



## Approach Paper

# Evaluation of the Implementation of the Private Sector Merge-out



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## ACRONYMS AND ABBREVIATIONS

AHC	Ad-hoc Committee (of IDB, IIC and MIF)
AUG	Internal Audit
CRF	Corporate Results Framework
CPE	Country Program Evaluation
CS	Country Strategy
DELTA	Development Effectiveness, Learning, Tracking and Assessment Tool
ETH	Office of Ethics
GCI-9	IDB's Ninth General Capital Increase
IDB(G)	Inter-American Development Bank (Group)
IIC	Inter-American Investment Corporation
LAC	Latin America and the Caribbean
MICI	Independent Consultation and Investigation Mechanism
MIF	Multilateral Investment Fund
NSG	Non-Sovereign Guaranteed
OII	Office of Institutional Integrity
OMB	Ombudsperson
OMJ	Opportunities for the Majority
OVE	Office of Evaluation and Oversight
PBA	Priority Business Area
PSD	Private Sector Development
SCF	Structured and Corporate Finance
SG	Sovereign Guaranteed
TC	Technical Cooperation
XSR	Expanded Supervision Report

## I. INTRODUCTION

### A. Origins of the merge-out

- 1.1 Discussions on how to organize IDBG's private sector activities date back more than a decade. In 2010, in the context of IDB's Ninth Capital Increase (IDB-9), IDB Governors set forth a series of reforms to make the Bank more effective, including making development through the private sector a key institutional priority (Cancun Declaration, AB-2728). The IDB-9 report (AB-2764) specified actions to achieve this objective through an integrated approach, including, among other actions, setting a strategic goal for development through the private sector, formalizing a PSD strategy, improving coordination among PSD windows, enhancing the development effectiveness of non-sovereign guaranteed (NSG) operations, and gradually expanding prudential limits for them, including through a US\$500 million subordinated loan from IDB to IIC.
- 1.2 In 2012, the Office of Evaluation and Oversight (OVE) carried out a *Mid-Term Evaluation of IDB-9 Commitments* (RE-425), which found that private sector activities were being carried out by four separate, poorly coordinated windows that rarely took advantage of potential synergies with IDB's public sector work. OVE recommended to "restructure the private sector windows of the Bank to integrate them much better with each other and with the public-sector side of the Bank," suggesting two possible forms: (i) fully integrating private sector activities into IDB (later also called "merge-in"), or (ii) merging the private sector activities into one entity ("merge-out") while simultaneously ensuring improved coordination between the public and private sectors.
- 1.3 In March 2013, IDB Group Management presented to the Governors a "Renewed Vision and Preliminary Options" for "Enhancing Development Impact of Private Sector Operations at IDBG" (AB-2908). The Governors resolved to establish an ad-hoc committee (AHC) to direct management to develop a renewed vision for IDB Group's private sector activities (CII/AG-2/13).<sup>1</sup>
- 1.4 In a two-year preparation process led by the AHC, consisting of members of the Boards of IDB and IIC as well as the MIF's Donor Committee, the different reorganization options were considered. In September 2013, IDB Group management recommended to proceed with the merge-out option with the transfer of some of the required capital from the IDB to IIC, recognizing that this would entail substantial costs for the shareholders, but believing that these costs were outweighed by the benefits in terms of development impact, quality of projects and partners, and increased resource mobilization (CII/CA-139). At a special Governors meeting in October 2013 (CII/CA-143), the majority of Governors supported the merge-out recommended by management and instructed the AHC to focus its analysis on this approach.<sup>2</sup>

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<sup>1</sup> Many documents that are relevant to this evaluation have different document numbers for IDB, IIC, and MIF. For consistency, where documents have more than one number, the IIC number is used.

<sup>2</sup> Some Governors expressed concern about focusing only on the merge-out option because of its high capital requirements, potentially increased coordination difficulties, and higher administrative costs.

- 1.5 Subsequently, the AHC and management, supported by “Internationally Recognized Experts”, developed an “Implementation Plan” (CII/GN-296-2), an Organizational and Capitalization Proposal (CII/GN-303-2), and a “Merge-Out Proposal” (CII/CA-165), covering various aspects such as human capital, structure and organization, capitalization and costs, as well as wide-ranging objectives. The Boards of Governors of the IDB Group decided in March 2015 to support the proposal for the “merge-out” of the IDB’s and IIC’s private sector operations<sup>3</sup> into a “new” IIC. Additional capital of US\$2.03 billion was authorized for IIC, in part from new contributions of US\$1.3 billion and in part from transfers from the IDB of US\$725 million during 2018-2023, subject to certain conditions (Governors’ Resolution CII/AG-2/15).
- 1.6 The merge-out took effect on January 1st, 2016. Operational and administrative functions associated with IDB’s private sector activities were transferred from IDB to IIC, and significant changes were made in the staffing of the new organization. Though implementation of various aspects of the merge-out is still underway as part of the 10-year framework of the *Renewed Vision*, the Boards of Directors of IDB and IIC asked OVE to evaluate the implementation of the private sector merge-out to date as part of OVE’s 2017-2018 work program.

## **B. Conceptual framework for evaluating the merge-out**

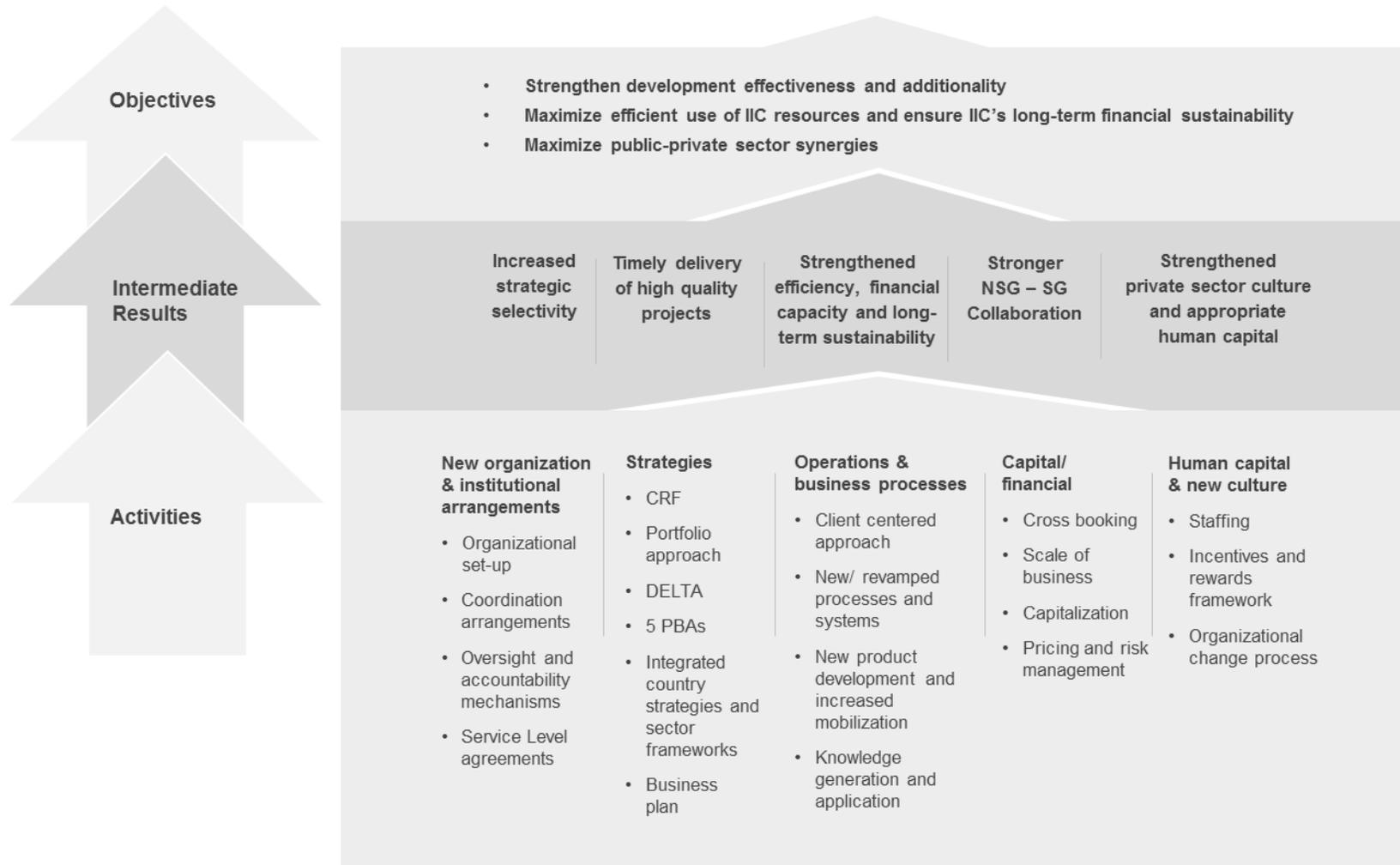
- 1.7 The merge-out was undertaken to deliver on a renewed vision to foster development through the private sector, aiming at improving the development effectiveness of IDBG’s interventions in the region (CII/CA-165). Though the key documents related to the merge-out contain a wide range of objectives,<sup>4</sup> three were highlighted throughout the process leading up to the merge-out:
- strengthening development effectiveness, development impact and additionality;
  - maximizing the efficient use of resources; and
  - maximizing the synergies between public and private sector activities.
- 1.8 Many activities have been undertaken to date as part of the merge-out, and others are underway. For purposes of the evaluation, OVE has prepared a merge-out framework (Figure 1.1) to capture how the actions that are being undertaken – the inputs – are expected to generate a chain of results that will ultimately lead to achieving the merge-out objectives.

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<sup>3</sup> The reorganization covered the previous IIC and the Vice-Presidency for the Private Sector, Structured and Corporate Finance Department (SCF), and Opportunities for the Majority Department (OMJ) in IDB.

<sup>4</sup> Many other objectives were included in the key documents, some broad – such as strengthening a high-performance private sector culture and establishing a more strategically focused and accountable entity – and others more specific, such as preserving sovereign guaranteed (SG) and non-sovereign guaranteed (NSG) lending, safeguarding IDB’s AAA-rating, having a sunset-clause on cross-booking, maintaining the full range of operations of the various preceding NSG windows, and reducing costs by US\$107 million over 10 years (despite significant additional resources for SG-NSG coordination, market intelligence, etc.).

**Figure 1.1. Merge-Out Framework\***



Note: \*As per Resolution CII/AG-2/15 and accompanying Renewed Vision (CII/CA-165)

## II. EVALUATION SCOPE, QUESTIONS AND METHODOLOGY

- 2.1 The evaluation seeks to provide the IIC and IDB Boards with an independent assessment of the status of the merge-out implementation process to date, seeking to shed light on whether such process is broadly supporting IIC's path towards effectively fostering development in the LAC region through private sector operations. The evaluation will cover the period from March 2015, when Governors approved the private sector merge-out at the Annual Meeting in Busan, to mid-2017. Given that the merge-out is still under implementation, the evaluation will focus primarily on the level 1 activities and inputs shown in Figure 1.1, with the intermediate results of level 2 serving as a set of objectives to anchor the analysis. OVE recognizes that not all activities have matured enough to show clear results, and an important objective of the evaluation will be to help IIC and IDB management identify useful approaches to enhance the success of the merge-out going forward.

### A. Evaluation questions

- 2.2 The overarching evaluation question is to what extent implementation of the merge-out process to date is helping to achieve the intermediate results envisioned: strategic selectivity, timely delivery of high quality projects, strengthened financial capacity and long-term sustainability, stronger NSG-SG collaboration, and strengthened private sector culture with appropriate staff. Related sub-questions are indicated below.
- a. To what extent is implementation of the merge-out process to date helping IIC achieve strategic selectivity? To answer this question, the evaluation will seek to shed light on:
- whether the portfolio of IIC's new operations is beginning to reflect a shift towards strategic selectivity and focus on the five priority business areas and other areas of strategic priority;<sup>5</sup>
  - whether IIC's portfolio approach, which considers both development effectiveness (through the DELTA – Development Effectiveness, Learning, Tracking and Assessment - Tool) and financial sustainability (through the financial contribution rating) is likely to allow for effective project selection based on a combination of financial and development contribution;
  - how the Corporate Results Framework (CRF), Business Plan and Country Strategies relate to IIC's activities, and whether they are starting to provide effective strategic guidance for project selection.
- b. To what extent is implementation of the merge-out process to date helping IIC deliver high quality projects in a timely manner? To answer this question, the evaluation will seek to shed light on:

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<sup>5</sup> Other areas of strategic priority include 3 transversal topics – gender and diversity; environmental and social sustainability and the enabling environment--as well as country priorities, such as enhanced engagement with C and D and Caribbean countries and other countries that had benefitted less from NSG operations.

- whether new operations are increasingly being designed and implemented to ensure a focus on development effectiveness and additionality;
  - whether new/streamlined processes and systems are in place, or are being put in place, to support the timely delivery of products and services to address client needs;
  - how the handover of the legacy portfolio has been handled by IIC;
  - whether policies, processes and systems are being put in place to effectively manage environmental and social risks in IIC operations, including cross-booked operations and the legacy portfolio;
  - how cross-booking is being implemented;
  - where IIC stands with generating, disseminating, and deploying knowledge products.
- c. To what extent is implementation of the merge-out process to date helping IIC strengthen its efficiency, financial capacity, and long-term sustainability? To answer this question, the evaluation will seek to shed light on:
- whether capital contributions to IIC are on track;
  - the effect of the merge-out on IDB and IIC's credit risk ratings;
  - how costs and investment volume and composition (including cross-booking) are evolving (both in absolute terms and compared to original projections), and what are, if any, the potential effects on profitability and IDBG's capital;
  - IIC's approach to assessing and addressing financial risk in operations.
- d. To what extent is implementation of the merge-out process to date helping NSG-SG coordination? To answer this question, the evaluation will seek to shed light on:
- whether IIC's new structure and institutional arrangements support effective coordination and synergies between NSG and SG;
  - how well IIC and IDB coordinate at the programming and operational levels.
- e. To what extent is implementation of the merge-out process to date helping IIC operate with a stronger private sector culture and appropriate staffing? To answer this question, the evaluation will seek to shed light on:
- the planning and implementation of IIC's organizational transformation process;
  - the efforts to ensure that IIC is appropriately staffed to deliver its functions;
  - whether IIC's incentive structure and rewards framework are well-designed to promote desired staff behaviors;
  - whether IIC is moving toward the desired culture;

- whether IDBG’s independent oversight functions are functioning effectively for IIC.<sup>6</sup>

## **B. Methodology**

2.3 The evaluation will use a mixed methods approach, including document reviews, analysis of business processes, portfolio and financial data, interviews, and focus groups. Among the key documents to be analyzed are:

- the Governors’ resolutions, merge-out proposal, organizational and capitalization proposal, and implementation plan,<sup>7</sup>
- progress reports prepared for the Board and Governors,<sup>8</sup>
- IIC business and financial plans,<sup>9</sup>
- quarterly presentations on NSG activities prior to and after the merge-out,
- internal management documents related to corporate results, the strategic framework, and public-private coordination,<sup>10</sup>
- IIC’s Strategic Selectivity presentations<sup>11</sup> and related processes to improve public-private synergies, as well as those projects that have been identified as priority for such collaboration, and
- documents related to changes in organization and processes, to the human capital component, and to the merge-out communication strategy.

2.4 To gain an understanding of how the merge-out is helping IIC deliver high quality operations in a timely manner, OVE will conduct a desk-based review of operations approved since the merge-out took place, with particular focus on those that resulted from business generation in 2016. OVE will also review the business processes and systems that support design and implementation of investments and technical cooperation, and will analyze portfolio information, including the distribution of approvals, commitments, disbursements, and mobilization for 2016 and the pipeline for 2017 by priority business area, country groupings, DELTA ratings, and other relevant characteristics (such as instrument type, etc.). As part

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<sup>6</sup> One of the goals of the merge-out was that quality oversight functions, including independent evaluation (OVE), the independent consultation and investigation mechanism (ICIM), institutional integrity (OII), internal audit (AUG), ethics (ETH), and the ombudsperson (OMB), be applied to the new IIC with the same standards and quality as in IDB.

<sup>7</sup> In that context, OVE will also review reports and presentation by the “Internationally Recognized Experts”, such as the McKinsey reports and presentations about the preliminary proposal (CII/CA-153), organization (CII/XR-2-3) and capitalization (CII/XR-2-5, 2-6 and 2-7 and CII/XR-4 and XR-4-1).

<sup>8</sup> Including the initial Status Reports about progress (CII/PP-158, CII/PP-158-1 and CII/PP-158-2), the Annual Progress Reports prepared for Governors (CII-AB-1440, CII/AB-1473).

<sup>9</sup> Newco Business Plan 2016-2019 and related reports and presentations (CII/GN-310, CII/PP-165, CII/PP-171); IIC 2017-2019 Business Plan and related reports and presentations (CII/GA-77, CII/GA-77-1 and CII/GA-77-2, CII/PP-197).

<sup>10</sup> Including updates to the Corporate Results Framework, the portfolio approach and the DELTA tool, country strategy guidelines, meeting agendas and minutes of relevant coordination committees, etc.

<sup>11</sup> IIC has conducted 19 “Strategic Selectivity Presentations”, jointly with the IDB, to familiarize IIC staff with country strategies and development priorities, to familiarize IDB staff with IIC activities, and to agree on priority areas for collaboration.

of the review OVE will interact with McKinsey, which has been hired by IIC management to suggest improvements and upgrades to business processes.

- 2.5 OVE will conduct interviews with key stakeholders, including managers, country representatives, and current and former IDB and IIC staff. OVE will carry out focus groups with IIC clients in five countries: Argentina, Bahamas, Chile, Ecuador, and El Salvador. These countries were selected because of the number of operations approved in 2016, geographical representation, and to take advantage of synergies in OVE’s work program. OVE will focus on clients with experience working with IDB and IIC both before and after the merge-out, and on experiences of clients during the transition. As available and relevant, OVE will also review results from IDB Group’s External Feedback Surveys. OVE will also conduct interviews with a small sample of B-lenders and competitors (such as IFC and CAF) about their perceptions of the changes in IIC, and how these changes have affected them.

### III. TEAM AND TIMELINE

- 3.1 The evaluation team includes Ana Maria Linares and Roland Michelitsch (team leaders), Ulrike Haarsager, Jose Claudio Pires, Alejandro Soriano, Roni Szwedzki, Stephany Maqueda Gassos, Patricia Oliveira, Nathaniel Russell, Raphael Seiwald, Ana Ramirez-Goldin and, as external expert consultant, Catherine Cardona.

Activity	Date
<b>Evaluation activities (e.g., document review, interviews, surveys, etc.)</b>	April – July 2017
<b>Draft for management review</b>	August 2017
<b>Delivery of evaluation to the Board of Executive Directors</b>	September 2017