



Corporate Evaluation

Fifth Independent Evaluation of SCF's Expanded Project Supervision Report Exercise





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Note: This document has been edited in accordance the Access to Information Policy. In particular, proprietary information pertaining to private sector firms has been removed.

ACRONYMS AND ABBREVIATIONS

CAPEX	Capital expenditures
DEM	Development Effectiveness Matrix
ECG	Evaluation Cooperation Group
EOM	Early operating maturity
ERR	Economic rate of return
EROIC	Economic return on invested capital
ESMS	Environmental and Social Management System
FRR	Real after-tax financial rate of return
GPS	Good Practice Standards
GPS3	Third Edition, Good Practice Standards
IDB	Inter-American Development Bank
IFC	International Finance Corporation
MDB	Multilateral development bank
MIF	Multilateral Investment Fund
MSMEs	Micro, small, and medium-sized enterprises
OVE	Office of Evaluation and Oversight
PSD	Private sector development
PPP	Public-private partnership
ROIC	Return on invested capital
SCF	Structured and Corporate Finance Department
XPSR	Expanded Project Supervision Report
XPSR-A	Expanded Project Supervision Reports Addendum

EXECUTIVE SUMMARY

Each year the Structured and Corporate Finance Department (SCF) of the Inter-American Development Bank (IDB, or Bank) prepares a set of Expanded Project Supervision Reports (XPSRs). This Fifth Independent Evaluation Report presents the annual independent validation of the XPSRs by the Office of Evaluation and Oversight (OVE). The exercise has been carried out in line with the Good Practice Standards (GPS) for Private Sector Operations issued by the multilateral development banks' Evaluation Cooperation Group (ECG).

Each project is evaluated on four dimensions: Development Outcome, IDB Profitability, IDB Additionality, and IDB Work Quality. This XPSR exercise covers all nine SCF projects that reached Early Operating Maturity (EOM) in 2011. These projects were approved mostly in 2008 and 2009 during the global financial crisis, although one dates back to 2006. The portfolio consists of five financial operations (all located in C&D countries) and four non-financial sector operations (located in A&B countries). Like previous validation exercises, this one was an interactive process. Throughout the discussions, disagreements on ratings between SCF and OVE were sorted out through the provision of additional evidence and clarifications by SCF. The percentage of disagreements (only 7%) was lower than in the previous exercise (15%), resulting in a total of seven downgrades.

According to ECG, projects reaching EOM in 2011 are to be evaluated based on the GPS3. Yet this version of the GPS suffers from several methodological shortcomings—the prescription of inadequate indicators for assessing the business and economic contribution of financial market projects, the lack of clear indicators for assessing the MDB's additionality and contribution to private sector development (PSD), and the absence of guidelines for validating the MDB's quality of work based on the project's evaluability criteria. Because of these methodological limitations and the small number of projects covered by this exercise, the results presented in this report must be interpreted with caution.

Discussions currently underway in the ECG and in several MDBs are focusing on how to bring the evaluation frameworks for private and public sector operations closer together and how to enhance the focus of XPSRs on development effectiveness. OVE will work with SCF and the other private sector windows of the IDB Group to consider how to focus future project evaluation criteria more centrally on the assessment of development results.

As in the previous exercises, OVE found that the performance of the projects was mixed: they performed well on IDB Profitability (100% positive), obtained moderate performance ratings in the IDB Work Quality (67% positive) and IDB Additionality (56% positive) dimensions, and underperformed on project Development Outcomes (33% positive). The low number of positive ratings on development outcomes was due to less than satisfactory business performance in five of the projects and lack of evidence of projects' economic and social impacts. The mismatch between IDB Profitability and

Development Outcome ratings suggests that the Bank has been achieving profitability through its project support but has not focused sufficiently on either project design or monitoring of project development results.

As in previous exercises, the Bank's additionality to the projects reviewed was primarily financial. All operations in C&D countries reviewed during this exercise were financial sector operations, generally credit lines to incumbents for SME lending in their respective markets, with limited evidence of Bank additionality. In A&B countries, the Bank's lending was to non-financial operations, and most were prepaid at the first sign of financial market recovery. This suggests that for most of these real sector clients in A&B countries, the Bank's role turned out to be largely one of providing financing for a short period of time while the markets dried up during the financial crisis, rather than being a long term project partner. While the Bank may have a role to play as a financier during financial crises, the Bank is less likely to have a significant effect on overall project development effectiveness if it is involved only in the short run, as prepayment of loans voids the Bank's contractual mechanisms that enforce developmental clauses and hinders the possibility of tracking and assessing project development outcomes.

Two main conclusions can be derived from this XPSR exercise. First, the evaluation criteria applicable to private sector operations need to be strengthened to ensure the focus on results and development effectiveness; the criteria should include requirements for adequate project results matrices and for the collection of evidentiary data during project implementation. Second, during the design and monitoring of projects and during XPSR preparation, SCF should enhance its efforts to collect and present evidence of development effectiveness and draw prescriptive lessons for future operations.

Looking forward, OVE has the following recommendations to Management, some of which reinforce recommendations of previous reports:

- ***Work with OVE to review and revise the system for project evaluation (in the context of broader ECG discussions also underway)***
 - Define guidelines to ensure that private sector project evaluation criteria focus on development effectiveness.
 - Define clear evaluation criteria for assessing the Bank's financial and non-financial additionality.
 - Define guidelines for evaluation of financial market projects based on outcome indicators that capture the project's contribution.
- ***Enhance the screening and monitoring of development effectiveness***
 - Identify each project's development objectives using measurable outcome indicators.
 - Ensure the measuring and tracking of project economic and financial indicators.
- ***Improve the quality of XPSR preparation***
 - Ensure that XPSRs contain sufficient evidence to justify project ratings.
 - Convey lessons learned in a concise and prescriptive way.

I. INTRODUCTION

- 1.1 **Each year the Structured and Corporate Finance Department (SCF) of the Inter-American Development Bank (IDB, or Bank) prepares a set of Expanded Project Supervision Reports (XPSRs).** This Fifth Independent Evaluation Report presents the annual independent validation of the XPSRs by the Office of Evaluation and Oversight (OVE). The exercise has been carried out in line with the Good Practice Standards (GPS) for Private Sector Operations issued by the multilateral development banks' (MDBs') Evaluation Cooperation Group (ECG).
- 1.2 **This exercise covers all nine projects that reached early operating maturity (EOM)¹ during 2011.** ECG guidelines call for the preparation of the XPSR during the same year a project reaches EOM; however, the XPSRs for 2011 EOM projects were completed in March 2013.
- 1.3 **According to the ECG, projects reaching EOM in 2011 are to be evaluated using the Third Edition of the GPS (GPS 3).** That version of the GPS suffers from several methodological shortcomings (see Box 1) that were partially addressed in the Fourth Edition, which ECG recommends applying to projects reaching EOM as of 2012. Discussions now under way in the ECG and in several MDBs underscore the need to bring the evaluation frameworks for private sector and public sector operations closer together and to enhance XPSRs' focus on the assessment of development effectiveness. OVE will work with SCF and the other private sector windows of the IDB Group to consider how to focus future project evaluation criteria more centrally on development results. Because of the methodological limitations of GPS3 and the small number of projects covered by this exercise, the results presented in this report must be interpreted with caution.

¹ According to GPS standard 2.1.3, Corporate Projects reach early operating maturity when: "(a) the project financed will have been substantially completed, (b) the project financed will have generated at least 18 months of operating revenues for the company, and (c) IDB will have received at least one set of audited annual financial statements covering at least 12 months of operating revenues generated by the project." On the other hand, standard 2.1.4 defines that "Financial Projects reach early operating maturity after the lapse of at least 30 months following the IDB final material disbursement for sub-loans or sub-investments, i.e., ignoring disbursements for small follow-up investments in existing client companies and disbursements to cover management fees or other expenses of investment funds."

Box 1. Key Methodological shortcomings of the GPS

GPS3. The GPS3 assessment of project Development Outcomes is deficient in three of its four sub dimensions: Business Performance, Economic Development and Private Sector Development (PSD).

- Attribution problems undermine the assessment of the business and economic development contributions of financial market projects. The GPS3 allows the use of return on invested capital (ROIC) and economic return on invested capital (EROIC) indicators as proxies of financial rate of return (FRR) and economic rate of return (ERR), respectively. However, except for stand-alone project companies, these proxies are inadequate since they capture the returns on invested capital of the whole company and not of the project itself.
- The GPS3 adopts a neutral approach to assess the project's contribution to PSD. Whenever no damage to PSD is verified, the GPS3 suggests giving the project a satisfactory rating, even when there is no evidence of any positive contribution to PSD.

The GPS3 lacks clear indicators for assessing MDB Additionality. Although financial additionality can be gauged by the provision of comparative evidence of similar operations at the time of project approval, the guidelines for non-financial additionality are usually anchored in subjective inferences about the MDB's contribution to the project.

The GPS3 also lacks guidelines linking project evaluability criteria to MDB Work Quality, allowing projects to receive satisfactory ratings even when they lack adequate result frameworks or do not track development outcomes during implementation.

Finally, the GPS3 double-counts the assessment of the Bank's value-added through two separate dimensions, MDB's Role and Additionality.

GPS4. The Fourth Edition of the GPS only partially addresses some of these shortcomings: it acknowledges the intrinsic attribution problems of ROIC and EROIC for the assessment of a financial market project's contribution to business and economic development; and to mitigate these problems, it recommends analyzing the contribution of sub-portfolios which partially addresses the attribution problem. It also eliminates the MDB's role as a validation dimension, fixing the double-counting issue between MDB's Role and Additionality.

However, the Fourth Edition still falls short in several respects: it does not establish clear evaluation criteria for financial market operations and, more specifically, does not define indicators for the evaluation of financial intermediaries' sub-portfolios; it does not include evidence-based criteria for rating the project's contribution to PSD; it still lacks assessment criteria for the MDB's Work Quality based on the project's evaluability; and it does not have a robust approach to measure project development effectiveness.

II. SCOPE AND VALIDATION PROCESS

- 2.1 **The nine projects that reached EOM during 2011 amounted to US\$694 million in loans and guarantees and supported projects totaling about US\$6 billion.** These projects were approved mostly in 2008 and 2009 during the global financial crisis, although one dates back to 2006. Three out of four non-financial projects were prepaid. The eight operations approved in 2008-2009 represent 24% of SCF's portfolio approved during those two years. Box 2 summarizes the main characteristics of the portfolio.
- 2.2 The evaluation process started when SCF's officers prepared XPSRs for each project and sent them to OVE for independent validation. OVE then sent SCF Expanded Project Supervision Reports Addenda (XPSR-As) assessing the quality of information provided by each XPSR section, requesting additional information to support the XPSRs' ratings, and suggesting re-ratings.² Finally, OVE defined the final validation ratings and received a formal agreement/disagreement from SCF.
- 2.3 **The XPSRs rate projects on four performance dimensions: Development Outcome, IDB Investment Profitability, IDB Additionality, and IDB Work Quality** (Table 2). Each of the performance dimensions was assigned a rating based on a standard four-point scale: Excellent (E), Satisfactory (S), Partially unsatisfactory (PU), and Unsatisfactory (U). Ratings for Project Development Outcome and IDB Work Quality are determined by performance on sub-dimensions, shown in Table 1.

² According to the ECG Guidelines, the Office of Evaluation conducts an independent desk review of each XPSR to "verify scope responsiveness, evident reliability of the analysis, impartiality and consistency in ratings judgments, and appropriateness and completeness of the identified lessons" and formalizes its findings on the XPSR-As. The XSPR-A assesses the adequacy of the information provided by each XPSR, such as project description, rationale for Bank's intervention, performance rating justifications, etc.

Box 2. Characteristics of the 2011 EOM Project Portfolio

Nine projects for US\$694.1 million:

- Four are non-financial market projects (US\$512.1 million) located in A&B countries. They support capital expenditures (CAPEX) programs on energy (two loans) and transportation (one guarantee and one loan).
- Five are financial market projects (US\$182 million) located in C&D countries. These are loans to financial intermediaries. All target micro, small, and medium-sized enterprises (MSMEs), and four also support mortgage issuing.
- Eight are loans, and one is a partial credit guarantee.
- Three projects are in A countries, one in a B country, two in C countries, and three in D countries.

Table 1. Performance Dimensions and Standard Ratings

Performance dimension	Performance areas
Project Development Outcome	Contribution to company business performance
	Contribution to economic development
	Environmental and social effects
	Contribution to private sector development
IDB Investment Profitability	Project gross profit contribution to IDB
IDB Additionality	Financial, environmental, corporate governance and regulatory additionality
IDB Work Quality	Screening, appraisal and structuring work
	Monitoring and supervision quality work
	IDB role and contribution of IDB

2.4 As in the previous validation exercises, OVE and SCF established an interactive process that increased the number of agreements from 44% (first XPSR draft) to 93% (final XPSR report). The few remaining disagreements resulted in no upgrades and seven downgrades by OVE: five in Work Quality and two in Additionality (see Tables 2 and 3). All but one of the downgrades represented binary changes (from E and/or S to PU and/or U).

2.5 **The role of peer reviews in XSPR preparation can be further strengthened.** Efforts have been made by SCF to upgrade the importance of peer reviews. A review of peer review minutes by OVE suggests, however, that there is room for further improvement. The minutes reviewed by OVE suggest that peer reviews seldom point out the need to ensure that ratings are consistent with and supported by evidence: in only two projects did the reviewers suggest the inclusion of additional information. In three of them, the participants suggested updating some of the indicators, to reflect the last results. In the other minutes, the reviewers' comments were limited to praise of projects' achievements, even when such achievements were not supported by evidence.

Table 2. Level of Agreement on SCF's Original XPSR Ratings

OVE ratings	a. Total	b. Agreements		c. Disagreements	
		Number	% (b/a)	Number	% (c/a)
PROJECT DEVELOPMENT OUTCOME	45	16	36%	29	64%
IDB INVESTMENT PROFITABILITY	9	9	100%	0	0%
IDB ADDITIONALITY	9	2	22%	7	78%
IDB WORK QUALITY	36	18	50%	19	53%
TOTAL	99	45	45%	55	56%

Table 3. Level of Agreement on Final XPSR Ratings

OVE ratings	a. Total	b. Agreements		c. Disagreements	
		Number	% (b/a)	Number	% (c/a)
PROJECT DEVELOPMENT OUTCOME	45	45	100%	0	0%
IDB INVESTMENT PROFITABILITY	9	9	100%	0	0%
IDB ADDITIONALITY	9	7	78%	2	22%
IDB WORK QUALITY	36	31	86%	5	14%
TOTAL	99	92	93%	7	7%

2.6 **As in previous exercises, project performance was mixed.** The projects were rated well on IDB Profitability (100% positive), moderately on IDB Work Quality (67% positive) and IDB Additionality (56% positive), and poorly on Project Development Outcomes (only 33% positive) (see Table 4). The low number of positive Project Development Outcome ratings is driven by less than satisfactory business performance of five projects and lack of evidence of projects' economic and social impacts.

Table 4. Performance Distribution (9 projects)

OVE ratings/General Performance (%)	Positive ratings		Negative ratings	
	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	0%	33%	56%	11%
IDB INVESTMENT PROFITABILITY	0%	100%	0%	0%
IDB ADDITIONALITY	0%	56%	44%	0%
IDB WORK QUALITY	0%	67%	33%	0%
Financial Market Operations	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	0%	20%	60%	20%
IDB INVESTMENT PROFITABILITY	0%	100%	0%	0%
IDB ADDITIONALITY	0%	60%	40%	0%
IDB WORK QUALITY	0%	60%	40%	0%
Non-Financial Market Operations	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	0%	50%	50%	0%
IDB INVESTMENT PROFITABILITY	0%	100%	0%	0%
IDB ADDITIONALITY	0%	50%	50%	0%
IDB WORK QUALITY	0%	75%	25%	0%

Note: these tables are based on OVEs validated ratings of the XPSRs.

A. Project Development Outcome

2.7 **As in the previous exercises, project ratings were lowest on contribution to Economic Development.** (Table 5 shows the ratings distribution for the various indicators contributing to project Development Outcome.) The negative ratings

were due to a combination of lack of evidence on results and inadequate indicators (see Box 1 and Box 3).³

Table 5. Development Outcome Performance

OVE ratings/General Performance (%)	Positive ratings		Negative ratings	
	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	0%	33%	56%	11%
<i>Contribution to Company Business Performance</i>	0%	44%	33%	22%
<i>Contribution to Economic Development</i>	0%	11%	22%	67%
<i>Environmental and Social Effects</i>	11%	56%	33%	0%
<i>Contribution to Private Sector Development</i>	0%	100%	0%	0%
Financial Market Operations	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	0%	20%	60%	20%
<i>Contribution to Company Business Performance</i>	0%	40%	40%	20%
<i>Contribution to Economic Development</i>	0%	0%	20%	80%
<i>Environmental and Social Effects</i>	20%	40%	40%	0%
<i>Contribution to Private Sector Development</i>	0%	100%	0%	0%
Non-Financial Market Operations	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	0%	50%	50%	0%
<i>Contribution to Company Business Performance</i>	0%	50%	25%	25%
<i>Contribution to Economic Development</i>	0%	25%	25%	50%
<i>Environmental and Social Effects</i>	0%	75%	25%	0%
<i>Contribution to Private Sector Development</i>	0%	100%	0%	0%

Note: these tables are based on OVEs validated ratings of the XPSRs.

2.8 **Given the limitations of EROIC as an indicator to assess an operation’s contribution to economic development, OVE also looked for -- but did not find -- other evidence on projects’ economic and social impacts.**⁴ The GPS allows adjustments to ratings to reflect additional evidence on project economic and social impact, but the common denominator in all of these projects is the lack of documented results. All financial market projects provided EROIC values below the cut-off point for a satisfactory rating.

³ As the GPS3 allows, all five financial market operations presented EROIC as a proxy for their contribution. Two of the four non-financial market operations mistakenly did the same, instead of presenting ERRs. The values of these proxies were also a contributor to the negative project ratings on Economic Development.

⁴ This evidence could come either from the effort of quantifying the project’s economic and social effects on population or from the results of a pilot impact evaluation of a similar project in a comparable context.

- 2.9 **Regarding non-financial market operations, two projects provided an ERR, but only one had a value consistent with an S rating.** One operation was rated S because the ERR was above 10%. Another one provided an ERR value below the benchmark for an S rating. The other two projects failed to provide the correct indicator for CAPEX programs and provided an EROIC instead of an ERR, resulting in a less than satisfactory rating.⁵

Box 3. Validation of Project Development Outcomes using the GPS3: Practical Examples

As discussed in Box 1, there are problems with the GPS3 assessment of Project Development Outcome in three of the four sub-dimensions—Business Performance, Economic Development, and PSD. During the current validation exercise, these flaws jeopardized the project assessment by creating several biases that were successfully mitigated in only a few cases.

For financial market operations the ROIC/EROIC does not appropriately measure the operation's contributions to business performance and economic development, because it measures the financial intermediary's overall performance rather than the performance of the Bank supported operation.

To overcome this measurement problem, OVE looked for additional information on project performance. If it found positive or negative evidence of reaching business targets, it rated financial projects independently of the ROIC value recorded in the XPSR. Two projects received positive ratings because they achieved their targets, while three projects received negative ratings because they failed to do so. OVE was unable to adopt the same procedure when assessing financial projects' contribution to economic development, since none of them designed indicators for and tracked evidence of economic and social impacts. The EROIC values were the only indicators available for rating financial projects on this dimension. Similarly, no evidence was found of economic and social impacts of the two non-financial market projects that mistakenly provided EROIC instead of ERR, and they were downgraded accordingly.

Lastly, because GPS3 recommends giving a satisfactory rating whenever no damage to PSD is verified, the assessment of the PSD dimension for both financial and non-financial operations is biased towards positive ratings. As a result, all the projects were rated Satisfactory even when they lacked evidence of any positive contribution. In the current exercise only two projects showed evidence of positive contribution to PSD. The table below breaks down the number of positive/negative ratings by rating rationale.

⁵ OVE automatically downgrades the rating of a non-financial market operation on economic development and business performance when ROIC/EROIC is presented instead of FRR/ERR.

FINANCIAL MARKET PROJECTS	Total	Positive rating	Negative rating
BUSINESS PERFORMANCE	5	2	3
<i>Adequate indicator (Project Contribution)</i>	0	0	0
<i>Targets were achieved</i>	2	2	0
ECONOMIC DEVELOPMENT	5	0	5
<i>Adequate indicator (Project Contribution)</i>	0	0	0
<i>Evidence of economic/social impact</i>	0	0	0
PRIVATE SECTOR DEVELOPMENT (PSD)	5	5	0
<i>Evidence of damage to PSD</i>	0	0	0
<i>Evidence of positive contribution to PSD</i>	0	0	0

NON-FINANCIAL MARKET PROJECTS	Total	Positive rating	Negative rating
BUSINESS PERFORMANCE	4	2	2
<i>Adequate indicator (FRR)</i>	2	2	0
<i>Targets were achieved</i>	2	2	0
ECONOMIC DEVELOPMENT	4	1	3
<i>Adequate indicator (ERR)</i>	2	1	1
<i>Evidence of economic/social impact</i>	0	0	0
PRIVATE SECTOR DEVELOPMENT (PSD)	4	4	0
<i>Evidence of damage to PSD</i>	0	0	0
<i>Evidence of positive contribution to PSD</i>	2	2	0

Note: these tables are based on OVE's validated ratings of the XPSRs.

- 2.10 **Negative ratings on Business Performance also contributed to the low ratings on Development Outcome.** Unlike the Economic Development dimension, where evidence was not available, OVE obtained evidence of all projects' business performance. Five of the nine projects -- three financial and two non-financial -- did not reach their business targets
- 2.11 **Six of the nine projects performed positively on Environment and Social Effects.** One went beyond expectations: the project led to the implementation of a new Environmental and Social Management System (ESMS) that was not only applied to the client's entire domestic portfolio, but also to its portfolio abroad. Four projects were in compliance with all the Bank's environmental and social safeguard policies. One project was technically out of compliance with the Bank's environmental and social safeguards since its ESMS did not cover the smaller loans for MSMEs. SCF stated that the Bank failed to give the client a threshold based on IDB's internal definition. There was, however, no indication that any material harm was caused by the client's application of its own system. Three additional projects failed to comply with some environmental requirements during project execution.

2.12 **Finally, all projects achieved a satisfactory rating on Private Sector Development.** Per GPS3, this means that they did not have any negative impact on PSD (see Box 3).⁶

B. IDB Profitability

2.13 **All projects received positive ratings on Profitability.** This rating is based on the gross profit contribution to IDB, and is assessed by comparing the fees and interest amounts collected by the Bank during the project lifecycle with the amounts expected to be received at the project approval time. The project's loan credit risk classification was also taken into account in the rating process.

C. IDB Additionality

2.14 **Eight of the nine projects were approved in the context of the global financial crisis, five achieved satisfactory ratings for financial additionality, but OVE did not find any evidence of non-financial additionality.** The five projects that achieved positive ratings had financial value-added through the mobilization of B-lenders or the provision of longer tenors than those available in the market at the time of project approval. However, for three of these projects the longer tenor eventually became irrelevant as borrowers pre-paid the loans as soon as financial markets recovered. Four projects had negative ratings because there was no evidence in the XPSR that the project would not have been implemented or would have been of lower quality without IDB.

D. IDB Work Quality

2.15 **Six projects received positive ratings on overall Work Quality.** There was, however, some variation across the three performance areas that comprise the Work Quality dimension (see Table 6).

⁶ GPS3 suggests negative project ratings on PSD whenever negative impacts on competition, development of capital market, private ownership, or physical infrastructure could be attributed to the project.

Table 6. IDB's Work Quality Performance

OVE ratings/General Performance (%)	Positive ratings		Negative ratings	
	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
IDB WORK QUALITY	0%	67%	33%	0%
<i>Screening, Appraisal and Structuring Work</i>	0%	56%	44%	11%
<i>Monitoring and Supervision Quality Work</i>	0%	67%	33%	0%
<i>IDB Role and Contribution</i>	0%	100%	0%	0%
Financial Market Operations	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
IDB WORK QUALITY	0%	60%	40%	0%
<i>Screening, Appraisal and Structuring Work</i>	0%	60%	40%	0%
<i>Monitoring and Supervision Quality Work</i>	0%	60%	40%	0%
<i>IDB Role and Contribution</i>	0%	100%	0%	0%
Non-Financial Market Operations	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
IDB WORK QUALITY	0%	75%	25%	0%
<i>Screening, Appraisal and Structuring Work</i>	0%	50%	25%	25%
<i>Monitoring and Supervision Quality Work</i>	0%	75%	25%	0%
<i>IDB Role and Contribution</i>	0%	100%	0%	0%

Note: these tables are based on OVEs validated ratings of the XPSRs.

- 2.16 **For Screening, Appraisal and Structuring, problems included failure to identify important risks affecting project implementation and lack of evidence that these events could not have been anticipated.** Five projects were rated less than Satisfactory. In the case of the lowest rated project, the Bank failed to identify the project's main risks and poorly screened the operation's technical quality. Technical design issues were not identified and the managing company's track record and financial situation were not properly analyzed during the structuring phase.
- 2.17 **Two-thirds of projects had positive ratings in Monitoring of Performance.** Three projects were rated PU. In one case, the extent of the financial and technical problems discovered early in the operation suggests that the Bank should have been more proactive, carrying out additional analysis and taking action to bring the project back on track, rather than agreeing to various waivers when financial covenants were not met. In the second case, after finding that the ESMS was inadequate because it did not consider the environmental and social safeguards aspects of smaller MSME loans, the client updated its ESMS policies based on the recommendation of the Bank's Action Plan of October 2010. The new ESMS was, however, only to be applied during the next operation without any effect on the ongoing operation. Finally, for the third project no adjustment was made to expected outputs and outcomes after the project was amended to reflect the withdrawal of its expected B-lenders.
- 2.18 **All projects were rated S for IDB's Role and Contribution,** because they were all consistent with the Bank's country strategy and received satisfactory feedback on client surveys.
- 2.19 **Most projects failed to include a results framework with measurable indicators to gauge project results.** In some cases the projects defined

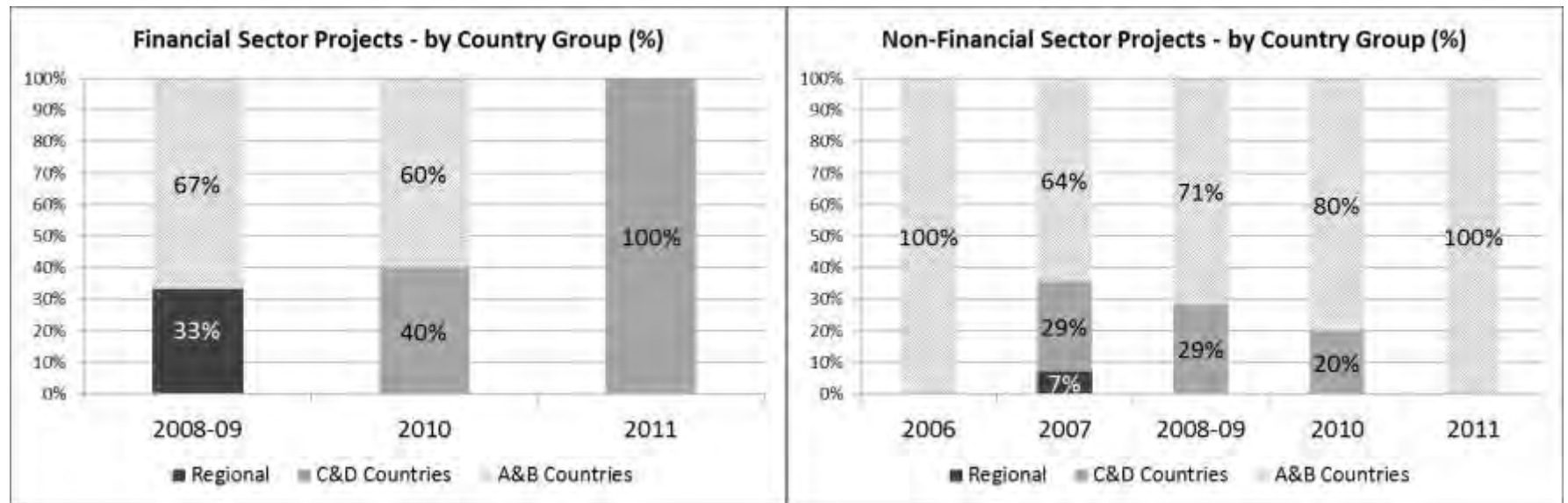
beneficiaries but did not quantify expected benefits, hindering the ex-post calculation of Economic Development results. These shortcomings were not captured by the Work Quality rating, since the GPS3 does not require such a framework.

E. Trends in Validated XPSRs Over Time

1. Evolution of Projects by Country Group and Type of Operation

2.20 **The shares of financial market and non-financial market operations in the different country groupings have varied throughout the XPSR exercises** (see Figure 1). This analysis covered 56 operations, representing 75% of all SCF projects approved between 2000 and 2009. The share of financial market operations in C&D countries has increased substantially. All operations reviewed during the fifth exercise were financial market operations, and most of the clients of these operations are incumbents in their respective markets. In A&B countries the Bank has generally selected non-financial market operations, raising their share in these countries from 64% in the second exercise to 100% in the fifth. Most of the clients are big players in their countries and ended up prepaying the Bank at the first sign of financial market recovery.

Figure 1. Evolution of Projects by Country Group and Type of Operations



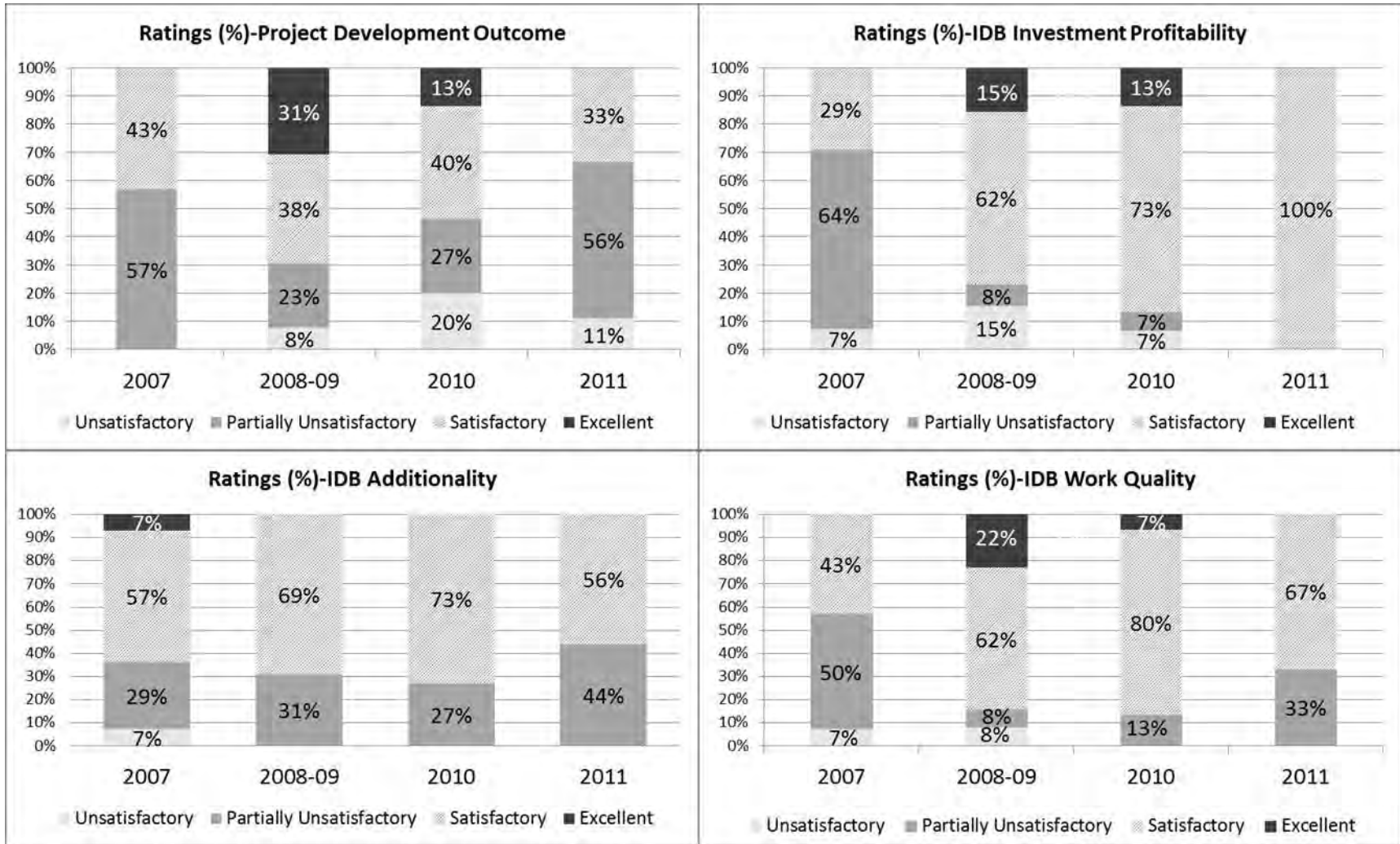
2. Evolution of Project Performance

- 2.21 Figure 2 depicts the evolution of project performance over the last four XPSR exercises (2007, 2008-09, 2010, 2011), covering 68% of all SCF projects approved between 2000 and 2009. OVE did not include 2006 projects in the analysis because their self-evaluation was not carried out in a comparable manner and in accordance with ECG/GPS guidelines.⁷ Though year to year differences need to be interpreted with caution given sample size, two broad trends are worth noting: decreasing Development Outcome ratings and improving ratings in Profitability to IDB. The share of projects with positive development ratings dropped from 69% in the third exercise to 33% in the current exercise. At the same time, the share of projects with positive profitability rose from 77% in the third exercise to 100% in the current exercise.⁸ Inter-annual changes in work quality and additionality are not statistically significant.
- 2.22 The mismatch between Profitability and Development Outcome ratings suggests that the Bank may not be giving equal weight to financial risks and to ensuring that projects can demonstrate positive development outcomes. The Bank has selected financially sound projects and protected its profitability during project implementation, but it has not sufficiently focused on ensuring that positive development outcomes are documented and achieved.

⁷ As stated in the First Independent Evaluation of XPSRs (RE-332): “PRI did not comply with the ECG requirements because the number of projects evaluated by PRI (five) is lower than the minimum number of projects necessary to comply with the ECG requirements. All of the ten projects that achieved early operational maturity should have been evaluated. The small quantity of projects self-evaluated by PRI limited the possibility of extraction and generalization of in depth lessons learned from project implementation.”

⁸ The downward trend in development outcome ratings is statistically significant at the 5% level; the upward trend in profitability is statistically significant at the 10% level.

Figure 2. Trends in General Performance by Number of Projects



2.23 In its efforts to increase overall private sector lending, particularly in C&D countries, the Bank appears to face challenges balancing prudent risk management with strong additionality. The share of financial market operations in C&D countries has increased substantially during the last exercises, generally credit lines for SME lending to leading incumbents in their respective markets with limited evidence of Bank additionality. In A&B countries, the Bank has supported non-financial operations, but most of these loans were prepaid, suggesting that the Bank's role for most real sector clients in A&B countries was to provide financing during the financial crisis that ended up being used only for a short time. While the Bank may have a role to play as a financier during a financial crisis, its role in ensuring development effectiveness is reduced if it is only involved in the short run. Prepayment of loans voids the Bank's contractual mechanisms that enforce developmental clauses and thus impairs the possibility of tracking and assessing projects' development outcomes.

3. Performance Correlations

2.24 **To provide some insights into the linkage between the Bank's work and projects' development outcome ratings,** OVE analyzed the long-term relationship between both Work Quality and Additionality and Development Outcome⁹ ratings and tested the association between IDB Profitability and Economic Development performance ratings.

2.25 **There is a significant positive association between Work Quality and Development Outcome ratings when other factors are controlled for** (see Table 7). OVE tested three different linear probability model specifications: a naive model that did not include any control, an intermediate model that controlled only for country fixed effects, and a fully controlled model that included controls for country, sector, operation type, operation amount, and the year when the project was validated.¹⁰ The positive correlation between Work Quality and Development Outcome ratings is significant in all three models and the coefficient of IDB Work Quality is similar, about 0.5.¹¹ This means that if a project's rating changes from negative to positive on Work Quality, it becomes about 50 percentage points more likely to have a positive Development Outcome rating.

⁹ OVE controlled several project characteristics to estimate three specifications of linear probability models. OVE made an econometric analysis of Development Outcome and two Bank's inputs: Additionality and Work Quality. As OVE found a positive and relatively high correlation between these inputs, it needed to analyze them separately to avoid multicollinearity problems during the estimation.

¹⁰ The inclusion of these controls is important to overcome possible bias occasioned, for instance, by a relatively smaller number of projects, a higher presence of either financial or non-financial market operations of a specific year, and so on.

¹¹ OVE tested the null hypothesis that the value of the Work Quality coefficient is 0.5 and it could not be rejected in any of the three alternative models. OVE also used an F-test to test for the equality of these three coefficients and could not reject the null that they are statistically equal.

Table 7. Estimated Correlation between Work Quality and Development Outcome

		Dependent Variable: Development Outcome		
		Naive Model	Intermediate Model	Controlled Model
Independent Variable	IDB Work Quality	0.49*** (0.15)	0.57*** (0.19)	0.47** (0.24)
Controls	Country	NO	YES	YES
	Sector	NO	NO	YES
	Operation Type	NO	NO	YES
	Operation Amount	NO	NO	YES
	Validation Year	NO	NO	YES
Observations		56	56	56
R-squared		0.17	0.42	0.60

Note: ***Significant at 1%

2.26 **There is also a positive correlation between Additionality and Development Outcome ratings that is significant for the three models** (see Table 8). The coefficient of Additionality ranges from about 0.5 to 0.7—suggesting, again, that if a project’s Additionality rating changes from negative to positive it becomes about 50/70 percentage points more likely to have a positive Development Outcome rating.¹² Finally, the analysis suggests that IDB Profitability is not significant in explaining Economic Development ratings.

Table 8. Estimated Correlation between Additionality and Development Outcome

		Dependent Variable: Development Outcome		
		Naive Model	Intermediate Model	Controlled Model
Independent Variable	IDB Additionality	0.46*** (0.13)	0.58*** (0.14)	0.70*** (0.19)
Controls	Country	NO	YES	YES
	Sector	NO	NO	YES
	Operation Type	NO	NO	YES
	Operation Amount	NO	NO	YES
	Validation Year	NO	NO	YES
Observations		56	56	56
R-squared		0.18	0.51	0.71

Note: ***Significant at 1%

¹² The similarity of the effects of Additionality and Work Quality supports OVE’s decision to run the analysis separately.

III. LESSONS LEARNED AND IMPLEMENTATION OF RECOMMENDATIONS

- 3.1 **The identification of lessons learned is still a challenge for SCF.** Most of the XPSRs in the current exercise do not identify lessons learned, and thus few allow the Bank to learn from good practices and mistakes to improve the design of future operations.
- 3.2 **To produce better lessons, SCF’s self-evaluations should be driven by evidence and based on critical judgment of project achievements.** The self-evaluations should provide insights on project shortcomings, gathering the perceptions of different stakeholders—staff and clients—who are involved in project preparation and execution. They should help identify actions the Bank could take to do better in future operations.
- A. Project Development Outcome**
- 3.3 **Two prescriptive lessons could be derived from the XPSRs, both concerning internal Bank coordination and both noted in previous exercises:**
- ***Improve coordination within the IDB.*** “The IDB’s public branch should engage with the country’s authorities in order to help the handling of regulatory and environmental issues in order to prevent delays by the authorities in granting permits to infrastructure projects”.¹³
 - ***Enhance country dialogue.*** “The Bank should have an active participation in the design of bidding processes in order to increase the competitiveness of proposals and ultimately lead to maximal public revenues”.
- 3.4 **One XPSR noted that prepayment halted the collection of information related to the project’s development outcome.** This lesson corroborates OVE’s findings noted earlier.
- 3.5 **In most cases lessons on development outcomes were incomplete or nonexistent.** Some XPSRs asserted project contributions without evidence—for example, “value added accruing to the loan security package” or “higher target lending achieved by the project”. In others, it was not possible to tell what implications the lessons could have for future Bank operations—for example, in one specific XPSR, SCF addressed “the project preparation’s complexity when a multiplicity of actors are present.” One XPSR stressed “[the] problem [of ensuring] the commitment of the client to achieve the goals established in the [Development Effectiveness Matrix]” but failed to recommend ways to address

¹³ In one project, SCF found that the project’s financial performance was negatively affected by delays that stemmed from the rights-of-way and local community issues, so that the economic impact was also delayed. This issue could affect other private investments in the Latin America region.

this shortcoming.¹⁴ Finally, some XPSRs tried to justify the lack of tracked indicators for development effects in financial markets.

B. IDB Investment Profitability

3.6 **No prescriptive lessons emerged from the analysis of Investment Profitability.** Only two XPSRs drew some lessons: one XPSR noted that engaging in several operations with the same client is likely to reduce processing costs; and another XPSR linked the project's profitability to the operation's high spread. Finally, one XPSR states, without evidence, that "the IDB's profitability can be high even if the loan was repaid much earlier than expected."

C. IDB Additionality

3.7 **There were two prescriptive lessons on Additionality:**

- ***Enhance country dialogue*** "The Bank should have an active participation in the design of bidding processes in order to increase the competitiveness of proposals and ultimately lead to maximal public revenues".
- ***Develop new lending instruments.*** "The XPSR states that foreign exchange exposure is a big burden on clients since their operations and revenues are almost exclusively in local currency".

3.8 **Most XPSRs lacked lessons on Additionality,** and a few justified the operation without evidence of Bank additionality.

D. IDB Work Quality

3.9 **SCF staff highlighted the following lessons on the Bank's Work Quality:**

- ***Closely monitor the financial intermediary's ESMS implementation.*** "The Bank should closely monitor the implementation of ESMS of financial intermediaries' projects when it involves sub-lending to MSMEs".
- ***Improve client selection.*** "The technical know-how of a sponsor is an important aspect accounting for the success of Greenfield project's implementation".
- ***Improve risk tools.*** "The Bank lacks instruments to hedge against hazard risks, as in the case of weather risks"
- ***Work closely with other private lenders.*** "In case legal documentation is prepared by private lenders, the Bank should work closely with these agents to ensure that IDB's requirements are incorporated in the legal documents signed by the client".

¹⁴ One XPSR states that "usually after signing, the client's commitment with the developmental goals is diminished in some way when the client has to operationalize the allocation strategies, or the developmental goals are optimistic."

- **Improve coordination within the IDB.** “The Bank should work in coordination with MIF to support clients’ institutional strengthening in order to enhance IDB’s overall role”.

E. Implementation Status of OVE’s Recommendations

3.10 Implementation of OVE’s recommendations for the previous validation exercise is still in progress (see Table 9).

Table 9. Implementation Status of OVE’s Recommendations

OVE’s recommendation (Fourth Exercise)	Implementation status informed by SCF	OVE assessment
<p>1. Improve the measurement of SCF’s development effectiveness.</p> <p>i. Strengthen project evaluability. Because evaluability is so important for the assessment of project results in XPSRs, OVE reiterates the recommendations of previous reports, some of them also underscored by staff recommendations in the XPSRs:</p> <p>a. Diagnose the market failure the project aims to address and the means through which the project will address that market failure.</p> <p>b. Identify each project’s development objectives using measurable outcome indicators.</p> <p>c. Ensure measuring and tracking of projects’ economic and financial indicators and financial and non-financial additionalities.</p>	<p>SCF will implement the new NSG Development Effectiveness toolkit, which was approved by the Board in July 2013.</p> <p>The development effectiveness toolkit is expected to strengthen the evaluability of projects, ensuring proper diagnostics, clear project development objectives, and identification of indicators and the Bank’s additionality.</p>	<p><i>Too soon to be evaluated.</i> SCF implemented the Development Effectiveness Matrix (DEM) to improve evaluability. No project in this current exercise had adopted the DEM as an evaluability tool, so it is not yet possible to assess whether the tool fulfills the OVE recommendation.</p>
<p>ii. Seek to build in prospective impact evaluation designs at project conception, in selected cases.</p>	<p>SCF is exploring the feasibility of incorporating impact evaluation in the project design for SCF projects.</p> <p>SCF is strengthening its internal capacity for impact evaluation through various trainings.</p>	<p><i>Not implemented.</i></p>

OVE's recommendation (Fourth Exercise)	Implementation status informed by SCF	OVE assessment
<p>2. Continue improving the quality and timeliness of XPSR preparation.</p> <p>i. Fully comply with the ECG Guidelines on the timing of XPSR preparation. Allocate resources to prepare one additional XPSR exercise before December 2013 to meet ECG Guidelines.</p> <p>ii. Calculate ex-ante/ex-post FRR/ERR for all projects that have a clearly identifiable CAPEX program, as required by ECG Guidelines.</p>	<p>SCF is completing the preparation of XPSR drafts for 2012, and the preparation of XPSR drafts for 2013 is also under way. SCF has increased the number of officers in the Development Effectiveness Group.</p> <p>SCF is committed to carry out ex-ante/ex-post FRR/ERR for all projects that have a clearly identifiable CAPEX program. Now Loan Proposals include an Economic Analysis Annex, and the quality of ex-ante analysis will be assessed by the new evaluability checklist.</p>	<p><i>Partially implemented.</i> SCF has devoted efforts and resources to enhance the preparation of the XPSR drafts, but so far only the 2011 exercise has been delivered to OVE.</p> <p>The XSPR did not show improvements in the provision of both FRR/ERR indicators and measurable assessment of projects' contribution to PSD. It is expected that the newest operations will show improvements in this regard since they require information about FRR/ERR.</p>
<p>3. Continue improving the quality of XPSR lessons learned and convey them in a concise and prescriptive way.</p>	<p>Draft XPSRs are now reviewed by an SCF Management committee to identify and share meaningful lessons learned.</p> <p>SCF uploaded all the lessons learned identified by the XPSR to its internal website so that they can be shared with project teams.</p>	<p><i>Partially implemented.</i> SCF developed a lessons learned database in the SCF internal website. However, few lessons presented in the current exercise are prescriptive, and there is no tracked evidence that the recommendations raised by staff in the XPSRs have been implemented, and no discussion of the results.</p>

Note: The implementation status of OVE's recommendations was rated as (i) fully implemented; (ii) partially implemented; (iii) not implemented, or (iv) to soon to be evaluated.

IV. CONCLUSIONS AND RECOMMENDATIONS

- 4.1 **This XPSR exercise covers the nine SCF projects that reached EOM in 2011.** The projects were approved mostly in 2008 and 2009 during the global financial crisis, although one dates back to 2006. **As in the previous exercises, the performance of the projects in this exercise was mixed:** they were rated well in the IDB Profitability (100% Satisfactory) dimension, obtained moderate performance ratings in IDB Work Quality (67% Satisfactory) and IDB Additionality (56% Satisfactory) dimensions, and underperformed on Project Development Outcomes (only 33% Satisfactory). The low number of positive ratings on development outcomes was due to less than satisfactory business performance of five projects and lack of evidence of projects' social and economic impacts.
- 4.2 **There appears to be a growing mismatch between increasing ratings for Bank profitability and declining ratings for development outcomes; it also appears to be difficult for the Bank to balance prudent risk management with strong Bank additionality, particularly as the Bank moves to increase overall private sector lending in C&D countries.** All operations in C&D countries reviewed during this exercise were financial sector operations, generally credit lines for SME lending to leading incumbents in their respective markets, but without evidence of strong Bank additionality. All operations in A&B countries were non-financial, and most were prepaid at the first signal of financial market recovery, suggesting that the Bank's role was largely one of providing financing during the financial crisis that ended up being used for a short time only, rather than being a long-term development partner.
- 4.3 **Two main conclusions emerge from the XPSR exercise.** First, the evaluation criteria for private sector operations need to incorporate a stronger focus on development effectiveness; the criteria should include requirements for adequate project results matrices and for the collection of data during project implementation. Second, during the design and monitoring of projects and during XPSR preparation, SCF should enhance its efforts to collect and present evidence of development effectiveness and draw prescriptive lessons for future operations.
- 4.4 **Looking forward, OVE has the following recommendations to Management, some of which reinforce recommendations of previous reports:**
- *Work with OVE to review and revise the system for project evaluation (in the context of broader ECG discussions also underway)*
 - Define guidelines to ensure that private sector project evaluation criteria focus on development effectiveness.
 - Define clear evaluation criteria for assessing the Bank's financial and non-financial additionality.

- Define guidelines for evaluation of financial market projects based on outcome indicators for capturing the project's contribution.
- ***Enhance the screening and monitoring of development effectiveness***
 - Identify each project's development objectives using measurable outcome indicators.
 - Ensure the measuring and tracking of project economic and financial indicators.
- ***Improve the quality of XPSRs' preparation***
 - Ensure that XPSRs contain sufficient evidence to justify project ratings.
 - Convey lessons learned in a concise and prescriptive way.