diverse portfolio, providing financing (to February 2012) of US\$186.2 million of the US\$250 million approved in 2007 for OMJ lending, including 26 loan operations and six Partial Credit Guarantees. Complementing the lending operations, OMJ has financed a portfolio of 31 Technical Cooperations (US\$6.34 million), most of which are still in progress. OMJ has also made significant efforts to build a system to monitor project indicators.

Project Logic and Design. The underlying rationale for OMJ engagement is to address market failures. OVE's evaluation found that thirteen of the 32 OMJ projects clearly identified in loan proposals the market failure and two identified the government failure that the project is designed to address. These failures include asymmetric information, missing markets, regulatory failure, and underinvestment in the provision of semi-public goods, and OMJ's models have provided credit and credit-history systems for individuals and micro and small enterprises (MSMEs), expanded value chains for small producers, and provided social infrastructure, education, social housing, and health and nutrition services.

In the other 20 projects reviewed, the market or government failures to be addressed – and thus the underlying program logic – were not clearly identified in the loan proposals. During the evaluation the OVE team sought to fill these gaps in program logic by independently identifying a potential economic rationale for each project. This was possible in most though not all of the projects, and whether the OMJ project was appropriately designed to address those rationale could not be verified.

Evaluability and Learning. Project evaluability is a key to ensuring learning and promoting successful replication. OVE found that ten of the projects reviewed were structured at the time of Board approval (when evaluability is generally assessed) to measure results by defining baselines and outcome indicators. Almost one-half included indicators on profitability. OMJ has made further efforts to define and measure performance indicators for projects during implementation, including through its PULSE system. To date no OMJ project has been designed for careful impact evaluation, which would help to understand fully the development impact and sustainability of OMJ models.

Reaching the Target Population. In defining its target population OMJ uses the terms “BoP”, “low income” and “poor” interchangeably. Yet these terms are not synonymous, as the BoP includes over two-thirds of Latin America’s population, far more than fall under national poverty lines. OVE analyzed data on current beneficiaries of 16 out of 41 OMJ clients (all those who were able to provide such data to OVE). Many projects have a relatively high proportion of beneficiaries at the BoP, though in many of these cases most beneficiaries are very near to the threshold. Only a small set of projects reach beneficiaries with incomes below national poverty lines.

Business Performance. Though it is too early to judge definitively, initial results point to a possible negative association between BoP targeting and likely business performance in OMJ projects approved to date, with worse business performance occurring on average in projects with better targeting (particularly if the BoP target is replaced by a poverty measure). It is important for the development and business communities to seek ways to serve the poor through market-driven private sector activities, but it must also be recognized that achieving the “double bottom line” (reaching the poor in a profitable way) is a difficult endeavor. The effectiveness and longer-term sustainability of business models supported by OMJ must therefore be monitored carefully.

Innovation and Additionality. Half of clients reported some non-financial additionality, most frequently related to reputation. In 19% of projects there was evidence that OMJ provided knowledge and/or corporate strengthening to its clients. One-third of projects appear to have supported “disruptive” or “incremental” innovations introducing new business approaches (generally devised by the firms themselves), with another half of OMJ projects supporting “replication,” or applying known models in new settings.

Overlaps with Other Private Sector Windows. OMJ supports similar sectors and target populations as other IDB private sector windows. A comparison of OMJ’s loans with a sample of IIC, MIF and SCF loans shows significant overlap among the projects’ objectives and clients. Numerous OMJ clients have also received support from other IDB private sector windows, and in interviews with OVE some expressed indifference or lack of clarity about the differences among them.

Internal Procedures. OMJ’s framework for risk assessment and pricing follows that of SCF (as both are supported by the IDB’s Ordinary Capital), though SCF’s benchmarks are based on clients with larger sizes and different business profiles than OMJ’s clients. MIF and IIC assess the risks of their operations and price them somewhat differently from SCF. IIC adopts a “portfolio approach” in assessing risk and pricing individual loans to “maximize development impact while maintaining long-term financial sustainability.” MIF contracts with IIC to use IIC risk assessment and pricing mechanisms for its loans. Regarding legal procedures, OMJ’s clients are critical of both the complexity and costs of their contracts. Loan agreements and

related financial documents for OMJ's operations are generally governed primarily by New York Law (NYL), consistent with the practice of most international financial institutions in their NSG financing. This is not an issue for SCF's clients because they tend to be financially sophisticated and have previous international financing experience. However, for OMJ's clients, the cost of understanding and negotiating NYL documentation can be high. According to OMJ staff, the high cost of finance is the most frequent reason for dropped projects, and OMJ and the Legal Department have recently been testing new approaches to address these concerns.

OMJ was originally set up for 3 years as an experimental and time-bound pilot initiative, with the intention of folding it into other IDB Group private sector windows at the end of that period. The OMJ team has worked diligently to test the BoP model and develop the OMJ portfolio, and publicize BoP approaches more broadly, and from that standpoint the Initiative should be viewed as a successful pilot. Regarding OMJ's more specific operational objectives, the evaluation finds that its achievements to date on targeting, innovation, learning, and replication have been mixed, and OMJ has not discovered a unique market niche that cannot be served by another IDB Group private sector window. Furthermore, interviews conducted for the evaluation indicate that the other private sector windows may have significant operational advantages over OMJ. IIC operations benefit from a more flexible "portfolio approach" to pricing and risk management and the expertise it has accumulated in pricing and legal support for operations with smaller SME clients (including through its loan pricing work on behalf of MIF). MIF has a similar mission to OMJ's to "act as development laboratory" to support innovative solutions to addressing poverty and supporting MSMEs, and it has access to more flexible grant instruments and resources for technical cooperation. MIF and IIC loans target clients with similar sizes and profiles to OMJ clients but have lower processing costs, and their operations take much less time from approval to signing. SCF's risk management, pricing, and legal procedures fit better with the larger projects it supports. In considering options for the future, OVE recognizes that these operational factors need to be considered alongside other factors -- including sources of funding, governance arrangements, internal management practices, and reputational issues -- that were outside the scope of this evaluation.

RECOMMENDATIONS

Based on the findings in this evaluation, OVE recommends that Management:

Strengthen OMJ's current operations:

- Carefully identify up-front in every project (including in loan documents) (i) the market and/or government failure that the intervention is designed to address and how the project will address it, (ii) the innovation that it is expected to support, and (iii) the target population and means to reach it;
- Improve the evaluability and M&E of projects -- including incorporating impact evaluations into a subset of operations -- in order to measure business performance and economic results and to learn from experience;
- Adapt risk management, pricing, and legal procedures to facilitate interactions with smaller and lower-income clients.

Consider options for consolidating OMJ activities and those of other IDB Group private sector windows, given the clear overlap in objectives and client base among the windows and the Board's original time-bound mandate for OMJ.



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OMJ's main hypothesis is that the private sector, working with communities and governments, can create jobs, increase income, and incorporate local communities as producers, while also being profitable.
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1 Introduction

In March 2007 IDB’s Board of Executive Directors approved the Opportunities of the Majority Initiative (OMJ) and its Financing Facility. OMJ was created to finance individual non-sovereign-guaranteed (NSG) loans and guarantees to support market-based solutions for poor and low-income communities (GN-2430-6). According to the Board resolution (DE-27/07), the amount of financing for any individual operation “shall not exceed the equivalent of US\$10 million from the Ordinary Capital resources of the Bank. All operations approved under the Facility will be counted against the 10% financing limit authorized by the Board of Governors (Resolution AG-9/01) to finance operations without sovereign guarantees.”

The Board also decided that OMJ’s budget should not exceed a total of US\$250 million during its three-year original term. The Initiative was originally envisioned as having a three-year life: “Management recommends that [OMJ] pursue a strategy based on a market based approach, to be implemented in phases, led by a small team with a mandate to fully integrate the initiative with Bank activities in 36 months and disband” (GN-2430-6, p.1).

In June 2007 the Board approved a three-phase implementation process for the initiative (GN-2430-7). The main objective of the first phase was to identify an implementation plan to be executed in the next two phases. This plan contemplated the identification of the “majority” needs and business models to address these needs. It also considered the identification of potential clients and partnerships to address private solutions, the definition of Bank products to be used, a plan for fundraising, and the integration of OMJ activities with NSG procedures (GN-2430-6, p.7).¹ In March 2008 Management reported to the Board the results of the first phase – the “incubation” phase – and received approval of its Implementation Plan for the two

OMJ's portfolio information updated to February 2012 shows that OMJ has built a portfolio of 32 projects (US\$186.2 million). These include 26 loan operations (US\$143.7 million) and six Partial Credit Guarantees (PCGs) (US\$42.5 million).

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subsequent phases (GN-2430-10). In June 2011, OMJ reported to the Board on the initiative's implementation to date (GN-2430-15), stating that “three years later, OMJ’s growing private sector operations portfolio and pipeline show that the poor can be served through innovative and inclusive business models that apply sustainable strategies to bring real development solutions to their communities.”

In July 2011 Management reported to the Board on progress under the Initiative. The Board resolved: (1) “...to (i) remove the US\$250 million cumulative cap to which all loans and guarantees granted under the OM Facility were originally subject and (ii) approve the OMJ plan for the 2011-2015 period set forth in section VI of document GN-2430-15;² (2) That [OVE] shall present to the Board of Executive Directors an evaluation of the OMJ during the first semester of 2012. Management shall adopt and implement any recommendations resulting from such evaluation that are approved

by the Board of Executive Directors; (3) That OM Facility operations continue to be counted against the limit authorized by the Board to finance operations without sovereign guarantees contemplated in document AB-2764...” (Resolution DE-62/11).

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With a population of 2.7 million, Medellín is the second largest city in Colombia.
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2 OMJ Objectives and Portfolio

A. FOUNDATIONS

At the start of the 2000s, several academics and research groups began to promote a new approach to poverty alleviation, termed the Bottom of the Pyramid (BoP), promoting market solutions for poor and low-income communities (see e.g. Prahalad 2004, Hart 2005, and London 2007). As summarized by London (2007, p.8), “This alignment between profits and poverty alleviation is a key relationship at the heart of a BoP perspective.”

The general assumptions of the original BoP approach were as follows: (i) There is much untapped purchasing power at the BoP; (ii) Private companies can make profits by selling to the poor; (iii) Through these sales private companies can bring prosperity to the poor and help eradicate poverty; (iv) Large multinational companies (MNCs) should play the leading role in this process of selling to the poor. Prahalad (2004) argued that new business models were required and that MNCs were better placed, financially and technologically, to adapt their products or services to the needs of the BoP throughout their supply, distribution, and value chains than small scale operators such as Non Government Organizations (NGOs) or medium sized enterprises.

Though inspired by Prahalad’s original contribution, other BoP authors have adopted a broader framework. They have approached the people at the BoP not only as consumers but also as potential producers and entrepreneurs (Hart 2005), and recognized that the BoP’s needs can be addressed by socially-oriented organizations, cooperatives, and domestic firms (London 2007) as well as MNCs. This broader framework underlies OMJ’s initiative.

B. OMJ's OBJECTIVES

OMJ's overall objective is to promote the inclusion of the "majority," or the BoP, through market-oriented initiatives. OMJ's main hypothesis is that the private sector, working with communities and governments, can create jobs, increase income, and incorporate local communities as producers, while also being profitable. Following this assumption, the initiative is meant to support interventions that address market failures through innovative, scalable and replicable models (GN-2430-7).

OVE identified several sub-objectives from OMJ's documents and approach:

- **Identification of market failure:** To be a successful solution, an OMJ business model should be designed to address one or more market failures that prevent the majority from accessing goods and services (GN-2430-6).
- **Replication:** OMJ projects should have the potential to be replicated and to allow the initiative to learn from good practices (GN-2430-7, p.2, Annex 1).
- **Targeting:** OMJ's objective is to promote the inclusion of the "majority" or the BoP, defined as people with annual income of US\$3,260 or less at 2005 purchasing power parity. The initiative states that the "majority" corresponds to 70% of the LAC population, comprising 360 million people. In this evaluation "BoP" refers to people below the OMJ threshold and "poor" refers to those below national poverty lines³ (GN-2430-6).
- **Business performance, additionality and innovation:** OMJ's hypothesis is that innovative private sector models are able to reach the BoP in a sustainable way while being profitable. OMJ projects should thus provide innovation, be profitable, and display clear additionality above and beyond what would otherwise be achieved (GN-2430-7).

C. THE OMJ PORTFOLIO

OMJ's operations have supported a total of 41 clients in the following sectors: i) agriculture; ii) education, iii) social infrastructure; iv) social housing; v) micro, small and medium enterprises (SMEs); vi) access to finance (including microfinance institutions, MFIs); vii) health and nutrition, and viii) multi-sectoral funds.

The portfolio information updated to February 2012 (Figure 1) shows that OMJ has built a portfolio of 32 projects (US\$186.2 million). These include 26 loan operations (US\$143.7 million) and six Partial Credit Guarantees (PCGs) (US\$42.5 million).⁴ Table 1 contains a brief description of these loans and PCGs.

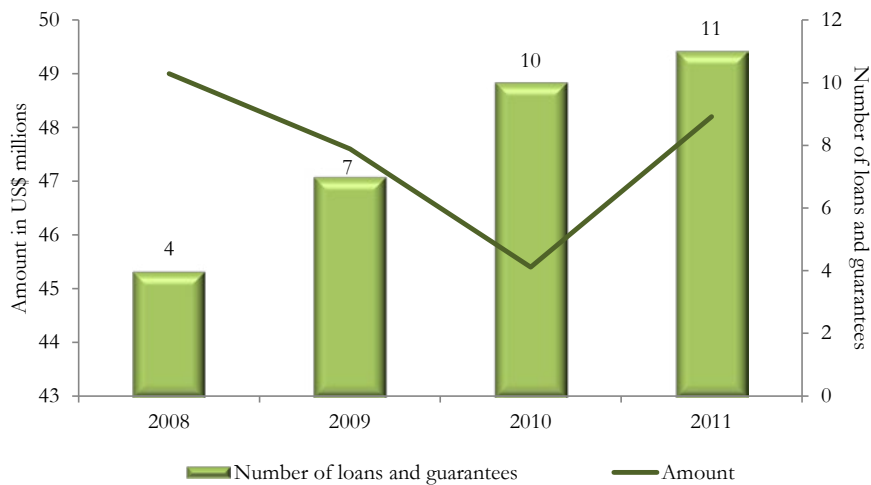


FIGURE 1

Evolution of Loan and PCGs

OMJ has also financed a portfolio of 31 Technical Cooperations (US\$6.34 million) (Figure 2). Of these, 22 are in execution (US\$5.16 million) and nine have closed (US\$1.18 million). The TCs finance market studies and private sector mappings (US\$ 2.33 million) and the strengthening of clients' business tools (US\$ 4.01 million).⁵

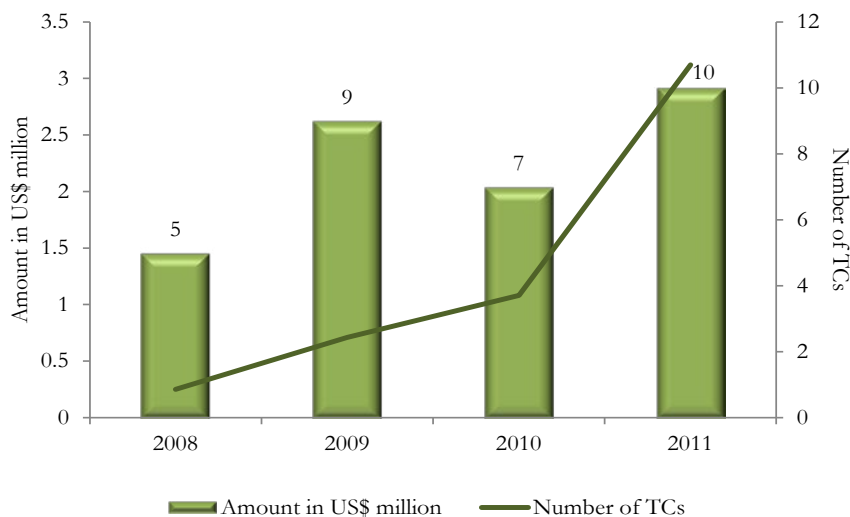


FIGURE 2

Evolution of TCs

OMJ has been able to tap external sources of funding despite difficulties in finding donors aimed at providing grants to private sector beneficiaries.⁶ OMJ resources have come from nine funds, primarily the Korean Poverty Reduction fund (28%), Market-Based Solutions for Social Change Multidonor Trust Fund (19%), and Japan Special Fund for Poverty Reduction (14%).⁷ Figures A.1 and A.2 show the amount donated by each fund as well as the proportions.

TABLE 1 – DESCRIPTION OF OMJ’S PORTFOLIO OF PROJECT LOAN AND PCGS

Sector	Project	Country	Year	Amount (US\$ million)	Description
Agriculture	Agricorp	NI	2009	3.6	Multinational export company owned by Riceland Foods provides working capital and technical assistance to farmers switching to a new product
	La Riojana	AR	2010	2.9	Cooperative provides micro-loans directly to individual producers
	LATCO	BO	2011	2.1	Local export company provides working capital and technical assistance to farmers switching to a new product
	FOPEPRO	RG	2011	2.0	Regional Agricultural investment fund lends to microfinance institutions (MFIs) aimed at providing micro-loans to small producers
	Sabritas*	MX	2010	5.0	PEPSICO’s Sponsored-project provides working capital and technical assistance to farmers who switch to sunflower cultivation
Education	PUPA	BR	2011	3.0	Start-up company will recruit and manage micro-franchisees to sell LEGO for early child development in formal and informal daycare centers
	FINAE	ME	2010	2.0	Private institution provides student loans for private higher education
	HEFF	RG	2011	10.0	Regional private fund will invest in micro lender in order to enhance higher education financing
Social Infrastructure	Mejora Tu Calle*	MX	2008	10.0	CEMEX’s Sponsored-project establishes public-private partnerships with Mexican municipalities to provide paved streets
	Jardin Azuayo	EC	2010	3.0	Cooperative provides micro-loans for individuals and local organizations to improve community infrastructure
	Fedecredito	ES	2010	10.0	Second-tier institution provides finance and technical assistance to cooperatives/commercial associations build and modernize municipal markets
	Fundación Covelo	RG	2011	3.0	Second-tier institution lends to microfinance institutions (MFI) to enhance lending for acquisition of solar photovoltaic systems by rural householders
	Fihidro	ES	2011	2.0	MFI provides credit to rural water companies (OLPES) in order to improve their water system provision
Social Housing	Caja Ica	PE	2010	3.0	MFI provides micro-loans for housing acquisition and improvement
	Caja Maynas	PE	2010	2.0	MFI provides micro-loans for housing acquisition and improvement
	Caja Sullana	PE	2010	5.0	MFI provides micro-loans for housing acquisition and improvement
	Fonavipo	ES	2009	7.0	Non-governmental organization (NGO) enhances the funding of unregulated MFIs to finance microloan housing programs to “poor households”
	Vision Bank*	PR	2010	2.5	Bank finances three different housing solutions in accordance with clients’ capacity to pay
	Credifamilia*	CO	2011	5.0	MFI provides mortgage for housing acquisition and improvement
	Patrimonio Hoy*	MX	2011	10.0	CEMEX’s Sponsored-project provides micro-loans, technical assistance and the provision of construction materials for “poor unbanked families”

Sector	Project	Country	Year	Amount	Description
				(US\$ million)	
Access to Finance	EPM	CO	2009	10.0	Public utility company provides micro-loans for households' acquisition of durable goods while allowing them to gain a credit history
	Mi Banco	PE	2009	10.0	MFI provides traditional solutions of microfinance plus a technical assistance component directed to female-owned small microenterprises (MSMES)
SMEs	Tenda	BR	2010	10.0	Wholesale company provides micro-loans and technical assistance to MSMEs in the food sector
	FIDEMYPE	ES	2008	4.0	Publicly-owned second tier bank funds 23 unregulated MFIs that support urban and rural MSMEs
	Idepro	BO	2011	5.0	NGO finances and assists SMEs linked commercially with processing- production-chains enterprises in farming, textile and tourism sectors
	G&T	GU	2008	10.0	Second-tier Bank finances MFIs to enhance their financial services (access to its ATM networks, savings accounts, micro-insurance and remittances)
	Banorte	BR	2011	5.0	NGO provides credit and training for small stores that are clients of large distribution networks' partners
	BCI*	CH	2009	10.0	Bank provides credit and training for small stores that are clients of large distribution networks' partners
	Mi Tienda	MX	2009	2.0	Wholesale company supplies small stores through door-to-door schemes and offers them micro-franchises (consultancy and training services)
Health and Nutrition	Ancalmo	ES	2011	1.1	Pharmaceutical company diversifies its activities by producing and distributing micronutrient powders – chispitas - through its regular sales chain
Multi Sectoral Fund	Global Partnerships	RG	2009	5.0	Regional fund supports SMEs and MSMEs aimed at providing social housing, micro-insurance, health care, education, savings and pension programs
	IGNIA	RG	2008	25.0	Fund invests in SMEs targeting social housing, agriculture, social infrastructure, health insurance and eye care for “poor people” in Mexico

Note: * Asterisk indicates that the project is a PCG; absence of this mark indicates a loan.

Mi Tienda-MX provides credit for small local markets based on information provided by wholesale distribution partners; this business model upgrades traditional banking for small entrepreneurs as it provides an additional tool to assess their payment capacity.

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D. METHODOLOGY OF THE EVALUATION

This evaluation focuses on OMJ's project lending and assesses whether OMJ is achieving its operational objectives. The evaluation team (i) reviewed all documentary evidence provided by Bank Management; (ii) personally visited every OMJ project approved before February 2012, conducting structured interviews with OMJ clients and project beneficiaries during these field visits; (iii) analyzed micro-data on beneficiaries obtained from OMJ clients; (iv) gathered additional information from OMJ clients through an on-line survey; and (iv) conducted structured interviews with IDB Group staff at headquarters and in country offices (See Box 1). The evaluation did not address internal management issues or assess non-project outreach efforts in depth.

BOX 1 –EVALUATION INSTRUMENTS

Desk review. OVE reviewed all existing official documentation since the OMJ's launch, including private sector strategies and business plans, OMJ's general documents, loan proposals and project supervision reports. The review assessed individual projects by analyzing project design and implementation and included an overview of BoP literature.

Field Visits. The field visits covered all OMJ projects, which by February 2012 had been approved in 12 countries (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Paraguay and Peru). During these visits, structured interviews were conducted with Bank's clients and clients' beneficiaries. The aim of these missions was twofold: (i) to validate and complement the desk review assessments and (ii) to collect administrative micro-data from all OMJ clients.

Client Micro-data Analysis. OVE analyzed micro-data provided by 16 OMJ clients (representing all sectors supported by OMJ) to understand the household income profile of beneficiaries. OVE asked for micro-data from all OMJ clients that are recipients of loans, PCGs and TCs, and 19 out of 32 shared data. In three of the 19 cases (*LATCO-BO*, *BMI-ES* and *Vision Habitat-PR*) the quality of data did not allow OVE to conduct the analysis.⁸

Online Survey. OVE conducted an online survey of Bank clients aimed at documenting their perceptions of the Bank's quality of work and added value. The survey was sent to all OMJ clients who received loans, PCGs and/or TCs. The questionnaire ranged over several topics including the Bank's added value, bureaucracy and flexibility; comparative pricing and tenor (if applicable); development objectives and their monitoring; etc. The survey received 39 responses from a total of 41 clients.

Structured Interviews of IDB Group Staff. OVE conducted structured interviews with staff of the IDB Group's private sector windows to complement desk review and field visit assessments. These interviews helped shed light on the extent of overlaps between OMJ and the IDB Group's other private sector windows and the adequacy of OMJ's internal processing procedures.

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OMJ's projects can use micro-loans as the instrument to address SMEs' credit constraints, the absence of inclusive value chains, and a lack of credit history.
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3 Meeting OMJ Objectives

A. PROJECT DESIGN AND LOGIC

OMJ aims to address the market failures that have constrained the private sector from reaching the “majority”.⁹ As stated in GN-2430-6, “these market failures could be due in part to information asymmetries that limit the understanding of target markets and the opportunities they present, due to the cost and difficulty of undertaking this type of analysis...Misperceptions that the poor don’t pay, don’t value quality or technology also have impeded the private sector’s response to majority markets” (GN-2430-6: 1). OVE’s portfolio review and field visits led to three findings on OMJ’s efforts to meet this objective.

Forty percent (13 of 32) of OMJ projects clearly identified, in the project documents, the market failure they aimed to address. If the problem is not clearly identified, it is unclear whether OMJ’s solution will address market failures that prevent “the private sector from reaching the majority.” For instance, in the social housing sector only two projects clearly identified market failures in their loan documents (*Patrimonio Hoy-ME* and *Credifamilia-CO*). Both projects provided innovative housing solutions through packages of credit and technical assistance for housing improvement or construction. Of the projects that did not identify market failures, only one -- *Vision Bank -PR* – provided an innovative package of housing solutions, while the others provided only financing for housing acquisition or improvements.

A few other positive examples of market failure identification stand out among these thirteen. *La Riojana-AR* identified the low investment-low return trap resulting from several constraints faced by small Argentinean producers. *FIHIDROS-ES* also identified positive externalities of access to water and sanitation and problems of network provision in rural areas of El Salvador. *Mejora Tu Calle-MX* analyzed constraints to the Mexican municipal provision of paved streets, and *EPM-CO* addressed the effects of asymmetry of information emerging from a lack of credit history among its beneficiaries in Medellin, Colombia.



More than 50% of the population of all countries except Argentina, Chile and Costa Rica are below the initiative's threshold – or more than 80% in the case of most countries in Central America.

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Two projects identified government failures that might also provide a rationale for OMJ intervention,¹⁰ such as the inadequate provision and/or regulation of semi-public goods.¹¹ They are *Credifamilia-CO* and *FIHIDROS-ES*, which identified government failures in housing interventions in Colombia and in water and sanitation in El Salvador, respectively.

In the other 20 projects reviewed, the market or government failure to be addressed – and thus the underlying program logic – is not clearly identified in the project documents, and thus it is not possible to judge from these documents whether the design of the project is appropriate to the situation. During the evaluation the OVE team sought to fill these gaps in program logic by independently identifying the potential economic rationale for each project. This was possible in most though not all of the projects (Table A.1 and Box 2), and whether the OMJ project was actually and appropriately designed to address that rationale could not be verified from OMJ documents.

It two cases it was not possible for OVE to identify any specific market failure. The first is *Sabritas-MX*, an agriculture project sponsored by PEPSICO in Mexico, which received a PCG to provide working capital and technical assistance to farmers switching from palm to sunflower cultivation. Since the local production of sunflower oil is costlier than its import, the company is receiving government subsidies to sustain local cultivation. This could create a market distortion since it is unclear whether subsidies are part of a sustainable solution to improve welfare.¹² The second is *Mi Tienda-MX*, a wholesale company in Mexico that tries to meet small entrepreneurs' needs for merchandise at lower costs and in smaller quantities than those supplied by competing wholesale stores.

The identification of the market failure alone does not mean that the logic of the problem and the model of intervention are clear. For instance, in the case of *PUPA-BR*, it is unclear whether the proposed model of ECD is effective and how micro-franchisees with very few skills are supposed to train unskilled informal daycare center staff to enhance ECD.

BOX 2: EXAMPLES OF MARKET FAILURE

Agriculture. OMJ projects can address problems related to credit constraints and missing credit markets for small producers, breaking the vicious circle of low-investment-low-return that results from technology constraints. In general, the companies supported by OMJ in this sector provide micro-loans, working capital and/or technical assistance.

Education. OMJ can help to overcome public underinvestment in human capital accumulation by supporting private interventions in the education sector to enhance higher education financing and to encourage early child development (ECD).

Social infrastructure. OMJ's projects can address the inadequate provision or regulation of semi-public goods due to the lack of either public or community financial resources. OMJ supports five companies that appear to be implementing business models to overcome these problems through loans and micro-loans to either private basic service providers or end users.

Social Housing. OMJ supports three business models that provide financing for people at the BoP. First, OMJ can enhance clients' capacity to provide micro-loans for housing acquisition. Second, some of OMJ's clients provide "financing plus housing construction" packages. Finally, the third model provides micro-loans for BoP unbanked families without a credit history, complemented by technical assistance and the provision of construction materials.

SME. OMJ's projects can use micro-loans as the instrument to address SMEs' credit constraints, the absence of inclusive value chains, and a lack of credit history. The institutions supported by OMJ focus on diverse financial services such as access to ATM networks, savings accounts, micro-insurance and remittances, and they provide traditional solutions of microfinance plus a technical assistance component directed to female-owned microenterprises. There are also financial institutions that (i) support urban and rural micro-entrepreneurs financial programs; (ii) provide credit and training for small financially underserved stores that are clients of large distribution networks' partners and; (iii) focus on micro-entrepreneurs linked commercially with processing enterprises that are part of production chains in farming, textile and tourism sectors.

Access to Finance. OMJ projects can address the problem of asymmetric information resulting from people's lack of credit history. A utility company uses the billing information and payment histories of its customers to provide micro-loans for households' acquisition of durable goods while allowing them to gain a credit history.

Health and Nutrition. OMJ can address malnutrition by supporting the production of a particular type of micronutrients for Salvadoran households at the BoP.

Multi-sectoral funds. Multi-sectoral funds invest in MSMEs targeting social housing, agriculture and social infrastructure sectors and also provide health insurance and eye care for BoP people.

Source: OVE field visits.

OVE identified several projects that are providing support for micro-private solutions at the same time that the public sector (sometimes with Bank support) is approaching similar problems and thereby potentially reducing existing market or government failures. There is little evidence of coordination between public and private sector activities in OMJ's projects for social infrastructure provision (*Fundacion Coveló-HO*), housing solutions (*Patrimonio Hoy-MX*), small farmer financing (*IDEPRO-BO*), and ECD (*PUPA-BR*). Indeed, OMJ's *Fundacion Coveló-HO* project is facing uncertainty due to a recent agreement between the Government of Honduras and South Korea to finance, at a subsidized price, solar panel solutions for 35,000 households through the *Programa Nacional de Desarrollo Rural y Urbano Sostenible* (PRONADERS). On the other hand, there are a few positive examples of collaboration within the Bank. OMJ's *FIHIDROS-ES* project in El Salvador, for example, will support microfinance to small municipal water providers as a complement to the public IDB loan 2358/OC-ES to El Salvador's National Water and Sewer Administration (ANDA). OVE also found evidence of some degree of coordination between the technical cooperation designed by the public sector to support a housing subsidy program in El Salvador and *FONAVIPO-ES*, an OMJ loan that was ultimately cancelled. These experiences suggest that there is room to improve coordination with the public sector and incorporate lessons learned into the design of solutions for the BoP.

B. EVALUABILITY AND LEARNING

OVE's analysis of loan proposals indicates that the evaluability of OMJ's projects at time of project approval has been limited, potentially affecting learning and replicability. The loan proposals approved to date have not have a full set of indicators and have particularly lacked indicators on outcomes. While projects may still specify indicators later during project implementation (and OMJ is clearly making efforts to strengthen its own monitoring system PULSE), indicators and data collected during implementation are not available as inputs to the approval process, when evaluability is typically measured in the Bank.

A minority of projects reviewed by OVE established baselines and targets for all indicators in their loan proposals. Table A.2 presents data on monitoring indicators in the 32 OMJ projects. OVE used a simple test as a first measure of evaluability: whether a project has monitoring indicators accompanied by three elements – baselines, milestones, and targets. Taking the indicators as given, if a project's monitoring and evaluation (M&E) system has all three, its score equals one according to this simple measure.¹³ Alternatively, if an indicator has only two of these attributes, its score equals 0.66.¹⁴ The average score for the OMJ projects is 0.53, indicating that there is a lot of space for improvements regarding the completeness of projects M&E systems.¹⁵ Only 14 projects presented baselines for all indicators. OVE also conducted this

analysis for the limited number of projects (10 out of 32) with development outcome indicators (see Table A.3). The overall score in this case is 0.59, and 7 of 10 projects present baselines and targets.

About one-half of projects defined business performance indicators that can provide an indication on whether the projects are profitable and potentially replicable (see Table A.4). Fifteen of 32 projects show a financial rate of return (FRR), of which seven also present an economic rate of return (ERR).

To date OMJ has not undertaken impact evaluations for any of its projects. Going forward, OMJ is planning impact evaluations to assess effectiveness of two of its projects, depending on data availability. The two projects to be analyzed are likely to be selected among *Banorte-BR*, *Vision Bank-PR*, *EPM-CO* and *Tenda-BR*.

C. DEFINING AND REACHING THE TARGET POPULATION

The description of OMJ's target population in program documents is inconsistent. As stated in the GN-2430-6 (p.1, OVE's emphasis), "the goal of the OM [J] is to pilot a novel approach that complements the Bank's efforts to improve the lives of those in the region who have been left behind. The potential of the OM [J] lies in promoting and financing an emerging business model that seeks to engage *poor and low income communities*, together with private business, in the development and delivery of quality products and services, the creation of employment opportunities, and the integration of the *majority* in the productive sector."

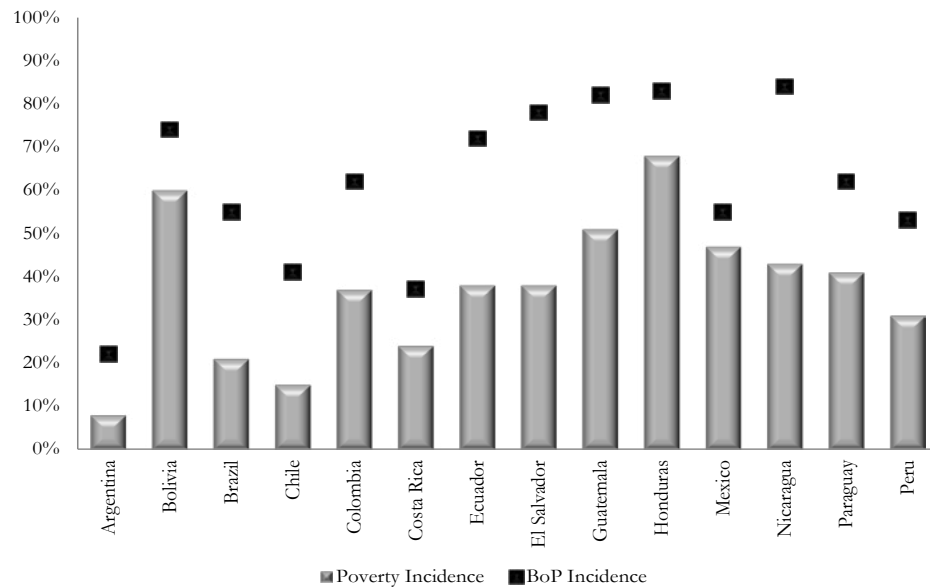
In its own definition of the target group, OMJ uses "majority (or "BoP"), "low income" and "poor" interchangeably. OMJ never defines "poor." but the definition of "majority" (or "BoP") used by OMJ is based on the income threshold of US\$3,260 (at 2005 purchasing power parity), which is higher than the official poverty lines used by Latin American and Caribbean (LAC).

Figure 3 shows the poverty and BoP incidence for the sample of LAC countries that have at least one OMJ project. (Table A.5 provides additional information.) The gray bar represents the proportion of the country's population below the poverty line, whereas the black dots correspond to the share of the country's population below the OMJ's BoP threshold.

The proportion of people in the BoP group is much higher than the proportion of poor at the country level. More than 50% of the population of all countries except Argentina, Chile and Costa Rica are below the initiative's threshold – or more than 80% in the case of most countries in Central America. On average, the population in the BoP group is 1.64 times higher than the population in poverty. The remarkably

high BoP incidence in Bolivia, Honduras, Guatemala, Ecuador, El Salvador, and Nicaragua suggest that it is unlikely that any Bank project would not reach OMJ's target population.

FIGURE 3
Poverty and BoP Incidence at
Country Level



To measure potential project targeting, OVE requested micro-data on household incomes of beneficiaries from all OMJ clients that have been recipients of loans guarantees and TCs. Benefiting from the cooperation of OMJ's clients, OVE analyzed data from 16 clients representing all sectors targeted by OMJ's projects. The beneficiary data used by OVE were already available in the clients' database even before OMJ support, since most OMJ projects are still undisbursed. This decision to use data from the active clients of undisbursed projects was based on the information gathered by OVE field visits, which indicated that the products to be financed by OMJ are likely to target beneficiaries with similar profiles to the current ones and/or enhance existing lines of business without explicit efforts to change the attributes of the client base towards better targeting of the BoP population.

Figure 4 shows a measure of likely OMJ targeting. It compares the proportion of OMJ clients' beneficiaries below the BoP threshold (gray bars) with the corresponding country's population below that threshold (black squares). If the gray bar is higher than the black square, there is at least some positive targeting to the BoP.

As shown in Figure 4, in most countries the BoP inclusion is greater at project level than at country level, indicating that most of OMJ clients are targeting BoP beneficiaries. The best targeted projects are those operating in countries or areas with a very high proportion of their population at the BoP. The six best-targeted projects are either in countries with very high BoP incidence, as in the cases of Nicaragua, Honduras and El Salvador, or in relatively poorer regions of countries with relatively

lower BoP incidence, as in the cases of *Banorte-BR*, *La Riojana-AR* and *Minuto de Dios-CO*.¹⁶ However, not all countries with a high incidence of BoP have well-targeted operations, as is clear from the case of *IDEPRO-BO* in Bolivia.

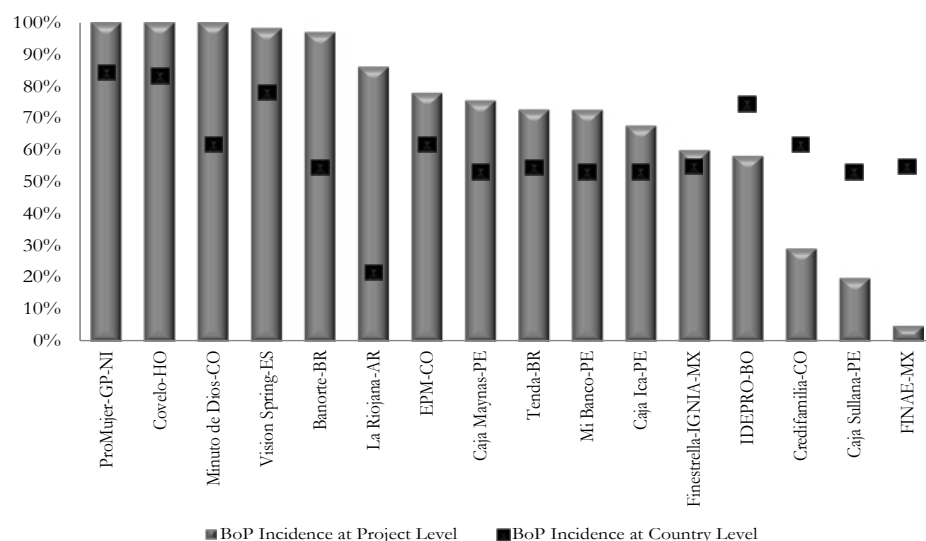


FIGURE 4
BoP Incidence at Project and
Country Levels

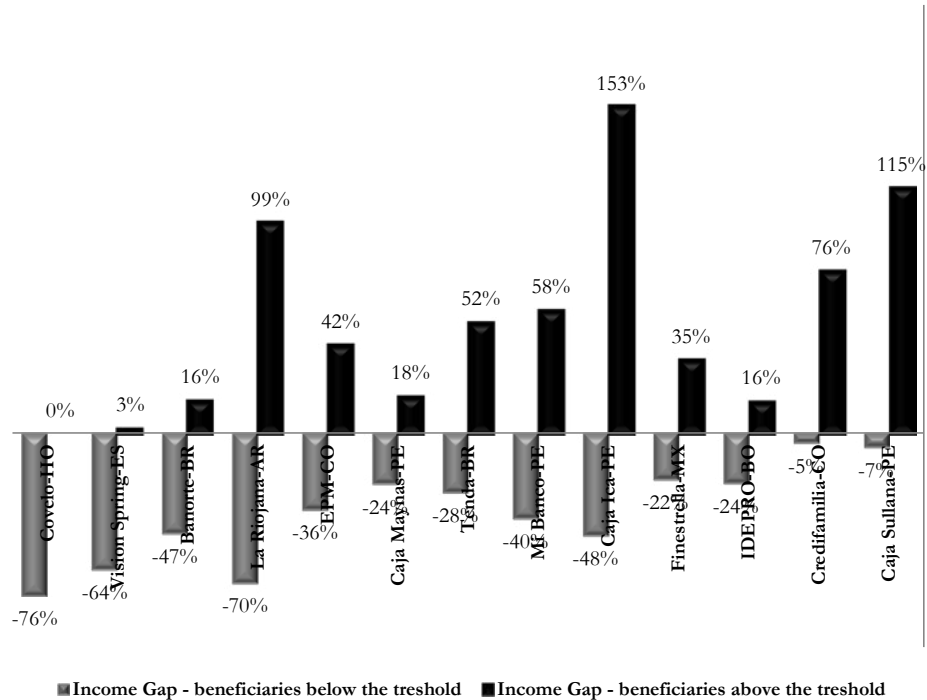
The six best-targeted operations are in diverse sectors. Two support SMEs (*ProMujer-NI* and *Banorte-BR*), one supports social infrastructure (*Fundación Covelo-HO*), one supports social housing (*Minuto de Dios-CO*), one supports health (*Vision Spring-ES*), and one is in the agriculture sector (*La Riojana-AR*).

Given that the estimation of the proportion of people below the threshold does not denote how near these beneficiaries are to the threshold, OVE also estimated the income gap for the beneficiaries below and above the threshold, as explained in Box 3.¹⁷ Figure 5 shows two income gap estimates for each of several OMJ projects -- one estimate for beneficiaries below the OMJ threshold (gray bars) and another for beneficiaries above it (black bars). Both estimates are expressed in terms of the threshold.

Clients with better BoP targeting (shown in Figure 4) are also reaching relatively worse-off beneficiaries. The correlation between the proportion of beneficiaries below the threshold and the negative income gap is estimated at 0.85. For example, 100% and 86% of the beneficiaries of *Covelo-HO* and *La Riojana-AR*, respectively, are below the OMJ threshold, and these beneficiaries have an average income that is 76% and 70% lower than the threshold. The figure also shows that most beneficiaries of some projects are close to the threshold (whether just below or just above it), as are the cases of *IDEPRO-BO*, *Tenda-BR*, *Cajas Mayans-PE*, *EPM-CO*, and *Finestrella-MX*. Finally, some OMJ clients appear to be facing difficulty in reaching people at the BoP -- such as *FINAE-MX* and the Peruvian and Colombian social housing programs *Cajas Sullana-PE* and *Credifamilia-CO*. According to the income gap estimates, the beneficiaries of

the *Credifamilia-CO* and *Caja Sullana-PE* who are above the threshold have average income 76% and 115% higher than the OMJ threshold, and the beneficiaries who are below the threshold are close to it.

FIGURE 5
Income Gap at Project Level



BOX 3. INCOME GAP ANALYSIS

The income gap is computed as the difference between the beneficiary's income and the OMJ threshold. The greater the difference, the more distant the beneficiary's income is from the threshold. To get a sense of the magnitude of this difference, the average income of beneficiaries above and below the OMJ threshold is divided by the threshold so that the gap can be expressed as a percentage of the threshold.¹⁸ There are four possible combinations. A project can have 100% of its beneficiaries below the threshold but with an income gap close to zero, meaning that those below the threshold are very close to it. A second possibility is a high incidence with a high income gap, which would suggest that the program is targeting the worse-off. A third combination is a relatively high proportion of beneficiaries above the threshold but with an average income gap close to zero, suggesting that the beneficiaries are above the threshold but close to it. Finally, the fourth combination is a low BoP incidence and high income gap, i.e. those above the line are not only above but far from it.

To get a sense of the degree of targeting of OMJ projects to the poor, OVE compared the proportion of beneficiaries below the OMJ threshold (Figure 6, gray bars) to the proportion of beneficiaries below the national poverty line (black squares). The aim of this comparison is to see whether the targeting figures would change if OMJ was

targeting the poor rather than people at the BoP. In some cases clients with a high incidence of beneficiaries at the BoP also manage to reach the poor, but in other cases, such as *Banorte-BR*, *Tenda-BR*, *Caja Maynas-PE* and *Finistrella-MX*, the poverty targeting is much lower than that of the BoP. This confirms the previous finding that some clients are not reaching the worst-off, as most of the beneficiaries are closer to the BoP threshold than to the poverty line.

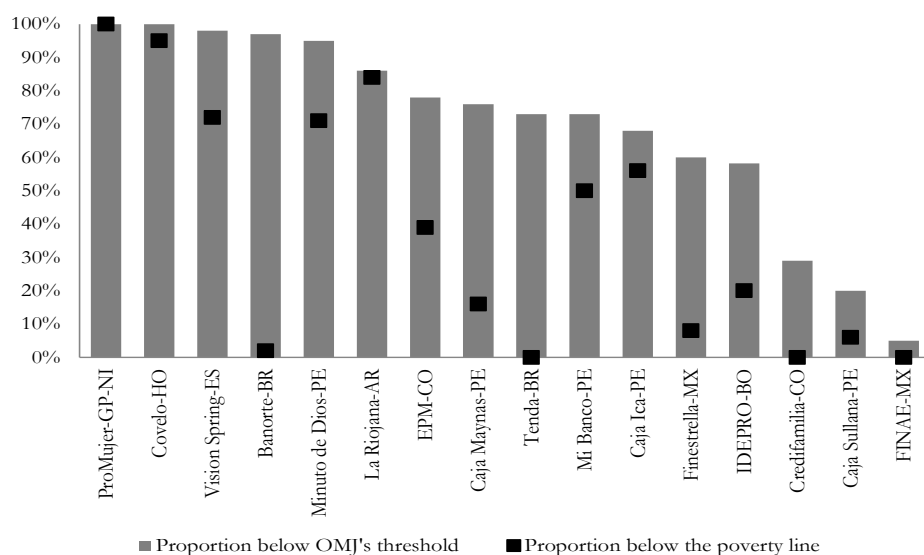


FIGURE 6
BoP and Poverty Incidence at
Project Level

In sum, the targeting analysis shows that most OMJ projects are likely to be reasonably well-targeted to the BoP, though not to the poor. A few of these are also likely to be poverty-targeted, while a broader set of projects have mixed performance – not too many beneficiaries above the BoP threshold but not too many who are poor by national standards. The beneficiaries of a small number of OMJ clients are mostly above the BoP cut-off, raising doubts about the likelihood that OMJ projects with these clients will reach their targeting objectives.

D. BUSINESS PERFORMANCE

It is too early to judge OMJ's business performance, given that its projects are in the early stages of implementation. However, as a preliminary look at what might occur in the future, OVE looked at data on business performance provided by clients as input to OMJ's pre-approval project analysis, as reported in loan documents.¹⁹

Performance to date appears to be stronger on average for those OMJ clients that do poorly in terms of targeting (Table A.6), such as *IDEPRO-BO* and *Finistrella-MX*. The exceptions are *FINAE-MX* and *Credifamilia-CO*, which are not well-targeted but still did not show indicators of good business performance at the time of the pre-approval project analysis. The negative correlation of about 0.1 between business

performance and the extent of targeting the BoP²⁰ (as discussed above) suggests that the profitability of work with people at the BoP and the affordability of products offered by OMJ clients to people at the BoP cannot be taken for granted.²¹

The evidence collected by OVE during field visits indicates that some clients appear to be prioritizing business performance in the short term because targeting the BoP during the early stages of project implementation could make it more difficult for them to break even. For example, *IGNIA's* multi-sectoral fund project risk classification was downgraded from RC4 to RC6 (watch list) in June 2010 by the Project Monitoring Unit (PMU) because the Fund's portfolio had been losing value due to the negative performance of beneficiary companies, mainly Chiapas Farms and MexVi Housing Mortgage enterprises. Ultimately, *IGNIA* decided to focus on increasing the value of its existing investments in the Mexican market before expanding regionally as originally stated in the loan document.²² None of *IGNIA's* beneficiary companies has reached the break-even point yet, although some are expected to do so in early 2012.

The challenge of profitability of BoP models is an issue that OMJ needs to consider carefully before replicating and scaling up existing models.²³ OVE's survey of clients revealed that only 56% believe that their business has the potential to be profitable without longer-term loans made by the Bank or other multilateral institutions, loans that would not be available in the local market. Indeed, *Minuto de Dios-CO* decided to finance house construction through partnership schemes and government subsidies and grants rather than through private lending, as the NGO provider was uncertain about beneficiaries' ability to pay off its micro-loans and thus its capacity to repay OMJ's loan at market rates. Similarly, though OVE does not have data on business performance for *Sabritas-MX*, this project also depends on public subsidies for sunflower seeds (accounting about one quarter of the price). The Mexican government also subsidizes social housing, a key sector for both *IGNIA* and *Patrimonio Hoy-MX*. *Vision Spring's* business model in El Salvador provides affordable reading eyeglasses thanks to donations of frames by international suppliers.

While it is important for the IDB and other development actors to continue to explore ways to support the private sector in reaching the poor, this needs to be done with care and humility. Lessons from the literature show that the double bottom line -- reaching the poor in a profitable way -- is a difficult endeavor (Box 4) and sustainability cannot be taken for granted. This appears to be supported by OMJ's experience to date, even considering that OMJ's projects are targeting groups that include people far above official poverty lines.

E. ADDITIONALITY

OVE's evidence indicates that the Bank's additionality is primarily financial.²⁵ In 63% of the operations (20 projects), financial additionality was achieved by the provision of better tenure or other financial terms than those available in the market at the time of project approval (See Table A.7). The analysis found a negative correlation of about 0.4 between OMJ's financial additionality and the size of partners in terms of assets. Considering that smaller firms have fewer financial options than multinational and large national companies, the size of the Bank's support – up to US\$10 million – is important for smaller companies.²⁶

BOX 4. TARGETING VS FINANCIAL SUSTAINABILITY:

LESSONS FROM THE LITERATURE

There is a body of evidence in the literature showing a trade-off between profitability and targeting the poor. Morduch (1999) shows, for instance, that Grameen bank cannot be considered a financially sustainable institution. Aghion et al. (2010) show that the BancoSol in Bolivia, Banco Compartamos in Mexico, and BRI in Indonesia have achieved profitability and success in their public bond offers but in terms of targeting they fall short compared to leading MFI programs in Bangladesh and India. Cull et al. (2007) used a sample of 124 MFIs to look for evidence regarding this trade-off. The authors found that only a few MFIs succeed in reaching the poor in a financially sustainable way. By the same token, Dehejia et al. (2012) show that only a handful of MFIs in Bengal managed to make a profit by working with poor people. These authors pointed out, however, that the poor reached by profitable institutions are not the poorest. Karlan and Zinman (2010) provide evidence that clients of an African MFI are very responsive to increases in a loan's interest rate. The same evidence was found by Dehejia et al. (2012). Both studies show that a small increase in the interest rate substantially reduced the demand for loans. These findings suggest that reconciling targeting with financial sustainability may not be an easy task for some institutions as the poorer tend to be very sensitive to small increases in the interest rate. Kremer et al. (2009) survey the health and education impact evaluation literature and show that the poor are very responsive to small charges for goods and services even knowing beforehand the welfare enhancement they would have if they paid a very small amount for them. The authors outline the trade-off between serving the poor and making a profit. Although the programs covered in the survey are not too similar to those supported by OMJ, they are useful as they shed light on the poor's unwillingness to pay for basic services that have large social benefits and suggest that the double-bottom line should not be taken for granted.²⁴

OVE found evidence of resource mobilization in 8 projects. OMJ has catalyzed a total of US\$47.8 million in B-loans and US\$24.4 million in co-financing to complement the approved IDB lending. This mobilization of additional resources is unevenly distributed across projects, with 8 of 25 loans presenting B-loans or co-financing an overall mobilization ratio averaging 0.50.²⁷

OVE's analysis was corroborated by interviews conducted with clients during field visits and by electronic surveys answered by the clients. Based on these two sources, OVE identified non-financial additionality in 50% of the projects supported by OMJ. The most frequent contribution appears to be the Bank's "reputation label" (41%), followed by "knowledge for innovation/replication" (19%) and, to a lesser extent "improvements in corporate governance" (9%).

During the interviews, the clients stated that the Bank's overall additionality was primarily financial. Some clients also valued technical cooperation as an important benefit of dealing with the Bank, though not all clients were aware of the possibility of receiving technical cooperation from OMJ. Similarly, 69% of the respondents to OVE's client survey stressed financing as the most important value-added coming from the Bank. Thirty-one percent also recognized non-financial additionality, either through provision of knowledge or through the demonstration of clients' social responsibility or creditworthiness to the market.

F. INNOVATION

Innovation is one of the eligibility criteria for the approval of an OMJ initiative. The OMJ documents (GN-2430-7) state that "projects should be innovative, be it for a specific market, country, or the region", and "should include new ways of doing business and accommodating the needs of the majority [by using] a hybrid or novel business model or process and partnerships or new relationships with a majority community...or the public sector for the benefit of the majority."²⁸

To evaluate this dimension, OVE used a typology that draws on the OMJ Eligibility Criteria Scorecard and on the innovation literature (see Box 5). A project is classified as having either "disruptive" or "incremental" innovation if a product, process or business model represents an innovation in the local industry. Alternatively, if a project allows the introduction of a product, service or business model in a new market or firms, it is classified as another type of innovation known as "replication."²⁹

Based on this typology, OVE classified 31% of the 32 projects in the OMJ portfolio as having disruptive or incremental innovation, 44% as promoting replication, and 25% as not presenting aspects of either (see Figure 7).³⁰ Among the eight projects in the first group, six present incremental innovation and two disruptive innovations (Table A.8). Among the disruptive innovations, the Colombian utility company *EPM-CO* is creating a paradigm shift as it is able to construct a payment history and makes possible the inclusion of some BoP people in credit markets.³¹ Another disruptive model is the *Mejora tu Calle-MX* project, which provides an alternative for people at BoP who are not likely to have their streets paved in the near future through traditional channels. In all cases of innovation, the Bank finances models devised by the firms themselves.

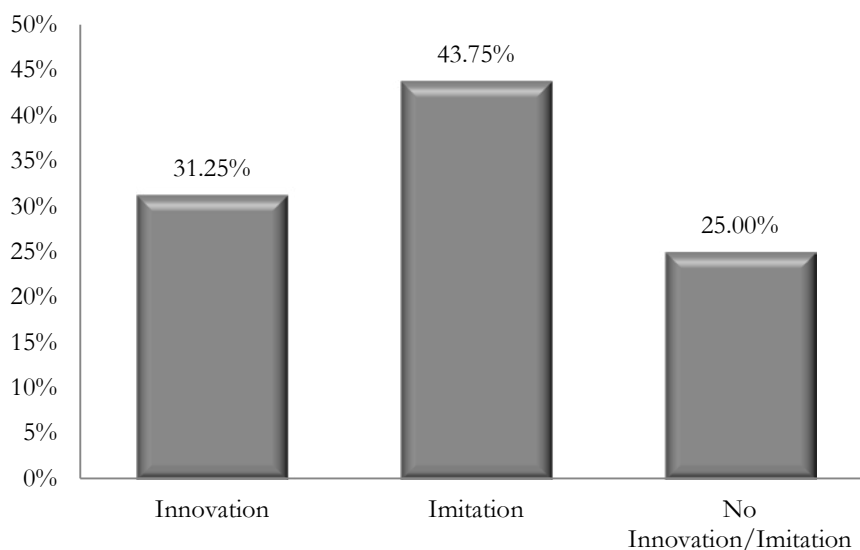


FIGURE 7
Innovativeness

BOX 5. TYPOLOGY OF INNOVATION

The typology of innovation used in this report is as follows:

(a) **Radical or Disruptive Innovation:** Radical innovation is defined as an innovation that generates discontinuities in the science and technology and/or market structure in an industry. This might influence the firm's existing marketing resources, technological resources, skills, knowledge, capabilities, or strategy. Radical innovations result in discontinuity at the industry and market level.

(b) **Incremental Innovation:** Incremental innovations can be defined as products that provide new features, benefits, or improvements to existing technology in existing market. Incremental innovations upgrade an existing business model. These upgrades may include cost-saving processes or technologies; product quality and utility improvements, environmental enhancements and others.

(c) **Replication in a New Market:** Introduction of a product, service or business model in a new geographic region and/or market segment (by a new or existing firm). Importantly, OVE paid particular attention to the introduction to the BoP market segment.

(d) **Replication in a New Firm:** Firm introduces a product, service or business model provided in the local market and that has been tried by another firm.

The first two categories presented above ((a) and (b)) are in line with the innovation literature and are very similar to the first two OMJ Eligibility Criteria Scorecard definitions. In addition, unlike OMJ, OVE used a typology for innovation that considers the introduction of products and/or services in a new market or firm. The classification used by OVE makes a clearer distinction among radical, incremental and replication concepts of innovation.



In the social housing sector only two projects clearly identified market failures in their loan documents (*Patrimonio Hoy-ME* and *Credifamilia-CO*). Both projects provided innovative housing solutions through packages of credit and technical assistance for housing improvement or construction.

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Most of the innovative projects present incremental innovations in microfinance. *Vision-PR*, *Credifamilia-CO* and *Patrimonio Hoy-MX* apply microfinance technology to provide housing loan solutions that allows these institutions to assess the payment capacity of the BoP and provide them mortgages or funds for housing improvement. Other projects that present incremental innovations are *Banorte-BR*, *BCI-CH* and *Mi Tienda-MX*. *Banorte-BR* and *BCI-CH* provide credit for small local markets based on information provided by wholesale distribution partners; this business model upgrades traditional banking for small entrepreneurs as it provides an additional tool to assess their payment capacity. *Banorte-BR* also provides micro-loans for the clients of these small markets and financial services to the unbanked and BoP people.³² Finally, *Mi Tienda-MX* is classified as an incremental innovation as it improves small shops' organization and develops the franchising model for the BoP.

In the current OMJ portfolio, replication is the main vehicle for introducing new products or practices into a market/firm serving the BoP (15 projects). Replication occurs mainly in new market segments and covers various sectors (e.g. agriculture, education, SMEs, equity funds). In the agriculture sector, *Agricorp-NI*, *Sabritas-MX*, and *LATCO-BO* are replicating and introducing different crops in new areas.³³ In the education sector, replication is occurring in the BoP segment of the market. *HEFF* and *FINAE-MX* replicate and adapt university student loans for BoP people, and the *PUPA-BR* project seeks to replicate kindergarten pedagogic models in BoP communities of Brazil.³⁴

Similarly, in the infrastructure sector OMJ projects are imitating existing solutions in BoP areas. *Fedecredito-ES* finances the construction of municipal markets for micro entrepreneurs in El Salvador, and *Fundacion Coveló-HO* and *FIHIDROS-ES* provide, respectively, solar energy and water and sanitation solutions in under-served BoP areas of Central America. Replication is also found in other sectors supported by OMJ. In the SME sector, *Tenda-BR* replicates the wholesale loyalty card model targeting BoP entrepreneurs in Sao Paulo, and *Global Partnership* and *IGNIA* replicate fund

management strategies targeting investments. *Ancalmo-ES*, a distinctive OMJ project in the health sector, is introducing a nutrition product that is already manufactured elsewhere to markets in Central America.

OMJ projects that do not present aspects of innovation or replication typically offer micro-loans either for housing or SMEs, such as *Banco G&T Continental-GU*, *FIDEMYPE-ES*, *Cajas-PE* and *MiBanco-PE*. These institutions had already been working with the same activities and technology in the same geographic area and market segments.

OVE found a positive correlation of 0.48 between the classification of innovation used in this section and the size of OMJ's partners as measured by assets. Conversely, OVE found negative correlations of 0.27 between size and replication and of 0.13 between size and non-innovativeness. These results suggest that larger firms are more innovative. Though OVE could not analyze in depth the factors behind this pattern, these results are in line with relevant literature, which suggests that larger firms are more able to diversify and mitigate the risks of pursuing innovations and have more resources to allocate to R&D departments. The literature suggests that larger firms are more innovative than smaller ones.³⁵ Waheed (2011) shows the same pattern in developing countries, where higher employment increases the likelihood of R&D and product innovation.



The availability of funding for non-financial support to SMEs is more limited in OMJ's case than in the cases of MIF and IIC.
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4 Overlaps Among Private Sector Windows

When the Board approved OMJ’s implementation process, it authorized its implementation by a dedicated unit created exclusively to support market-oriented business models targeted at the BoP. The unit was expected to be in operation for a set period of time to get the Initiative off the ground. As part of this evaluation OVE sought to verify to what extent OMJ has a different sector orientation, client base, or set of core objectives from other IDB Group private sector windows and what implications these differences might have for organization of the IDB Group’s private sector activities.

As noted in the NSG Business Plan 2012-14 (GN-2591), while each of the IDB Group’s private sector windows has a specific focus, there is overlap in certain areas, in particular regarding support to SMEs. With regard to instruments, IIC and MIF provide technical assistance, loans and equity investments to SMEs, and OMJ provides technical assistance and loans.³⁶ The availability of funding for non-financial support to SMEs is more limited in OMJ’s case than in the cases of MIF and IIC; MIF is the largest grant facility in the Region, while the IIC established the Technical Assistance and Strategic Partnerships (TAS) division in 2008 specifically tasked with “expanding sources of donor funding, as well as designing, implementing and monitoring technical assistance activities.”³⁷

All of IDB’s private windows support SMEs and mortgage programs through financial intermediaries. Both IIC and SCF provide on-lending facilities to financial institutions to expand SME access to finance. MIF also supports SMEs indirectly through NGOs and financial institutions that support MSMEs to transition to SME status.

MIF supported a US\$2-million NI-PRODEL loan (NI-M1010) to enhance “housing financing for the poor” through nine MFIs – a model is similar to OMJ’s FONAVIPO-ES.

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As mentioned above, OMJ was designed to “test a very new concept around market-based solutions to serve the poor.”³⁸ In order to assess the extent to which OMJ introduced new solutions, OVE compared OMJ’s loans with a sample of IIC, MIF and SCF loans approved from 2005 to 2011.³⁹ OVE reviewed all loan documents of IIC, MIF and SCF for the period analyzed and selected the projects that presented similar description and targeting when compared with OMJ’s projects, as explained in Box 6 (see also Tables A.9 and A.10).⁴⁰

BOX 6. DEFINING OVERLAPS AMONG PROJECTS

The overlap analysis was based on a desk review of all loan documents approved by the IDB’s private windows from 2005 to 2011 (186 of SCF, 32 of MIF and 372 of IIC). OVE looked for similarities in clients, size of the loan and projects’ objectives and description when comparing with OMJ’s projects. OVE did not visit the projects financed by other private sector windows loans and restricted its selection to projects that explicitly mentioned in their loan documents the terms “microfinance,” “BoP,” “poor” or “low-income people.” Thus, the selected sample could be even larger if the projects that are similar but do not explicitly mention those terms were included. The result of this selection criterion was a sample of 38 projects (22 from IIC and 16 from MIF) that are similar to OMJ’s projects. This suggests that at least 6% of the IIC and 50% of the MIF loans portfolios approved between 2005 and 2011 have some overlap with OMJ’s projects.

The analysis suggests a significant overlap among the objectives, targets and clients of projects that were supported by other IDB groups' private-sector window. The overlap in the MSME sector is significant, particularly between OMJ and IIC. As discussed in section III, OMJ's projects have strong focus on microfinance and/or targeting lending to people at BoP. For instance, OMJ's *BCI-CH* project indicates that it expects to "provide over 80,000 micro-loans to low-income individuals and informal microenterprises." This is similar to the IIC's *Banco Compartamos* loan (CII/PR-578), which "is aimed at the most underserved groups by providing credit to microenterprises owned primarily by women living in rural areas of Mexico." CII/PR-578 offers micro-loans to "low-income individuals and businesses owners." CII/PR-578 is one of 18 IIC projects selected that present objectives and targets similar to OMJ. Similarly, the MIF *Cordial* loan (AR-M1022) targets "middle and poor formal and informal micro entrepreneurs...Argentinean micro-entrepreneurs and their families who lack access to formal financing." OMJ's SME projects *IDEPRO-BO*, *Tenda-BR* and *Mi Tienda-ME* have a supply chain aspect. OVE found one similarly sized loan in the MIF portfolio, the project *Fundacion Sartawi* (BO-M1047), that was designed "to facilitate access to financial and nonfinancial services for the rural population, mainly linked to agricultural chains, using an integrated intervention model." This is similar to the OMJ's *IDEPRO-BO*, whose the "main objective is to strengthen the competitiveness of small producers and rural and periurban entrepreneurs in Bolivia" that are "at the base of the socioeconomic pyramid."

A second area of overlap appears to be social housing. IIC has supported four projects (in Brazil, Mexico, Panama and El Salvador) directed to housing with targets similar to OMJ's projects in this sector. The projects *Banco Itau* (CII/PR-446), *Banco La Hipotecaria* (CII/PR-572) and *Hipotecaria Su Casita* (CII/PR-359-2) offer mortgages to low-income people. The former project focuses on "poor households," while the others focus on low and middle-income households. The *Vinte Viviendas Integrales* (CII/PR-629) loan focuses on "housing for the poor" and has similar targeting as the OMJ's *Vision-PR* and *Patrimonio Hoy-MX* projects.⁴¹ MIF supported a US\$2-million *NI-PRODEL* loan (NI-M1010) to enhance "housing financing for the poor" through nine MFIs – a model is similar to OMJ's *FONAVIPO-ES*.

There are also similarities among some interventions in the agriculture sector. OMJ's *FOPEPRO* project (jointly supported by MIF) is an investment fund that targets agriculture value chains and local rural MFIs. With a similar objective, MIF lent to *RootCapital* (RG-M1153), a US\$4.9-million project which is a non-profit fund focused on developing small producers' value chains connected to commercial and nontraditional financial intermediaries in rural areas of Guatemala, Nicaragua and Honduras. In addition, MIF also lent US\$2.35 million to *Fundacion Sartawi* (BO-M1047), which, similarly to other OMJ projects (*LATCO-BO* and *Agricorp-NI*), provides access to credit and non-financial solutions for small agricultural producers.



In education, OMJ is the only window with projects that aim to increase access to education for BoP people. IIC has some projects in the education sector, but they are related to upgrading and building new education facilities.

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MIF has supported social infrastructure loan projects in Argentina that are similar to those supported by OMJ's loans. MIF's *Fundacion Pro-Vivienda Social* (MIF/AT-1042) project is a US\$3-million project that contributes to the social inclusion of "poor populations living in peri-urban areas."⁴² The purpose is to coordinate a sustainable model of demand, supply, and delivery of energy services in the second belt of Greater Buenos Aires, and one of its main components is financing external networks and home gas service connections. The OMJ's *FIHIDROS-ES* (ES-L1053) also finances social public utilities, targets local small-scale community operators that provide water and sanitation services "for low-income people in rural and periurban communities." The review performed by OVE did not identify similar infrastructure projects undertaken by the IIC.⁴³

In other sectors OVE's review suggests that the overlap is less significant or negligible. In education, *OMJ* is the only window with projects that aim to increase access to education for BoP people. IIC has some projects in the education sector, but they are related to upgrading and building new education facilities.⁴⁴ As in education, OVE did not find projects similar to the one supported by OMJ in health and nutrition (*Ancalmo-ES*). Neither IIC nor MIF has a project similar to OMJ's *EPM-CO* project, which is classified by OVE as access to finance. These sectors that have negligible overlaps encompass only 5 out of 32 projects (three in Education and one in access to finance and health and nutrition).

Finally, OVE also analyzed whether OMJ's projects were supporting clients previously or currently supported by IIC or MIF, whether or not the projects or instruments are similar. OVE found that nine of 32 OMJ's clients had previously been supported by IIC, and three of OMJ's clients had been supported by the MIF (see Table A.11). This coincidence does not imply that the projects are similar, but shows that OMJ is supporting organizations that have been previously supported by other IDB groups' private sector windows. And OMJ has provided a loan to the *IGNIA* fund, which is also supported by MIF's equity. It is unclear whether these multiple IDB Group engagements with the same client have costs in terms of efficiency or potential conflicts of interest since OMJ has seniority in case of fund default.

5



Busy Rio de Janeiro. OMF funded projects in Brazil to strengthen SMEs and to promote early childhood education.
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5 Internal Procedures

Many of the processes typically used in large private sector transactions in IDB are less suitable for the smaller transactions that are the norm for OMJ. In addition to the challenges of meeting the double bottom line – profitability while reaching the BoP – OMJ also faces procedural challenges in serving its client base.

A. PRICING AND RISK FRAMEWORK

Because the resources used by OMJ operations come from the ordinary capital of the Bank—as with SCF operations—and consequently affect the Bank’s risk and credit rating, the Risk and Management Unit (RGM) uses the same type of risk assessment for OMJ operations and SCF projects. According to the Operational guidelines for non-sovereign guaranteed operations (GN-2400-11, p.11) “NSG operations will be priced based on market comparators to cover the Bank’s cost of funds and to reflect the operations’ corresponding risk profile under a given set of applicable macro and project-specific conditions. Pricing parameters will be justified on a case-by-case basis in NSG operations proposals.” Yet this framework for the risk assessment and pricing of NSG operations was originally designed for multi-million-dollar operations and is less suitable for smaller OMJ operations. The average amount per SCF operation approved between 2008 and 2011 was US\$42.7 million, compared to US\$5.9 million for the average OMJ operation approved in the same period.

In order to price SCF’s operations, syndication (SYN) establishes benchmarks, which are usually firms rated by credit rating agencies like Moody’s, Fitch, and S&P’s. In some cases these comparable firms have bonds that are actively traded in capital markets, and their yields can be tracked in real time through financial information providers such as Reuters and Bloomberg, which simplifies the pricing of SCF’s operations. In the case of OMJ’s operations, comparable firms are not easily identified, because OMJ’s clients have limited access to financial markets and might have no rating from rating agencies.

Moreover, SYN does not have expertise in pricing operations that deal with smallholder farming, access to finance, social housing and infrastructure or education aimed at the poor or the BoP.⁴⁵ To price an OMJ operation, SYN relies on B lenders' and co-lenders' prices—which are not always available—or derives “comparables” based on the internal rating assigned by RGM.⁴⁶ However, OMJ's comparables might operate in different markets and provide different products than SCF's clients (see Table A.12).

Risk assessment procedures in MIF and IIC differ from those in OMJ and SCF,⁴⁷ and IIC and MIF use a different benchmark than SCF for similar operations in their portfolios. IIC has been contracted to do the pricing for MIF's loans using its own portfolio benchmarks, which are concentrated in financial services, agriculture and agribusiness, and utilities and infrastructure.⁴⁸ MIF has an appetite for risk that is larger than OMJ's or IIC's, because its mission is “to act as a development laboratory - experimenting, pioneering, and taking risks in order to build and support successful micro and SME business models.”⁴⁹ This in turn drives the special basis of accounting for MIF financial statements, in which investments are written off on its balance sheets.

Rather than focus exclusively on the characteristics of individual transactions in assessing risk (as in OMJ), IIC adopts a “portfolio approach” in order to “maximize development impact while maintaining long-term financial sustainability.”⁵⁰ IIC claims that “by combining two detailed metrics, the Development Impact and Additionality Scoring System (DIAS) and the Financial Contribution Rating (FCR), the system draws part of the approval focus away from individual transactions and towards a balanced portfolio in terms of impact and return to which each project contributes in accordance to its own strengths and characteristics” (CII/GA-60-5, p.15).

B. LEGAL PROCEDURES

OVE heard many complaints from OMJ's clients about the complexity and costs of OMJ contracts. Loan agreements and related financial documents for OMJ's operations are governed primarily under New York Law (NYL) consistent with the practice of most international financial institutions in their NSG financing.⁵¹ This is not an issue for SCF's clients because they tend to be financially sophisticated and have previous international financing experience. However, for OMJ's clients, the cost of understanding and negotiating NYL documentation can be disproportionately high.⁵² OMJ's clients take 5.2 months on average to sign a contract structured under local law, while they take 11.8 months on average to sign a contract structured under NYL, and in some cases this period can exceed 25 months. OVE found a negative correlation between the size of the firm (in terms of equity) and the time it takes to sign a contract structured under NYL -- the smaller the firm, the longer it takes (Figure 8).

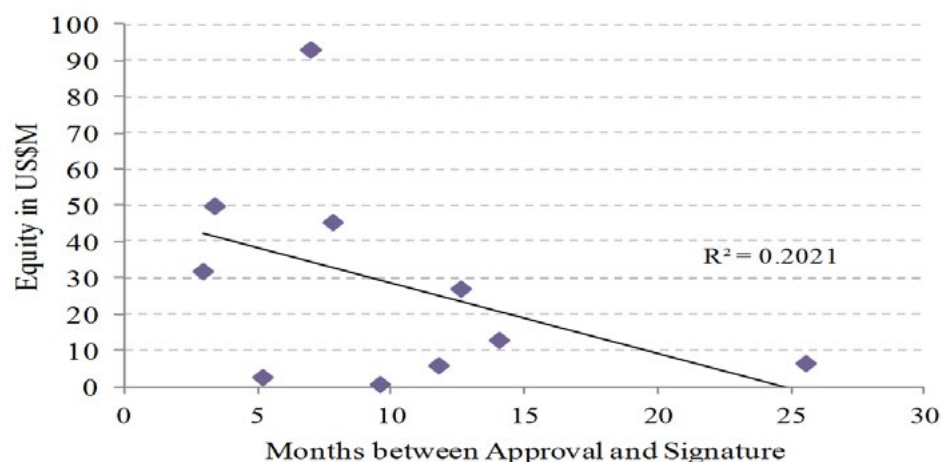


FIGURE 8
Firm Size vs. Time to Signature

The legal work for IDB NSG operations is subcontracted to private law firms outside the Bank. As a result, the costs associated with legal work for OMJ operations—which are borne by OMJ’s clients—represents an important fraction of the loan and significantly affects the market price quoted by SYN.⁵³ Although potential OMJ clients are informed upfront that they will be charged market interest rates, the effective interest rate they end up paying is well above market rates.^{54 55} These high transaction costs create an incentive for OMJ to work with larger clients.⁵⁶ The length of contracts, reflecting covenants required to ensure adequate portfolio management and uniform risk review both at closing and throughout the life of the loan, can also be an issue for OMJ’s clients as well.⁵⁷

The costs associated with legal counsel are smaller for IIC’s and MIF’s loans (Table 2). IIC has a pool of about 11 lawyers who do the legal work in-house in parallel to the due diligence done by the investment officer, reducing the legal fees its clients pay. MIF pays for four staff members in IDB’s legal department to do most of the legal work required by MIF, and if they need to subcontract to private law firms outside the Bank, MIF pays any legal fees for its clients.⁵⁸

TABLE 2. EXTERNAL LEGAL COSTS OF IDB GROUP WINDOWS⁵⁹

	External Counsel Cost (US\$)			
	OMJ Facility	SCF	MIF	IIC
Average Cost	39,971	105,914	4,576	12,745
Cost when using Local Law	21,354	21,096	3,446	5,987
Cost when using NY Law	58,588	122,877	14,742	24,008

OMJ has taken some steps to address the problems encountered with its legal procedures and financial instruments. Recognizing that the use of NYL carries certain cost implications and may deter less sophisticated borrowers from seeking Bank financing, at the end of 2008 LEG recommended the use of local law in NSG transactions under certain circumstances. Loans made under an OMJ facility in

The Bank can only offer local currency to clients subject to the availability of acceptable long-term swaps in the country, i.e. only in Brazil, Chile, Colombia, Mexico and Peru.

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Peru approved by the Board in 2010 (the *Cajas* projects in PE) were the first to be documented under local law on a pilot basis. Since then, several other OMJ and SCF transactions have been governed by local law, as noted in the NSG Business Plan.⁶⁰

C. FINANCIAL INSTRUMENTS

IIC has often been the first within the Bank Group to use innovative instruments. For instance, IIC has provided local currency financing in eight different markets in the region since 2005.⁶¹ More recently, starting with the Mexican market, IIC upgraded this instrument by developing capacity to manage local IIC's currency treasuries in the region through a local IIC entity. IIC also completed two major transactions with PCG in local currency to support domestic market bond issues. The first transaction was with the Mexican company *Cablemas* (CII-PR-330) that was approved in October 2004. Based on that transaction the IIC established a joint program with NAFIN – “Proposal for the establishment of PCG program with *Nacional Financiera* (CII/PR-347) which was approved in March 2005.”⁶²

MIF has made no local currency loans. However, it has invested in a fund which itself provides local currency, *LOCFUND*. MIF has also supported small loans through the Social Entrepreneur Program (SEP) since 1978.⁶³

OMJ has also been seeking innovations in financial instruments. In 2008 OMJ approved a PCG with *CEMEX (Mejora tu Calle-MX)* in which both guaranteed parties were individuals, and for the first time a reimbursement agreement was not required.⁶⁴

In 2009, the *Mi Banco-PE* transaction inaugurated the first local currency loan, the first local currency B loan for any multilateral, and the first IDB operation with Impact Investors as B Loan participants. Another example is the *BCI-CH* transaction, in which the first pool-based risk sharing facility was developed.

OMJ has limited local currency options available to its clients but has innovated by using second-best solutions. The Bank can only offer local currency to clients subject to the availability of acceptable long-term swaps in the country, i.e. only in Brazil, Chile, Colombia, Mexico and Peru. Alternatively, PCG is a second-best solution to enhance clients' risk profile with local bond issuances. As in the case of *Vision Bank-PR*, OMJ has also innovated within NSG by using PCG in countries where long-term swaps are not available. The OMJ solution was risk-sharing in the issuance of the loan to its client with a local bank, who provided the financing in local currency. However, this innovation does not address the need for local currency in countries where it is not available under terms and conditions sufficient to facilitate private sector investment. PCG also does work for companies whose investment needs are too small to issue a bond or whose revenue streams are not in US dollars or US dollar-indexed. As a result, to go ahead with the *Credifamilia-CO* project, OMJ provided a PCG to IIC lending in Colombian pesos to OMJ's client.⁶⁵

D. PROJECT DROP-RATES AND SIGNATURE DELAYS

The expensive internal procedures and resulting costs to clients may contribute to a high drop-rate for prospective projects and delays in client signatures once projects are approved. According to OMJ staff interviewed for the evaluation, 12 of 26 projects were dropped from the portfolio before approval, due in part to the high costs of financing up to February 2012. The time between Board approval and client signature is also longest for OMJ – 9.8 months as compared to 3.5 months on average for SCF, 5.4 months for MIF, and 2.4 months for IIC.⁶⁶ As of February 2012 20 approved OMJ loans/PCGs (62% of the total) were not been signed yet by clients.

OVE's online survey of OMJ's clients indicated that most of them have a negative perception of the legal costs and internal processing procedures related to OMJ's financing. Forty-one percent of OMJ's clients consider OMJ's lending process "much more" or "more" bureaucratic than other market options. On the other hand, clients recognize that Bank staff is seeking solutions – 51% of clients considered the Bank more flexible than other financial institutions in attempting to adapt to their needs.⁶⁷



The OMJ team has worked diligently to test the BoP model and develop the OMJ portfolio, and from that standpoint the Initiative should be viewed as a successful pilot.
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6 Conclusions & Recommendations

The evaluation finds that OMJ’s effectiveness to date has been mixed. The OMJ team has worked diligently to bring the program to life and to identify a market niche in which solutions for the BoP can be tested. Even using internal procedures more adequate to sophisticated clients, OMJ has been able to build up a diverse portfolio of 32 projects and 31 TCs. OMJ has also made significant efforts to build a system to monitor project indicators. OMJ operations are introducing financial innovations, many mirroring procedures and instruments used by IIC and MIF to deal with similar clients. OMJ has also reached out to the impact investor community and established a reputation for knowledge on BoP issues.

OMJ faces challenges in meeting key objectives. OMJ projects have only partially identified the market failures they aim to address, and only a subset have been designed to facilitate evaluation, learning and replication. Most but not all projects appear to target the BoP effectively (though this is a broad category comprising 70% of LAC’s population), and few projects reach poor beneficiaries according to national poverty lines. Indeed, OVE’s preliminary analysis indicates that better targeting might be negatively correlated with business performance, reinforcing the challenges of achieving the double bottom line – pro-poor yet profitable operations – and the need to monitor project effectiveness and sustainability diligently. Most but not all OMJ projects appear to support innovative solutions – a core OMJ criterion – with replication being more common than “disruptive” or “incremental” innovation. One-half of projects provide non-financial additionality. Other IDB Group private sector windows appear to provide similar services to similar clients with similar – and to some extent more flexible – instruments. Finally, OMJ’s internal procedures – risk assessment, pricing, legal -- are unduly expensive for the small clients it targets, leading to dropped projects and delays.

Most but not all OMJ projects appear to support innovative solutions – a core OMJ criterion – with replication being more common than “disruptive” or “incremental” innovation.

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OMJ was originally set up for 3 years as an experimental and time-bound pilot initiative, with the intention of folding it into other IDB Group private sector windows at the end of that period. The OMJ team has worked diligently to test the BoP model and develop the OMJ portfolio, and from that standpoint the Initiative should be viewed as a successful pilot. OMJ has not discovered a unique market niche that cannot be served by another private sector window, and interviews conducted for the evaluation indicate that each of the other IDB Group private sector windows has significant advantages over OMJ. IIC operations benefit from the more flexible “portfolio approach” to pricing and risk management and the expertise it has accumulated in pricing and legal support for operations with smaller SME clients (including through its loan pricing work on behalf of MIF). MIF has a similar mission to OMJ’s to “act as development laboratory” to support innovative solutions to addressing poverty and supporting MSMEs, and it has access to more flexible grant instruments and resources for technical cooperation. MIF and IIC loans target clients with similar sizes and profiles to OMJ clients but have lower processing costs, and their operations take much less time from approval to signing. SCF’s risk management, pricing, and legal procedures fit better with the larger projects it supports. OVE recognizes that in considering options for the future, these operational factors need to be considered alongside other factors – including sources of funding, governance arrangements, internal management practices, and reputational issues– that were outside the scope of this evaluation.

Based on the findings in this evaluation, OVE recommends that Management:

Strengthen OMJ's current operations:

- Carefully identify up-front in every project (including in loan documents) (i) the market and/or government failure that the intervention is designed to address and how the project will address it, (ii) the innovation that it is expected to support, and (iii) the target population and means to reach it;
- Improve the evaluability of projects -- including incorporating impact evaluations into a subset of operations -- in order to measure business performance and economic results and to learn from experience;
- Adapt risk management, pricing, and legal procedures to facilitate interactions with smaller and lower-income clients.

Consider options for consolidating OMJ activities and those of other IDB Group private sector windows, given the clear overlap in objectives and client base among the windows and the Board's original time-bound mandate for OMJ.

ENDNOTES

- ¹ Regarding the full integration of OMJ, GN-2430-6 (p.8) states that “all of OM initiative’s activities will be integrated with the Bank’s country focus and respond to local markets and conditions (including governmental priorities), which ultimately will validate its effectiveness. If proven successful, OM approaches and components would be incorporated in operations of the Bank Group’s private sector windows and in country based exercises (...). The OMJ may be significantly down sized or disappear as only a few functions of monitoring, promotion and evaluation may need a dedicated staff upon full integration.”
- ² The Section VI of the OMJ Plan is summarized in GN-2430-15, p. 26:“(i) continue and increase its financing of new business modes and to replicate and take to scale the most successful modes in this portfolio; (ii) measure results and impacts and capture lessons learned; and (iii) generate and share its knowledge and catalyze new business innovations in order to accelerate and foster the growth of an emerging business ecosystem dedicated to supporting market based solutions for the Majority. OMJ will strive to continue to mobilize grant resources in carrying out this plan, in coordination with ORP.”
- ³ Word Resource Institute (2007).This evaluation will use “poor” with the quotation marks when there is some direct reference to the loan document.
- ⁴ Two approved loans in El Salvador have been cancelled out in February 2012: *FONAVIPO-ES* and *FEDECREDITO-ES*.
- ⁵ The mapping identified 521 medium and large firms as potential OMJ clients in the region. OMJ also promoted conferences and communication campaigns. For instance, in June 2011, OMJ organized in Brazil the first LAC Forum on business at the BoP, which was attended by over 850 participants. The initiative set up an indicator to verify the engagement of firms in providing services for the BoP. OMJ has been engaged with Global Impact Investing Network (GIIN) since 2008 and is part of the GIIN working group for the design of Impact Reporting Investment Standards. Inside the IDB, the initiative promoted “OMJ Champions” meetings in order to establish links with other Bank’s departments (GN-2430-10, p.4)
- ⁶ See GN-2591-4, NSG Business Plan 2012-14 (p. 10), which states that “[there are] limited funds administered by the IDB that are available to support developmental projects undertaken by private sector executing agencies.”
- ⁷ In 2010, the Austrian Development Bank donated US\$1.34 million to the Market Solutions to Mobilize Social Change Multidonor Fund. All resources have been committed. This Fund should be used to strengthen capacity to develop and benefit from new market-based initiatives that promote, finance and disseminate private sector business models for the social and economic development of poor populations by supporting non-reimbursable TCs activities. GN-2591-4, NSG Business Plan (2012-14).
- ⁸ *BMI-ES* is a special case since the dataset sent by the client contains the whole portfolio of BMI beneficiaries rather than only those benefited by the OMJ project. OVE decided to drop the project to avoid any risk of bias in the analysis due to top deciles outliers.

- ⁹ Traditional literature suggests that in the presence of market failures, government interventions can be justified and enhance welfare as long as they logically identify mechanisms for correction of the failure. For instance, the existence of natural monopoly conditions, externalities, public goods, missing markets and asymmetry of information could be the rationale for the public provision and/or regulation of goods, services and subsidies. See for instance the comprehensive survey organized by Stiglitz (1988).
- ¹⁰ Some authors stress that government interventions are also subject to failures where the outcome is worse than what would have occurred even under an imperfect market solution. These government failures fall into two categories: “omission,” e.g. failure to maintain existing infrastructure, and “commission” e.g. failure in running enterprises. See for instance, Krueger (1990).
- ¹¹ Fesmire and Beauvais (1978) defines semi-public good as all goods which production or consumption affects at least two people’s welfare, except the limiting case of a pure public good which affects all people’s welfare.
- ¹² OVE learned in the field interviews that without subsidies *Sabritas-MX* would not be able to keep supporting sunflower oil production.
- ¹³ This is a considerably lower bar for an index of evaluability than that used in the IDB’s SG Development Effectiveness Matrix (DEM) or OVE’s DEM validation exercise.
- ¹⁴ The ex-ante evaluability conducted by this report only assesses the degree of completeness of the indicators of the projects. This evaluability exercise is not as complete as the in-depth evaluability exercise that will be conducted by OVE at annual basis.
- ¹⁵ Table A.2 also provides two measures with a less restricted set of evaluation elements. The first is the proportion of indicators including a baseline and a target, and the second is the proportion of indicators with a baseline. The results for these two measures are 0.58 and 0.60 respectively.
- ¹⁶ These three projects are located in relatively poorer regions of Brazil, Argentina and Colombia respectively. As a result, the BoP incidence in these regions is surely higher than the country’s average.
- ¹⁷ For some clients, such as *ProMujer-NI*, *Minuto de Dios-CO* and *FINAE-MX*, OVE was unable to estimate the income gap as above as below the threshold because these clients’ dataset classify the beneficiaries income in five strata – A, B, C, D or E. OVE estimated the proportion below OMJ’s threshold based on the correspondent household income per capita level of each strata. Although this strategy allowed OVE to estimate the incidence, it does not permit OVE to do the same to measure the income gap. For an introduction to poverty measures see Foster, Greer, and Thorbecke (1984).
- ¹⁸ Assuming a threshold of US\$ 100 and an average income of those below the threshold of \$ 50, the income gap is \$ 50 or 100% of the threshold. It means that the income of those below the threshold should increase, on average, 100% to bring the BoP incidence to zero. The analysis for those above the threshold is similar, and it adds to the leakage analysis as it shows whether those above the threshold are just above it or relatively far.

- ¹⁹ OVE classified the indicator as ‘0’ when there was indication of bad business performance (e.g. negative ROI, ROA, EBITA, or profitability), and as ‘1’ in case of indication of good results in business performance indicator. It is important to clarify the difference between the creditworthiness of the client (defined by the Loan/Guarantee Agreements) and the profitability of the business model supported by OMJ. The former is standard in the industry and defined by RGM and LEG. The latter is related to the expected business performance of the company, defined by ex-ante indicators which in most projects are missing (see evaluability section). As a result of this important difference, a business model supported by OMJ could fail without affecting the creditworthiness of the client if adequate corporate guarantees were ensured at the time of the project’s approval.
- ²⁰ The correlation jumps to -0.22 when BoP incidence is replaced by the poverty incidence measure.
- ²¹ The trade-off is recognized by the initiative. For example, in the TC document for the *Center for Digital Inclusion* (BR-T1124, p. 2) it is stated that one of the objectives is the “better understanding the possible correlation and trade-offs between financial sustainability and social impact.”
- ²² *IGNIA* also counts with the participation of the largest Mexican state-owned fund, *Fondo de Fondos* (FdF) as its third largest equity holder, by providing 10% of *IGNIA*’s equity (US\$ 7.7 million).
- ²³ In fact, this is in line with London (2007, p.31) who argues that alleviate poverty with profitable market-oriented models is “a hypothesis that requires more comprehensive testing to better understand the interactions and boundary conditions in the relationship between profits and poverty alleviation.”
- ²⁴ The survey covers programs such as deworming drugs, and mosquito nets in places with high incidence of malaria contamination. Duflo et al. (2006) argue that because the poor tend to discount the future heavily they tend to be unwilling to pay for basic services if they believe these investments will pay off in the medium or long run only.
- ²⁵ In line with the NSG’s Operational Guidelines, OMJ uses an Eligibility Scorecard to identify whether its operations demonstrate financial and non-financial additionality. The evaluation looked for evidence that the projects could not go ahead without the financial support of the Bank by providing better tenure than available in the market and/or by mobilizing resources. In addition, OVE also looked for evidence that the Bank is providing non-financial additionality, including “reputational effects” and “knowledge contribution” to the clients. Finally, the “catalytic demonstration effect” of the projects was already analyzed in the section of learning and replication.
- ²⁶ In order to classify the operations by final beneficiaries, OVE followed the NSG (GN-2591-4). According to these criteria, 22 out of 32 projects in the OMJ’s pipeline are targeting small firms, seven are large and 3 are medium.
- ²⁷ The overall mobilization ratio is given by the value of B-loans and co-lending divided by the value of the A-loan. The alternative B-loan mobilization ratio is also computed and is the ratio between the B-loan and the A-loan. As a reference, SCF mobilization ratio in 2011 was 1.06. [GN-2641-1: Quarterly Report on SNG Operations – 4th Quarter 2011].

- ²⁸ See GN-2430-7, Eligibility Criteria, Annex I.
- ²⁹ See Garcia and Calantone (2002) for a discussion about innovation typology. They argue for instance that “measuring product innovativeness based on marketing and/or technological discontinuities” is a common feature of this literature. The definitions of innovation used in this report incorporate this consensus as it considers product and marketing discontinuities as innovation. Also, according to these authors, the dichotomous classification of radical and incremental innovations is usual in the literature. In this report, the term replication is used in a broad manner and refers to replication (which is a common concept used in the literature) and replication as well. OVE chose to use the word replication to avoid confusion with the concept of replicability that is used in other sections of the document. Importantly, according to Winter and Szulanski (2001), replication/imitation is part of the theory of innovation and can be considered a type of organizational/management innovation.
- ³⁰ Table A.8 shows the information about the innovation classification for individual projects.
- ³¹ The EPM-CO management reported to OVE during the field mission that 22% of the clients using their credit lines were granted access to credit markets for the first time; the line of credit represents the beginning of their credit history.
- ³² Banorte-BR provided micro-data information to OVE and the analysis show that 95% of Banorte-BR microloan clients were given access to a credit line for the first time and 97% did not report having a bank account (only 1.56% reported having a current account and 1.4% reported having a savings account).
- ³³ Agricorp-NI is expanding bean production in areas that originally produced rice in Nicaragua. Similarly, LATCO and Sabritas are introducing new crops that are not traditionally produced in Bolivia and Mexico respectively.
- ³⁴ During the field visit, the director of *FINAE-MX* told OVE that the project drew from a Brazilian initiative called ‘Brasil Invest’. The project is not innovative for the sector, though it is for Mexico. For the PUPA projects, the field visit confirmed that the pedagogic model is not defined yet.
- ³⁵ See Schumpeter (1950). This result is confirmed by Acs and Audretsch (1988).
- ³⁶ Differently of IIC and MIF, OMJ cannot make equity investments because it is funded by Ordinary Capital of the Bank (IDB Chapter). For more details, see Agreement establishing the IADB, Article III, Section 2(b). Notwithstanding, the Bank may lend to financial intermediaries such as investments funds that on-lend or make equity investments.
- ³⁷ In 2011 SCF joint the other IDB’s private windows in the provision of non-financial products. It received approval from the Nordic Development Fund for € 1.5 million to increase private sector investments in clean energy by funding early-state auditing and project feasibility technical assistance to clients and projects in Central America. (GN-2591-4, footnote 21, p. 10)
- ³⁸ See GN-2430-15, pg. 2.
- ³⁹ OVE decided to go back three years from the approval of OMJ to see if the other private windows were supporting similar projects before its creation.

- ⁴⁰ As described in Box 6, the evaluation looked for similarities in clients, size of the loan and project objectives and description when compared with OMJ's projects. The complete analysis of the business model was not the focus of the evaluation for the following reasons: (i) OMJ is not an incubator of business models. They were already put in place by the clients when OMJ's support was given; (ii) the Bank's financial support is fungible. For these reasons, despite the fact that the business model is not explicitly assessed, the analysis based on similarities in clients, size of the loan and projects' objectives and description provides an indication of overlaps among the IDB's private sector windows.
- ⁴¹ *Vinte viviendas integrales* is a holding company with subsidiaries that develop, promote, design, build, and sell low-, middle-, and upper-middle income housing primarily in four states of central Mexico: Hidalgo; México, Querétaro, and Quintana Roo.
- ⁴² This project was one of the OMJ's cancelled ones. OMJ staff stated that the client did not pursue support due to pricing considerations. SYN pricing Libor plus 6% was too high for the client, who would accept Libor plus 4%. The client decided to pursue only the MIF grant resources and later MIF loan funding, with less stringent information requirements and loan pricing parameters than OMJ's.
- ⁴³ The IIC also has infrastructure projects but they do not explicitly target poor people. For instance, the projects PN3755A-01 finance the construction of a hydroelectric power plant on the Fonseca River in Panama.
- ⁴⁴ For instance, the projects ME3445A-01 will help *Universidad Autónoma de Guadalajara* upgrade its facilities and extend the reach of the local health care system.
- ⁴⁵ By December 2011, SCF portfolio was concentrated on financial institutions (31%), energy (23%), transportation (15%) and oil and gas (14%). [GN-2461-1]. The financial institutions comprise banks with more than US\$500 million in assets and there is no micro financial institution within SCF clients.
- ⁴⁶ Given the particular nature of its portfolio, OMJ in 2010-2011 worked with RMG to develop a specific OMJ Risk Assessment Methodology (OMJ RAMP) within the Credit Risk Classification System. The OMJ RAMP was revised and updated by an interdepartmental working group and validated, together with recommendations by Standard & Poor's and entered into effect in September, 2011. The methodology used in the assessment of OMJ projects is similar to that considered in S&P's templates and other best practice rating approaches in the assessment of credit quality for comparable asset classes. However, pricing continues to be a challenge in the structuring of OMJ operations since there are few or no real comparables in the market.
- ⁴⁷ In contrast to OMJ's operations, resources from IIC operations come from IIC's capital while resources from MIF's investments come from MIF's donors. Neither IIC nor MIF operations affect the Bank's risk profile.
- ⁴⁸ Among IIC's client are microfinance institutions (that offer loans for home purchasing, improvements, etc.); agribusinesses that provide financing to small producers (supply chain financing).
- ⁴⁹ Mission Statement at MIF website <http://www5.iadb.org/mif/About/OurMission/tabid/339/language/en-US/Default.aspx>
- ⁵⁰ See IIC General Planning Parameters, IIC 2011-2013 Business Plan (CII/GA-605).

- ⁵¹ New York law and forum are usually preferred because the body of commercial law developed in New York tends to be lender-friendly and the courts are impartial and experienced in complex commercial transactions. Lender's exposure to adverse changes in local legislation and biased decision, and exposure to political risk are reduced by using New York law and forum. See memo "Choice of Law and Forum in NSG Transactions: Legal Report and Recommendations" dated November 3, 2008 and prepared by J. James Spinner.
- ⁵² See memo "Choice of Law and Forum in NSG Transactions: Legal Report and Recommendations" dated November 3, 2008 and prepared by J. James Spinner.
- ⁵³ In one specific case, the IGNIA project, the legal cost exceeded US\$170,000. LEG informed OVE that the amount ultimately paid by the borrower was US\$158,000 given write-offs provided by the NYL firm. In accordance with LEG, "the total fees were appropriate given that the project consisted of a US\$25 million loan to a regional fund (an exposure that is in line with the SCF exposure). Also, the project involved multiple jurisdictions, where the security instruments required specialized review by Canadian counsel as they were governed by Quebec law and the documentation was subject to heavy negotiation by a sophisticated borrower."
- ⁵⁴ The issue of the effective interest rate being higher due to legal and other costs is prevalent in all private sector financings. OVE calculated the increase in interest rate by assuming disbursement after the contract is signed, subtracting the legal costs to funds received by the client, and estimating the new interest rate that would produce the same net present value. In case of FOPEPRO, based on the information available in the pre-closing package, these fees increased the interest rate paid by the client by up to 121 basis points (242 basis points if one considers all the fees charged above the interest rate).
- ⁵⁵ Some of the benchmarks used by syndication use an all-in pricing where no additional fees are charged above the interest rate (see the CMAC Ica, PE-L1096, and CMAC Maynas, PE-L1095, pricing memo for an example).
- ⁵⁶ The scorecard used by OMJ to select potential projects penalizes small clients for this reason.
- ⁵⁷ The short form loan has been an innovation to address the complexity of larger legal contracts to OMJ's clients, in which LEG has weighed on the convenience of more streamlined documents vis-à-vis greater risk for the Bank.
- ⁵⁸ It is worth noting that LEG also dedicates six full time equivalents to support MIF activities.
- ⁵⁹ Only SCF, IIC and MIF projects similar in nature to the OMJ projects approved so far were selected for this comparison (see Table A.13).
- ⁶⁰ LEG and the NSG windows are continuing to identify opportunities to use local law in NSG transactions. See GN-2591-4, "NSG Business Plan (2012-2014). Revised version," pages 17-18, paragraph 2.43.

- ⁶¹ See GN-2591-4, page 16.
- ⁶² For the *Cablemas* transaction a guarantee was issued for the equivalent of US\$9.7 million. IIC's partial guarantee was for US\$1.15 million to support a commercial paper program in local currency.
- ⁶³ The predecessor program to SEP was the Small Projects Program, □Program for the Financing of Small Projects GN-1238-2, approved June 15 1978 by Resolution DE-85/78.
- ⁶⁴ By offering its clients the option of a PCG in the form of an innovative Risk Sharing Facility, OMJ is able to share the risk the client would potentially incur by undertaking operations that include extending microcredits to BoP endcustomers. Instead of using a traditional reimbursement agreement governed by New York law, the IDB's reimbursement is tied to the cash flows generated by the individual microloans based on local law-governed reimbursement mechanisms, such as subrogation, endorsement of *pagarés*, and/or assignment of rights. Given the perceived credit risk associated with the BoP population, this product has become attractive for many OMJ clients.
- ⁶⁵ As the Bank signed the International Swap and Derivatives Association Agreement with TCX Fund, it is expected that the IDB treasury will be able to start providing local currency hedged off with TCX.
- ⁶⁶ These calculations were done using the approval date and signature date of the operations available in the Bank's information systems.
- ⁶⁷ This finding is corroborated by the OVE visits to the clients. They acknowledge the effort of the Bank's staff in adopting alternative solutions to overcome high transaction costs defined by the NSG guidelines, such as, for instance, dealing with pro-bono lawyers.