



Approach Paper

Evaluation of Direct Support to SMEs by the IIC



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IIC/RE-23
November 2016

TABLE OF CONTENTS

[ACRONYMS AND ABBREVIATIONS](#)

I.	CONTEXT	1
	A. Rationale	1
	B. How do we define SMEs?	3
	C. Evolution of the IIC's TA and direct SME lending products.....	3
II.	EVALUATION APPROACH.....	7
	A. IIC Portfolio of direct lending and TA to SMEs	7
	B. Evaluation questions and methodology.....	8
III.	TEAM AND TIMELINE	10

[REFERENCES](#)

ACRONYMS AND ABBREVIATIONS

DFI	Development Finance Institution
FI	Financial Intermediary
IDB	Inter-American Development Bank
IDBG	Inter-American Development Bank Group
IFC	International Finance Corporation
IIC	Inter-American Investment Corporation
OVE	Office of Evaluation and Oversight
SBRL	Small Business Revolving Line
SME	Small and Medium Enterprises
SLP	Small Loan Program
TA	Technical Assistance
TASP	Technical Assistance and Strategic Partnerships
XASR	Expanded Self-Assessment Report

I. CONTEXT

- 1.1 **This document describes the approach that the Office of Evaluation and Oversight (OVE) will take in reviewing the work of the Inter-American Investment Corporation (IIC)¹ in directly supporting² small and medium-sized enterprises (SMEs).** This evaluation was included in OVE's 2016-17 work program ([RE-492-1](#)) at the request of the IDB and IIC Boards of Executive Directors.

A. Rationale

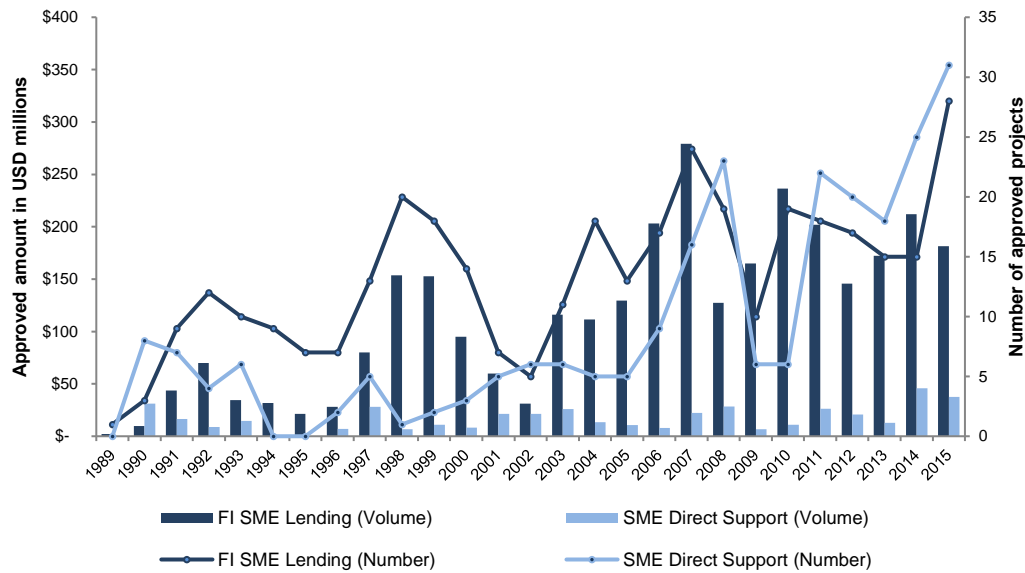
- 1.2 **The IIC is unique among Multilateral Development Banks (MDBs) in its explicit mandate to support SMEs.** The 1984 Agreement Establishing the Inter-American Investment Corporation (widely referred to as the "IIC Charter") lays out a preference for the IIC to support SMEs. However, the Charter does not specify the form of such support (e.g. direct vs. indirect),³ and the IIC has provided such SME support both directly (i.e. with the IIC's direct client being an SME) and indirectly (via financial institutions, funds or other entities) throughout its history. Graph 1.1 below shows the amounts and numbers of direct and indirect IIC lending operations to SMEs over time, whereas Graph 1.2 illustrates the amounts disbursed under the various technical assistance (TA) programs destined primarily at SMEs, as well as their overall number.

¹ Other non-sovereign-guaranteed (NSG) windows, namely the Opportunities for the Majority initiative (OMJ) and the Multilateral Investment Fund (MIF) of the Inter-American Development Bank Group (IDBG) count a total of seventeen (loan, equity and TA combined) direct operations undertaken with SMEs over the last ten years. However, their work with SMEs was incidental and not part of their broader strategy. This evaluation therefore focuses on IIC, which accounts for the overwhelming majority of direct SME support within the IDBG.

² Unless otherwise specified, "support" encompasses lending and technical assistance activities. The evaluation will not consider equity operations due to their low number during the proposed evaluation period, as further detailed in Section II below. "Direct support" means that the IIC's direct client is an SME, as opposed to an intermediary (such as a financial institution, a fund or a larger corporation) through which SMEs would be reached.

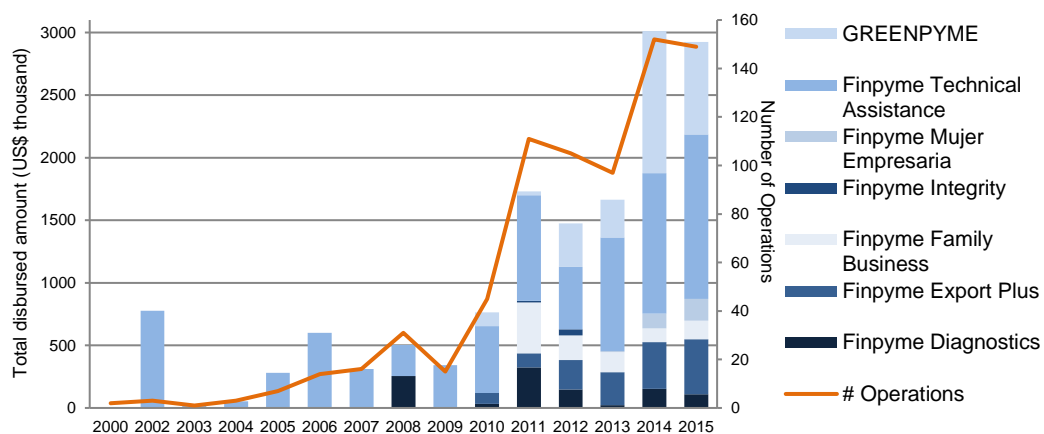
³ Article I, section 1 of IIC Charter states that "The purpose of the Corporation shall be to promote the economic development of its regional developing member countries by encouraging the establishment, expansion, and modernization of private enterprises, preferably those that are small and medium-scale, in such a way as to supplement the activities of the Inter-American Development Bank." Article I, section 2 states that the IIC shall assist in the financing of enterprises (preferably SMEs, from section 1) "alone or in association with other lenders or investors", and article III, section 1 authorizes – but does not require – the IIC to "make direct investments, through the granting of loans, and preferably through the subscription and purchase of shares or convertible debt instruments, in enterprises located in regional developing member countries, and make indirect investments in such enterprises through other financial institutions (...)", again not specifying whether the IIC should support SMEs directly or indirectly.

Graph 1.1 - Evolution of SME direct vs. indirect (via FIs) support, 1989-2015



Source: IDEAS, OVE analysis.

Graph 1.2 - Disbursed amounts and number of FINPYME TA operations, 2000-2015



Source: Data provided by IIC staff, OVE analysis.

- 1.3 **The recent IDB Group Private Sector merge-out⁴ has substantially broadened the IIC's activities⁵, extending the organization's role beyond its core mandate of SME support while focusing attention on the question of how best to support SMEs.** The FINPYME credit program expired in May 2016 and was temporarily extended pending completion of this evaluation (CII/DE-11/16). Given that the FINPYME programs and direct SME support in general have

⁴ Approved in March 2015 (AG-9/15; CII/AG-2/15); effective as of January 1, 2016

⁵ This refers to the IIC's mandate prior to the merge-out – most new activities to be assumed by the larger IIC had previously been performed by other IDBG private sector windows.

never been systematically evaluated,⁶ this evaluation is meant to fill an important information gap for defining the way forward.

B. How do we define SMEs?

- 1.4 **There is no global consensus as to what constitutes an SME.** Most definitions employed by national authorities, financial institutions or international development finance institutions (DFIs) use one or more key enterprise size attributes, namely the number of employees, revenues, and/or assets, to differentiate SMEs from micro and large enterprises. Some DFIs also use the size of their loans or investments as a proxy for enterprise size. While discussing the motivation for, and the implications of, using different size variables and cutoff values exceeds the scope of this approach paper, extensive reviews of these topics can be found in CII/GN-225-1, IFC (2000), IFC/World Bank (2010) and Gibson and van der Vaart (2008), among many other studies.
- 1.5 **For purposes of this evaluation, OVE will use the SME definition employed by the IIC for corporate operations (CII/GP-15-9; CII/GP-15-10).** The IIC's SME size criteria, as shown in Table 1.1 below, comprise assets, revenues and number of employees, wherein an enterprise is classified in the corresponding category when its size does not exceed the threshold in at least two out of the three applicable parameters.⁷

Table 1.1 - IIC's SME definition

Country	Sector	Employees		Revenues (in US\$)		Assets (in US\$)	
		Small	Medium	Small	Medium	Small	Medium
A and B countries	Primary	200	400	7,000,000	20,000,000	7,000,000	20,000,000
	Industry	150	350				
	Service	100	300				
C and D countries	Primary	150	250	3,000,000	10,000,000	3,000,000	10,000,000
	Industry	100	200				
	Service	50	150				

C. Evolution of the IIC's TA and direct SME lending products

- 1.6 **The first dedicated SME program, created by the IIC in 2000, was a technical assistance program called FINPYME Diagnostics, with funding from Spain.** The program consists of a competitiveness evaluation for SMEs,⁸ and the pilot was launched in Bolivia and Chile before expanding to other countries⁹ in the region in

⁶ FINPYME operations were neither evaluated at the operation nor at the program level. Some non-FINPYME operations have had Extended Self-Assessment Reports (XASRs) validated by OVE, however the limited number of such reports and the absence of contrasting any findings of direct SME vs. other operations does not allow for drawing systemic conclusions.

⁷ An exception to this rule are greenfield projects, for which only assets are considered.

⁸ FINPYME Diagnostic was intended to (i) bolster IIC's project pipeline, (ii) streamline project processing, and (iii) gather useful information on the business environment in which the private sector operates.

⁹ Today, FINPYME Diagnostics is available to companies in Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Trinidad and Tobago and Venezuela.

2007. Additionally, the IIC provided direct technical assistance, supported by several trust funds,¹⁰ and mostly on a case-by-case basis to companies undergoing IIC consideration for lending and investing.¹¹ In 2005/2006, with the establishment of the US\$40 million Korea-IIC SME Development Trust Fund, the IIC started to design specific long-term strategic programs to provide technical assistance. Among those programs were: (i) FINPYME Diagnostic, (ii) Renewable Energy and Energy Efficiency, (iii) Transfer of Technology and Know-How for Private Sector Development, (iv) Promotion of Good and Sound Practices for Governance of Family Owned SMEs, (v) General Consulting Services. In addition to Korean funding, several other trust funds¹² contributed to financing these strategic programs.

- 1.7 **In 2008, the IIC created a dedicated TA business support area called Technical Assistance and Strategic Partnerships (TASP).**¹³ The creation of TASP was intended to bolster the value-added offered by the IIC, following an OVE recommendation from the Fourth Independent Evaluation Report (CII/RE-7). Initially, TASP focused on four strategic programs that had been implemented previously,¹⁴ but over time expanded its programs to seven¹⁵ and rebranded all services under the FINPYME name in 2010.¹⁶ As of today, the IIC's TA lines consist of (i) FINPYME Diagnostics,¹⁷ (ii) FINPYME Direct Technical Assistance,¹⁸

¹⁰ Spanish Trust Fund (2000), Austrian Trust Fund (2002), Danish Trust Fund (2004), Italian Trust Fund (2005).

¹¹ Report to the Board of Executive Directors on the development of a Technical Assistance and Strategic Partnership Initiative (CII/GN-238).

¹² In addition to the trust funds established earlier, technical assistance programs were also financed by the Swiss Trust Fund (2008), Infrafund (2008), Norwegian Trust Fund (2010), Belgium/ Wallonia Trust Fund (2011), Nordic Development Fund (2011), US Government (2013), China Technical Assistance Fund (2014), Netherlands Trust Fund (2014), Clean Technology Fund (2015).

¹³ TASP was made possible primarily thanks to the Korean Trust Fund, and the IIC also contributed US\$5 million of its own resources. See Report to the Board of Executive Directors on the development of a Technical Assistance and Strategic Partnership Initiative (CII/GN-238).

¹⁴ General Consulting Services for SMEs, FINPYME Diagnostics, Energy Efficiency and Renewable Energy; and Promotion of Good and Sound Practices for Governance of SMEs.

¹⁵ Adding FINPYME ExportPlus and FINPYME Integrity in 2009/2010, and FINPYME Mujer Empresaria in 2013.

¹⁶ IIC 2010 Annual Report.

¹⁷ Funded by the Spanish and Korean Trust Funds, FINPYME Diagnostics is a two-phase program, starting with an online competitiveness assessment, and then providing individual or group technical assistance to improve identified areas of weakness (IIC's Annual Report 2010).

¹⁸ Formerly called "General Consulting Services for SMEs", FINPYME Direct Technical Assistance finances specific consulting services for IIC financing operations (i.e. IIC due diligence costs that would otherwise be paid by the client) in areas such as environmental regulation compliance and financial, technical and market reviews.

(iii) FINPYME ExportPlus,¹⁹ (iv) FINPYME Family Business,²⁰ (v) FINPYME Integrity,²¹ (vi) GREENPYME,²² and (vii) FINPYME Mujer Empresaria.²³

- 1.8 **The IIC recognized the need for more efficient and standardized procedures and created special programs and procedures for lending to SMEs.** In 2002, the IIC launched the Small Loan Program (SLP) for loans ranging from US\$150,000 to US\$1.5 million in only a few countries.²⁴ The SLP introduced simplified and shortened processing and approval procedures, and was intended to operate through local third-party agents. However, the SLP lasted only two years, as the offered fee and interest income participation structure failed to generate enough interest from qualified agents and certain requirements (e.g. the need for audited financial statements) and terms were misaligned with SME capabilities and needs. In 2006, IIC introduced a new SME financing initiative to offer senior loans, the Small Business Revolving Line (SBRL) (CII/GN-224-2). Given IIC's limited balance sheet and operational capacity, the program covered only selected countries²⁵ and had narrow size and other eligibility requirements.²⁶ As opposed to the SLP, the SBRL was administered by IIC staff based in the region and did not require audited financial statements,²⁷ but also relied on a faster and more

¹⁹ FINPYME ExportPlus aims at improving SME access to international markets through individual and group TA, specifically for (i) certification processes, (ii) operational processes and (iii) management processes.

²⁰ Formerly called "Promotion of Good and Sound Practices for Governance of Family Owned SMEs", FINPYME Family Business offers individual and group technical assistance for succession planning and operating protocols in family-owned businesses.

²¹ FINPYME Integrity offers individual and group technical assistance for improving SME's transparency and anti-corruption practices.

²² Formerly "Renewable Energy and Energy Efficiency", GREENPYME offers simple and detailed energy audits and monitoring of results.

²³ FINPYME Mujer Empresaria is a version of FINPYME Diagnostics focusing exclusively on women-owned business.

²⁴ The SLP was to initially operate in Bolivia, Costa Rica and El Salvador, but was only launched in Bolivia.

²⁵ Divided in two groups (depending on whether the IIC had local presence and qualified Investment Officers to be in charge of origination), Group I was initially composed by Costa Rica, Honduras, Nicaragua, Paraguay and Uruguay (later, Bolivia, El Salvador and Guatemala were added, see CII/GN-224-8 and CII/GN-224-10); and Group II by Bahamas, Barbados, Dominican Republic, Guyana, Haiti, Jamaica, Suriname, and Trinidad & Tobago (later, Belize was added, see CII/GN-224-10). Group II operations would start once the IIC established a local presence in the area (CII/GN-224-2). While initially restricted to operations where a qualified investment officer was stationed locally, the eligibility criteria later changed to "*when the IIC has an investment officer or qualified representative in place*" (CII/GN-224-21).

²⁶ (i) Cumulative program amount: Up to US\$12m (later increased to US\$19m, then US\$23m; see CII/GN-224-8/10); (ii) Loans from US\$100,000 to 600,000. (iii) SME must have been in existence for at least three years, with sales not exceeding US\$6m, and meet certain financial health indicator thresholds; (iii) Repayment term: minimum of three, maximum of five years (later increased to ten years; see Resolution CII/DE-30/07) (iv) Transactions: Direct senior loans; (v) Minimum of 100% matching collateral coverage and personal guarantees from all owners; (vi) Limit per eligible country: up to US\$2m/country for Group I and up to US\$2m for all countries in Group II combined (later increased to US\$5m, then US\$7m, see CII/GN-224-8/10); (vii) Interest rates: fixed, based on the risk of the operation and market conditions.

²⁷ Other waivers to the IIC Operating Policy included the ability to finance up to 100% of project cost, and be the sole source of funding.

efficient approval process.²⁸ In 2010, the SBRL program was re-branded under the FINPYME umbrella and is now known as FINPYME Credit (CII/GN-224-14). In 2013, IIC introduced subordinated loans under FINPYME Credit (called “FINPYME Credit Plus”) that did not require collateral, but charged a higher interest rate to cover the increased risk.²⁹

- 1.9 **In addition to FINPYME Credit, in 2013 the IIC also introduced streamlined internal approval processes for other SME loans not exceeding US\$3.9 million.** Called “SME Direct”, this initiative does not replace or supersede the FINPYME Credit program; both programs work under different terms, especially those related to approval amounts, beneficiary countries, processes, and documentation.
- 1.10 **OVE’s validation reports on IIC’s Expanded Self-Assessment Reports (XASRs)³⁰ have reflected the difficulty of balancing development impact with financial sustainability when lending to SMEs directly and indirectly.** In general, OVE recognized that reaching SMEs through FIs is a cost-effective mechanism (CII/RE-11), while stressing the importance of choosing FI clients with a high degree of SME specialization and networks in order to achieve development and financial goals (CII/RE-9; CII/RE-13). Throughout the validation exercises, no consistent development performance differences emerged between FI and corporate operations,³¹ with findings often driven by period-specific financial shocks to the IIC’s portfolio (high write-offs in the early 2000s, wave of prepayments in the mid-2000s, etc.) and somewhat contradictory over time. When IIC operations tried to increase impact by financing smaller FIs or earlier-stage corporate projects, XASR ratings were often affected by the increased risk, materializing in higher failure rates. Such instances prompted OVE to recommend focusing on financial client strength as a necessary (albeit not sufficient) precondition for development results (CII/RE-3). When IIC redirected operations towards financially stronger clients, OVE questioned additionality in some instances and recommended taking on more developmental and riskier projects, as well as increasing IIC’s value-added (e.g. tailoring loan terms to project needs, and/or offering technical assistance) compared to commercial funding sources to stem prepayments and increase competitiveness (CII/RE-4; CII/RE-7; CII/RE-8).

²⁸ A loan request through the SBRL was not supposed to take more than ten working days upon verification of eligibility, with final approval delegated from the Board to the IIC’s General Manager or his/her designee.

²⁹ A total of US\$2.5m (of the overall US\$23m program limit) can be used for subordinated loans, with an additional US\$2.5m funded by the sale of participations to the China-IIC SME Equity Investment Trust Fund for all transactions. Subordinated loans can have tenors of three to seven years (max. two years grace), require personal guarantees from the owner and/or main shareholder (but no collateral), and carry a fixed interest rate of 500 basis point above the FINPYME Credit reference rate (CII/GN-224-20/21).

³⁰ Please note that XASR exercises have only comprised non-FINPYME projects, i.e. they do not cover the majority of IIC’s SME operations. Moreover, not all non-FINPYME SME projects had XASRs, i.e. lessons learned have to be taken with caution due to potential lack of representativeness.

³¹ The XASR validation reports did not differentiate between SME and non-SME corporate projects.

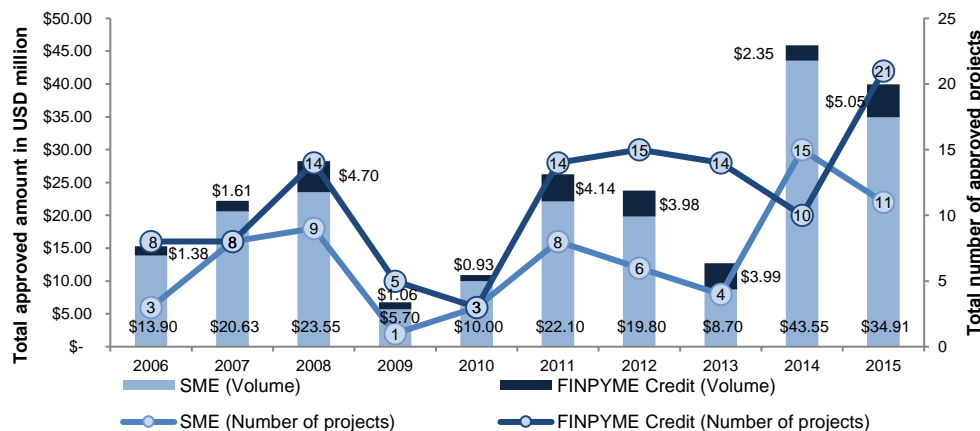
II. EVALUATION APPROACH

- 2.1 The evaluation will cover all approved IIC SME lending operations to SMEs³² from 2006 to 2015 and will strive to consider disbursed³³ IIC FINPYME TA operations during the same period, with the feasibility and extent of the analysis depending on data quality and characteristics of the TA.³⁴ This time period will allow OVE to assess a meaningful number of operations, as well as their evolution over time in terms of approach and results. As relevant, the direct SME support activities may be compared to other types of IIC operations during the same evaluation period.

A. IIC Portfolio of direct lending and TA to SMEs³⁵

- 2.2 The IIC approved a total of 177 direct SME lending operations between 2006 and 2015, amounting to a total of about US\$219 million. This represents 37 percent of all lending operations and 6 percent of the total lending amount approved by IIC during the same period.
- 2.3 Of the direct SME lending operations approved between 2006 and 2015, 112 (for US\$29 million) were operations under the FINPYME credit program, and 65 (for US\$190 million) were regular direct SME lending operations. The average operation size was about US\$261 thousand for FINPYME and US\$2.9 million for direct SME lending. Graph 2.1 below shows the evolution of the FINPYME and other direct SME lending approvals 2006-2015.

Graph 2.1 - FINPYME vs. regular direct SME lending approvals 2006-2015



Source: IDEAS, OVE analysis.

³² This includes all operations in which the direct client of the IIC was an SME, regardless of whether these operations were part of FINPYME or not.

³³ At this point, OVE assumes that information will only be available on the disbursed, not the approved, TA operations.

³⁴ See sections II.A.2. and II.B. for more detail on the TA data situation and evaluation approach,

³⁵ The portfolio description in this section is based on the team's knowledge and available data at the time of elaboration of this approach paper. Numbers may change as a result of new data or corrections the team becomes aware of during the evaluation exercise.

- 2.4 **The IIC disbursed a total of 735 TA operations under the FINPYME TA umbrella between 2006 and 2015, amounting to a total of about US\$13.3 million³⁶ and benefiting 10,929 enterprises or individuals.³⁷** In recent years, FINPYME Export Plus, GREENPYME and FINPYME Direct TA featured the largest highest number of operations and disbursed amounts. TA operations could take the form of Individual TA (ITA, usually directed at individual firms), Group TA (GTA, usually meaning a workshop or conference with several participating firms), Training TA (TTA) or Virtual TA (VTA). Of the 735 disbursed operations, about half were ITA (with a total amount of about US\$10 million), with the other half being GTA or TTA (amounting to US\$3.2 million).
- 2.5 **The IIC did not consistently track whether beneficiary enterprises were SMEs.** As of today, OVE has received information on the beneficiary type (SME vs. non-SME) for a bit less than half (4,323) of the beneficiaries. Of these already classified TA recipients, the vast majority (96 percent) were SMEs. By number, most SMEs benefited from FINPYME Export Plus.

B. Evaluation questions and methodology

- 2.6 **The objective of the evaluation is to review IIC's experience with direct support to SMEs. The following questions will guide OVE's analysis:**
- a) What have been the origins and evolution of direct support to SMEs by IIC?
 - i. What has driven IIC direct support to SMEs?
 - ii. How has the direct SME support portfolio evolved over time?
 - iii. How has direct SME support evolved compared to indirect support?
 - b) How relevant has IIC direct support been?³⁸
 - i. To what extent has IIC's direct SME support filled a development need not otherwise met?
 - ii. To what extent have products employed by IIC in directly supporting SMEs been adequate for the constraints or needs to be addressed?

³⁶ This amount includes only the expertise and logistics cost, and does not include IIC staff cost nor IIC staff travel cost.

³⁷ As the same company could benefit from several TA (by, for example, first participating in a workshop and then receiving individual TA), this number is likely to contain considerable double-counting of unique beneficiaries. More generally, the analysis of the IIC's TA operations is very challenging due to the absence of information systems or consistent practices to track TA operations at the IIC. This means that numbers, approved vs. executed amounts and types of TA, as well as any other data (including beneficiary types and names) have to be collected manually by the IIC's TA staff and OVE. As this lengthy process is still ongoing, the data are based on OVE's preliminary knowledge at the time of elaboration of this Approach Paper, and are likely to change over the course of the evaluation as more data are compiled and cleaned. Moreover, it is unclear at this point whether reliable data will indeed be available for this evaluation for the entire 2006-2015 evaluation period, as inconsistent operations tracking allowed for some loss of especially historic TA knowledge upon staff leaving the IIC.

³⁸ This question will take into consideration heterogeneity in development needs across different LAC countries.

- iii. What can be said about the magnitude and reach (i.e. at the aggregate, e.g. country or regional) of IIC support compared to development needs?
 - iv. At the operational level, what evidence exists about the additionality of IIC's direct support to SMEs?
 - v. What do we know about access to alternative commercial sources of financing by SME clients?
- c) What can be said about the development results of IIC's direct support to SMEs?
 - i. What information has been collected on development results?
 - ii. What evidence exists on the development results of IIC's direct SME support operations at the firm level?³⁹
 - iii. What evidence exists on the role of IIC's technical assistance in delivering development results?
 - iv. What has been the extent of operation cancellations, droppages, or prepayments, and what evidence exists about the reasons for them?
- d) What can be said about the financial results of IIC's direct support to SMEs?
 - i. How financially sustainable have direct SME operations been in terms of revenues and costs to IIC, according to available data?
 - ii. From a capital adequacy and risk perspective, what are the implications of direct lending to SMEs?
 - iii. What evidence exists about the role of technical assistance in supporting the financial sustainability of direct SME lending and investments?
- e) To what extent have IIC's internal processes and operational structure helped and/or hindered development and financial results of direct SME support?
- f) What has been the experience of other DFIs with direct support to SMEs?
- g) What are some key drivers for success in SME lending and investing by commercial financial institutions?
- h) Are there any implications stemming from this analysis for IIC going forward?

³⁹

While clear attribution of results to the IIC intervention is difficult without a clear counterfactual, OVE will try to identify what difference the IIC operation made, for example through client feedback.

2.7 To answer the above questions, OVE will build on the following evaluation components:

- a) Portfolio review of all approved IIC direct SME lending operations from 2006 to end-2015, as well as of those TA operations disbursed during the same period for which data availability and quality allows for meaningful analysis.
- b) Document desk review of representative random samples of i) the approved FINPYME credit and ii) the approved non-FINPYME SME lending portfolios 2006-2015, with the samples checked for approximate validity across key portfolio characteristics. The desk review will be complemented by (written and/or telephonic) client surveys in case of additional information needs.
- c) Document desk review of samples⁴⁰ covering the main FINPYME TA programs from 2006-2015 for which relevant information is available in reasonable quality.⁴¹ The desk review will be complemented by (written and/or telephonic) client surveys in case of additional information needs.
- d) Review of financial results of IIC direct SME support activities, including – to the extent available in reasonable quality – financial flows, operational cost and other financially relevant data.
- e) Desk reviews of (IIC, IDBG and peer DFI) strategy, policy and guideline documents, relevant OVE or other evaluations, and other applicable reports and publications.
- f) Expert, management and staff interviews, both inside and outside IIC.

III. TEAM AND TIMELINE

- 3.1 The report will be prepared by a team led by Ulrike Haarsager, Jose Ignacio Sembler, and Roland Michelitsch under the direction of Cheryl Gray (Director, OVE). Other team members include Maria Camila García Jimenez, Nadia Ramirez Abarca, Maria Fernanda Rodrigo Lopez, Maya Jansson, and Richard Rutherford (external consultant).
- 3.2 The draft report is expected to be ready for Management review in February 2017 and for discussion at the IIC's Board of Executive Directors in April 2017.

⁴⁰ At this point, it is foreseen that these samples will be illustrative rather than statistically representative given the substantial information gaps in the TA portfolio, which make it impossible to determine the key characteristics driving representativeness and sample validity criteria.

⁴¹ The TA programs and types that can be covered will depend, among other factors, on whether objectives were clear and documented enough for OVE to assess effectiveness. OVE may focus on certain individual TA activities in which client-specific goals were expressed, and perform a more descriptive analysis on group and other TA activities.

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