

Corporate Evaluation

Fourth 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
EBITDA	Earnings before Interest, Taxes, Depreciation, and Amortization
ECG	Evaluation Cooperation Group
EFI	Eligible Financial Institution
EOM	Early Operating Maturity
ERR	Economic Rate of Return
EROIC	Economic Return on Invested Capital
ESHS	Environmental and Social and Health and Safety
FRR	Real After-Tax Financial Rate of Return
GPS	Good Practice Standards
IDB	Inter-American Development Bank
LD	Loan Document
MDB	Multilateral Development Banks
OVE	Office of Evaluation and Oversight
PCG	Partial Credit Guarantee
PDO	Project Development Outcome
PPP	Public-Private Partnership
RF	Results Framework
ROIC	Return on Invested Capital
SCF	Structured and Corporate Finance Department
TCD	Technical Completion Date
WACC	Weighted Average Estimated Cost of Capital
XPSR	Expanded Project Supervision Report
XPSR-A	Expanded Project Supervision Reports Addendum

EXECUTIVE SUMMARY

This report presents OVE's independent validation of the Expanded Project Supervision Reports fourth exercise (XPSRs), prepared by the Structured and Corporate Finance Department (SCF). The Evaluation Cooperation Group (ECG)'s guidelines require the preparation of the XPSR in the same year they reached Early Operating Maturity (EOM). SCF is still in noncompliance with this requirement since the current exercise validated the XPSRs of projects that reached EOM in 2010. These 15 projects represent US\$1.37 billion among Loans and Guarantees, supporting total project costs of about US\$4.65 billion. Most of the self-evaluated projects (67%) are from non-financial markets. Five self-evaluated projects are from financial markets. Four projects were prepaid.

Each project is evaluated on four dimensions: *Development Outcome, Profitability, Additionality* and *Work Quality*. The *Development Outcome* dimension assesses project performance in four areas: *Business Performance, Economic Development, Environmental and Social Effects* and *Private Sector Development*. The *Profitability* dimension measures the project's gross profit contribution to IDB. The *Additionality* dimension assesses whether the project adds value regarding financial, environmental, corporate governance and regulatory issues. Finally, the *Work Quality* dimension assesses the Bank's work performance in three areas: *Screening, Appraisal and Structuring; Monitoring and Supervision Quality* and *Role and Contribution to IDB*.

As in previous exercises, the XPSR validation was an interactive process. As a result, the level of agreements between OVE and SCF systematically increased during the exercise (from 59% to 84% of the total of ratings). However, the percentage of disagreements (16%) rose in comparison with the previous exercise (only 5%), mainly on *Development Outcome* and *Work Quality* dimensions, resulting in a total of 26 downgrades. The main explanation is that, unlike previous exercises, SCF did not agree to adjust its ratings in the cases that OVE identified inadequate indicators -- lack of economic rate of return (ERR) and financial rate of return (FRR) for assessment of capital expenditure projects (CAPEX) contributions. Neither did SCF agree to downgrade projects' ratings when they obtained quantitative rating indicators below the threshold established by ECG to justify the original XPSR ratings.

***Work Quality* was the dimension where the projects received the highest percentage of positive ratings (87%), followed by *Profitability* (86%), *Additionality* (73%) and *Development Outcome* (53%) dimensions.** The ranking of results by performance indicators is exactly the same if projects' approved amounts were considered. In this case, *Development Outcome* still obtained a lower percentage of positive ratings (43%).

Among the performance areas belonging to the *Development Outcome* dimension, *Private Sector Development* (80%) achieved the highest percentage of positive ratings; in contrast, *Economic Development* obtained relatively lower performance with 26% of positive ratings, due to either poor development performance of projects or low evaluability. The lack of tracked outcome indicators, the screening flaws in the definition of benefits and beneficiaries, and the lack of ERR calculation instead of economic return on invested capital (EROIC) hindered the *Economic Development* ratings of some projects.

Regarding *Profitability*, most of the projects achieved positive ratings but few had outstanding performance measured in terms of high expected profitability for the Bank. There are only two negative performers for which either the risk classification was higher or the total guarantee fees collected amount was lower than the costs incurred by the Bank for the transaction.

In terms of *Additionality*, most projects achieved positive ratings. The Bank's financial added value was related either to the mobilization of B-lenders or to the provision of longer tenors than those available in the market at the time of project approval. In terms of non-financial additionality, the Bank's contribution was related to either the incorporation of covenants to ensure prudent management practices or the improvement of environmental regulations. It is worth noting that two projects obtained negative ratings because there was evidence that they would have gone ahead without the Bank's intervention since the first disbursement took place only after the end of the project CAPEX program.

Most of the projects were positively rated in terms of *Work Quality* dimension, but this overall performance hides mixed results. Among the areas belonging to the *Work Quality* dimension, the projects achieved better results in *Monitoring and Supervision* (94%) and *IDB's Role and Contribution* (93%) than in *Screening, Appraisal and Structuring Work* (66%). For *Screening*, the observed problems are related to both the underestimation of risks that affected the project's implementation and processing times higher than the average of SCF's transactions. The Bank performed well in *Monitoring* because of proper actions taken during the project's implementation and corrective procedures, when necessary, to fulfill issues not addressed during the appraisal phase. For the *IDB's Role* the majority of projects showed consistency with the Bank's country strategy and received satisfactory feedback from client survey.

The trend analysis reveals some concern about the path in the *Development Outcome*. The percentage of positive ratings dropped from 69% to 53% between the third and fourth exercise. On the positive side, the projects included in the current exercise reached the best performance regarding *Work Quality* (87% of positive ratings), if compared to previous exercises. OVE also ran some correlation analysis among the long-term performance of all dimensions and found a relatively high positive association between both *Work Quality* and *Additionality* with *Development Outcome*. When the effect on *Profitability* was considered, only *Additionality* showed a significant association.

The quality of lessons learned was mixed. The ECG-Guidelines require that the lessons learned should be concise, prescriptive and easily derived from the self-evaluation. However, the lessons relating to *Development Outcome* declined in quality and most were limited to justify the lack of tracked or adequate indicators. No lessons learned for *Additionality* were provided by SCF. On the positive side, several lessons recommended improvements in *Screening, Structuring and Monitoring Work* by enhancing coordination among the private and public windows of the Bank, by improving risk mitigation mechanisms, defining new models of interventions and adopting a new fee policy for clients. Finally, the analysis of the minutes of the peer reviews showed a potential for improvements in their role of overseeing XPSRs' quality.

Based on the analysis of the XPSRs, OVE has the following recommendations to Management:

1. Improve the measurement of SCF's development effectiveness:

- i. Strengthen project evaluability. Due to its importance for the assessment of project results in XPSRs, OVE reinforces the recommendations of previous reports, some of them also underscored by Staff recommendations in the XPSRs:
 - a. Diagnose the market failure the project aims to address and the means through which the project will address that market failure;
 - b. Identify each project's development objectives using measurable outcome indicators;
 - c. Ensure measuring and tracking of projects' economic and financial indicators and financial and non-financial additionalities.
- ii. Seek to build in prospective impact evaluation designs at project conception in selected cases.

2. Continue improving the quality and timeliness of XPSR preparation:

- i. Fully comply with the ECG Guidelines on timing of XPSR preparation. Including allocating resources to prepare one additional XPSR exercise before December 2013 to meet ECG Guidelines;
- ii. Calculate ex-ante/ex-post FRR/ERR for all projects that have a clearly identifiable CAPEX program, as required by ECG Guidelines.

3. Continue improving the quality of XPSRs lessons learned and convey them in a concise and prescriptive way.

I. INTRODUCTION

- 1.1 **This Fourth Independent Evaluation Report presents OVE’s independent validation of Expanded Project Supervision Reports (XPSRs) prepared by the Structure and Corporate Finance Department (SCF).** In order to comply with the Good Practice Standards (GPS) of the Evaluation Cooperation Group of the Multilateral Development Banks (ECG-MDB), OVE is required to prepare this Annual Report to inform the Board of Executive Directors.
- 1.2 **This exercise applied the Third Edition of the ECG-Guidelines because the exercise had already started when the Fourth Edition was approved in November 2011. The ECG guidelines require the preparation of the XPSR in the same year they reached Early Operating Maturity (EOM).¹** To accomplish this requirement, SCF agreed with OVE’s previous recommendation of establishing during 2011 a schedule for preparation of 15 XPSRs for all projects that reached EOM in 2010 (the current exercise) plus one additional exercise for projects that reached EOM in 2011. The schedule was not accomplished and as a result, only the 2010 validation exercise was completed.

II. SCOPE AND VALIDATION PROCESS

A. The Scope

- 2.1 **The 15 projects that achieved EOM during 2010 amounted to US\$ 1.37 billion of Loans and Guarantees. They supported total project costs of about US\$ 4.65 billion.** Box 1 below summarizes the main characteristics of the projects.

Box 1: Characteristics of the Sample Projects

- Cohort of 15 projects for US\$ 1.37 billion, of which 10 are non-financial market projects (US\$ 1.28 billion) and 5 financial market projects (US\$ 340 million);
- 13 loans and 2 guarantees;
- Seven projects are in A countries, four in B countries, one in a C country, and three in D countries.

- 2.2 **The break-down of projects by type of markets is similar to the current SCF’s portfolio.** Most of the self-evaluated projects (67%) are from non-financial markets. They financed capital expenditures (CAPEX) programs on energy (five loans), transportation (two loans), telecommunication (one loan) and electricity and telecommunication utility company (one loan). Finally, there is a partial credit guarantee (PCG) aimed at increasing the tenor of an electricity distribution

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.”

company's debt profile. Five self-evaluated projects (33% of the total) are from financial markets. This sub-group contains four loans and one PCG. Four projects are related to mortgages, and one to rural-based lending.

B. The Validation Process

- 2.3 **The evaluation process started with SCF's Officers preparing XPSRs for each project and sending them to OVE for independent validation.** Then OVE sent XPSR-As to SCF assessing the quality of information provided by each XPSR section, requesting additional information to support the XPSR's ratings and suggesting re-ratings.²
- 2.4 **The XPSRs rated the projects on four performance dimensions: (i) *Development Outcome*; (ii) *Investment Profitability*; (iii) *Additionality* and (iv) *Work Quality* (Table 1).** Each of the performance dimensions was assigned a rating based on a matrix that uses a standard four-point scale for each indicator. The ratings are: (i) Excellent (E), (ii) Satisfactory (S), (iii) Partially Unsatisfactory (PU) and (iv) Unsatisfactory (U).

Table 1: Performance Dimension and Standard Ratings

Performance Dimension	Performance Areas
Development Outcome	Project Contribution to Company Business Performance
	Project Contribution to Economic Development
	Project Environmental and Social Effects
	Project Contribution to Private Sector Development
Investment Profitability	Project Gross Profit Contribution to IDB
Additionality	Financial, Environmental, Corporate Governance and Regulatory Additionality
Work Quality	Screening, Appraisal and Structuring Work
	Monitoring and Supervision Quality Work
	Role and Contribution of IDB

- 2.5 As in the previous exercises, OVE and SCF established an interactive rating process during the validation exercise that increased the number of agreements from 59% (first XPSR draft) to 84% (final XPSR report). Ultimately, the remaining disagreements resulted in no upgrade and 26 OVE downgrades.
- 2.6 **Half of OVE's downgrades (13 of 26) represented negative binary changes (from E and/or S to PU and/or U). Regarding the four overall performance dimensions, the majority of the downgrades made by OVE were related to *Development Outcome* (50%) and to *Work Quality* (42%), with 13 and 11 out of the 26 downgrades, respectively (Table 2).** The remaining two downgrades

² As stated in the ECG-Guidelines, Third Edition, the Office of Evaluation conducts an independent on 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 XPSR-A assesses the adequacy of the information provided by each XPSR, such as project description, rationale for Bank's intervention, performance rating justifications, etc.

were related to *Additionality* (8%). As in the previous exercise, no upgrade/downgrade was made for the *Profitability* dimension.

Table 2. Agreements on SCF's Final Report Ratings

OVE ratings	a. Total	b. Agreements		c. Disagreements	
		Number	% (b/a)	Number	% (c/a)
PROJECT DEVELOPMENT OUTCOME	75	62	83%	13	17%
IDB INVESTMENT PROFITABILITY	15	15	100%	0	0%
IDB ADDITIONALITY	15	13	87%	2	13%
IDB WORK QUALITY	60	49	82%	11	18%
TOTAL	165	139	84%	26	16%

Table 3. Agreements on SCF's Original XPSR Ratings

OVE ratings	a. Total	b. Agreements		c. Disagreements	
		Number	% (b/a)	Number	% (c/a)
PROJECT DEVELOPMENT OUTCOME	75	42	56%	33	44%
IDB INVESTMENT PROFITABILITY	15	12	80%	3	20%
IDB ADDITIONALITY	15	8	53%	7	47%
IDB WORK QUALITY	60	36	60%	24	40%
TOTAL	165	98	59%	67	41%

C. The Role of the Peer Reviews

- 2.7 **OVE validated the minutes of the 14 peer reviews of the XPSRs and identified some similar comments to OVE's XPSR-As:** (i) for projects whose main objective is to promote the development of the housing market, the increase in housing units to low-income families is a more relevant indicator than the increase in mortgage availability; (ii) for debt refinancing loans it is very difficult to attribute certain development results to the Bank's involvement; (iii) two different facilities (PCG and loan) given to the same client raise the attribution problem of how to assess the individual contribution to economic development; (iv) it is difficult to judge whether a co-lender is actually mobilized by the IDB, while the mobilization role of the IDB is clear in the case of B-lender and; (v) an assessment of project development results cannot be done if there is a lack of funding for an ex-post evaluation.
- 2.8 **Some peer review comments underlined a lack of alignment with the ECG Guidelines**, such as the recommendation of rating the projects' contribution to *business performance* based on indicators other than FRR/ROIC.
- 2.9 **OVE verified that several comments and recommendations raised by SCF staff reviewers were incorporated in the XPSRs.** However, no Peer Review reflected OVE's request of FRR/ERR calculation even for those projects that have a clear CAPEX Program, as required by ECG Guidelines.

III. THE MAIN FINDINGS OF THE XPSRS' ANALYSIS

- 3.1 The projects received a high share of positive ratings (either E or S) in *Work Quality* (87%) and *Profitability* (86%). In contrast, *Development Outcome* received relatively lower ratings, with 53% positive. Table 4 shows results from the analysis of the 15 XPSRs.

Table 4. Performance Distribution (15 projects)*

General Performance - Number of Projects (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	13%	40%	27%	20%
IDB INVESTMENT PROFITABILITY	13%	73%	7%	7%
IDB ADDITIONALITY	0%	73%	27%	0%
IDB WORK QUALITY	7%	80%	13%	0%

General Performance - Approved Amounts (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	7%	36%	16%	41%
IDB INVESTMENT PROFITABILITY	8%	63%	21%	7%
IDB ADDITIONALITY	0%	60%	40%	0%
IDB WORK QUALITY	5%	68%	27%	0%

(*) Based on the OVE's validated ratings of the XPSRs.

A. Development Outcome

- 3.2 Table 5 shows the ratings distribution for the various indicators contributing to project *Development Outcome*. The lowest performance was in *Economic Development*, with only 26% of ratings being positive. *Private Sector Development* achieved the highest percentage of positive ratings (80%), followed by *Environmental and Social Effects* (60%) and *Business Performance* (40%).

Table 5. Development Outcome Performance*

DO Performance - Number of Projects (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	13%	40%	27%	20%
<i>Contribution to Company Business Performance</i>	20%	20%	13%	47%
<i>Contribution to Economic Development</i>	13%	13%	40%	33%
<i>Environmental and Social Effects</i>	33%	27%	40%	0%
<i>Contribution to Private Sector Development</i>	13%	67%	13%	7%

DO Performance - Approved Amounts (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	7%	36%	16%	41%
<i>Contribution to Company Business Performance</i>	13%	20%	9%	57%
<i>Contribution to Economic Development</i>	7%	14%	31%	48%
<i>Environmental and Social Effects</i>	29%	26%	45%	0%
<i>Contribution to Private Sector Development</i>	11%	48%	20%	21%

(*) Based on the OVE's validated ratings of the XPSRs.

- 3.3 As in the previous exercise, OVE found that projects obtained the worst results in contribution to *Economic Development*. Only four projects showed clear evidence of positive economic impacts. Two projects rated E because their

- ERR and EROIC were above 20% while two others were rated S because they provided an EROIC calculation between 10% and 20%.³
- 3.4 **Most of the projects were negatively rated (PU or U) on *Economic Development* (73% of the total of projects) because they either showed evidence of low performance (6 projects) or they lacked adequate indicators (5 projects).**⁴ Three projects provided ERR or EROIC values consistent with a PU rating. Another project also obtained PU since its XPSR stated that the project did not have a significant economic development contribution to the sector or the country.⁵ Two projects obtained an EROIC consistent with U ratings. Even though ECG-GPS allows the possibility of adjustments based on the achievement of other material, documented costs and benefits to project' stakeholders, OVE did not find evidence for upgrading *Economic Development* ratings in any of these projects.
- 3.5 **The lack of tracked outcome indicators, the screening flaws in the definition of benefits and beneficiaries and the lack of ERR calculation instead of EROIC hindered the *Economic Development* ratings of four projects.** Since an ERR calculation was not carried out as explicitly required by the ECG Guidelines and an EROIC calculation was provided instead, Two projects were downgraded from S to PU and two others were downgraded from PU to U. For one of them, EROIC was not an adequate indicator since the project aimed at supporting a very specific window of the Company, i.e. mortgage origination.⁶ Finally, there is one project that lacked any financial model.
- 3.6 ***Business Performance* also contributed to the low ratings of *Development Outcome* since 9 projects obtained negative ratings in this performance area.** The projects' *Business Performance* was evaluated mainly by comparing the SCF's calculations of *ex-post FRR* with the weighted average estimated cost of capital (WACC) of the company. For projects that do not target specific CAPEX projects, the ECG Guidelines accept the calculation of real ROIC.⁷

³ This is an electricity distribution company but there is not a CAPEX program associated to the project. The XPSR informs that the client recurred to the Bank's support in order to refinance its debt.

⁴ The projects' performance on *Economic Development* were assessed mainly by the analysis of the ex-post ERR informed by the XPSR. Likewise in the case of *Business Performance* dimension, the ECG Guidelines alternatively accept the calculation of real EROIC only where the ERR cannot be calculated.

⁵ This project's XPSR (Pg. 4) adequately justified the PU rating stating: "...the project did not have a significant economic contribution to the development of the sector or the country (in terms of additional taxes and new jobs creation)..." In the project to stakeholders, the XPSR included US\$ 65.3 million in tax credit due to negative financial results of the company. However, tax credit means more a transference from society to the Company than a benefit to stakeholders.

⁶ The XPSR provides projected cash flows and ex-post ROIC/EROIC for the Company as a whole. This fact hinders the possibility of evaluating the financial and economic contribution of the project itself. It is worth noting that the project involves a specific financial instrument that allows tracking its specific financial performance. The Bank's financial contribution allowed the company to supply only 10% of the total planned amount of mortgages.

⁷ OVE followed ECG-GPS Guidelines which recommends the provision of FRR/ERR calculation for CAPEX projects in which the incremental costs and benefits can be separately quantified. The ROIC/EROIC is accepted as a good indicator when the FRR/ERR on the project cannot be calculate.

- 3.7 **Five out of nine projects showed poor *Business Performance* indicators and the other 4 lacked adequate indicators.** Four projects produced FRR/ROIC below than their WACC and obtained U ratings. One project obtained a PU rating since its XPSR showed evidence that the project did not contribute to company business performance goals.⁸ Two projects inadequately provided ROIC instead of FRR and were automatically downgraded from PU to U. One project was downgraded from PU to U because it provided an inadequate rating based on ROIC calculation instead of FRR, given that it is a CAPEX program. Finally, there is one project that lacked any financial model.
- 3.8 **Six projects achieved positive ratings in the *Business Performance* area.** One project achieved E rating because its FRR exceeded WACC by more than 700 bps. Two financial-market projects were also rated E based on ROIC calculation. Three projects were rated S in this dimension because their FRR or ROIC were lower than the required by ECG guidelines to be awarded with an E rating.
- 3.9 **On *Environment and Social Effects*, the majority of the projects achieved positive ratings** i.e., they were at least in compliance with all the Bank's safeguard policies regarding environmental and social impacts and risk procedures. Five projects achieved the best results of all the projects because they supported higher standards than those implemented in the industry at the time of project approvals. *Six projects* obtained a PU rating in this benchmark because they were in non-compliance with some environmental issues during project execution.
- 3.10 **Finally, regarding *Private Sector Development*, the majority of the projects also achieved positive ratings.** One project was rated E due to the evidence of clear contribution to competition and market expansion. For two projects, the lack of evidence of project contribution was the main driver of their PU ratings. Finally, for one project, the U rating was a result of the lack of evidence of the project's contribution to *Private Sector Development*.

B. Profitability

- 3.11 **As previously shown in Table 6, 86% of projects achieved positive ratings on *Profitability*.** This rating is based on the Gross Profit Contribution to IDB, and is assessed by comparing the amount of fees and interests collected by IDB during the lifecycle of the project with the amount expected to be received by IDB at the time of project approval. Loan Credit Risk classification was also taken into account in the rating process.
- 3.12 **Two outstanding performers achieved E because their loan credit risk is low (classified as RC2) and there is clear evidence that they are expected to be paid as scheduled.** On the downside, *one project* obtained PU because of both its higher risk classification (RC8) and the prepayment of the loan, and one project

⁸ This project's XPSR (Pg. 3) adequately justified the PU rating stating that "...In terms of the achievement of other business goals articulated at-approval, even though the company was able to increase the average tenor of its debt from approximately 10 months to 2.3 years; the company's expected goal to increase the average tenor of its debt to 6 years was not achieved due to additional liquidity needs of the company that were required to compensate company's losses in 2008 and 2009..."

obtained U because the total guarantee fees collected were lower than costs incurred by the Bank for the transaction.

C. Additionality

- 3.13 **Most projects achieved positive ratings on *Additionality*.** For these projects the Bank's financial added value was related either to the mobilization of B-lenders or to the provision of longer tenors than those available in the market at the time of project approval. In terms of non-financial additionality, the Bank's contribution was related to the incorporation of covenants to ensure prudent management practices or the improvement of environmental regulations by implementing Environmental Action Plans.
- 3.14 **Four projects obtained negative ratings on *Additionality*.** In the case of one project, the Bank's financial contribution allowed the company to supply only 10% of the total planned amount of mortgages. For another project, the transaction was approved in 2008 and fully prepaid just one year later, raising questions about the need for the Bank intervention. Two projects obtained PU because there is no evidence in the XPSR that the project would not have gone ahead without the IDB. The CAPEX program of these projects ended before the start of the first project disbursement. The XPSR stated that the companies might not have been able to finance their CAPEX with short-term financing, and they replaced it by the IDB's long-term financing. However, this statement was not supported by evidence in either case.

D. Work Quality

- 3.15 **Most of the projects were positively rated in terms of *Work Quality*,** though there were mixed results in the three performance areas that comprise the *Work Quality* dimension. The projects achieved better results in *Monitoring and Supervision* (94% positive ratings) and *IDB's Role and Contribution* (93%) than *Screening, Appraisal and Structuring* work (66% positive ratings) (Table 8).

Table 8. IDB's Work Quality Performance*

WQ - Number of Projects (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
IDB WORK QUALITY	7%	80%	13%	0%
<i>Screening, Appraisal and Structuring Work</i>	13%	53%	33%	0%
<i>Monitoring and Supervision Quality Work</i>	7%	87%	7%	0%
<i>IDB Role and Contribution</i>	13%	80%	7%	0%
WQ Performance - Approved Amounts (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
IDB WORK QUALITY	5%	68%	27%	0%
<i>Screening, Appraisal and Structuring Work</i>	15%	39%	46%	0%
<i>Monitoring and Supervision Quality Work</i>	5%	89%	5%	0%
<i>IDB Role and Contribution</i>	9%	70%	21%	0%

(*) Based on the OVE's validated ratings of the XPSRs.

- 3.16 **For *Screening, Appraisal and Structuring*, problems included underestimation of risks affecting project implementation and processing times higher than the average for SCF's transactions.** Five projects were rated PU.

- 3.17 **One project lacked demand and competitor risks analyses.** There was also a lack of information regarding the expected results of *one project aimed at lending* to microfinance and housing. Furthermore, the XPSR provided incomplete information related to processing costs, stating only that "during the structuring and administration phase, the project did not incur in consultancy costs, except the legal costs."
- 3.18 **Two projects did not adequately assess the need for tariff adjustments.** One project's XPSR argued that the main factor explaining the company's poor financial performance was the tariff readjustments applied by the regulatory agency. Due to an underestimation of cost projections, the breakeven analysis miscalculated the necessary tariff adjustment from the base case scenario. In the case of the other project, the project team identified the tariff adjustment as one of the potential risks, but based on the sensitivity analysis, it considered that the tariff adjustment would be an acceptable risk.
- 3.19 **One project identified the main risk, but failed to mitigate it during the screening phase.** The XPSR stated that the project identified the risk that a definitive adverse ruling by the Constitutional Court would "cast serious doubts over the Bank financing." Since it was not possible to identify an appropriate risk mitigation mechanism, it is difficult to see why the project went ahead before the Constitutional Court issued its ruling.
- 3.20 **One project did not adequately mitigate risks of operator replacement and shareholder changes at screening phase.** As a result, the Bank needed to approve a range of requests for waivers/consents and amendments to adjust to the client's noncompliance with the affirmative covenants.
- 3.21 **Monitoring performance is the performance area that had the highest positive ratings for *Work Quality dimension*.** The Bank performed well in *Monitoring* because of actions taken during project implementation and corrective procedures, when necessary, to address issues not addressed during appraisal. In one project, actions were taken to deal with the client's several requests for waivers to the Loan Agreement and inclusion of additional servicers. The only exception was one project which obtained PU due to flaws in the monitoring phase. The client had been noncompliant with negative covenants since June 2009 and was placed on the Watch List.⁹ Yet the XPSR states that several waivers were provided to the client based on the assumption that they were temporary issues, yet due to operational and financial shortfalls, these a-priori temporary issues became structural ones.
- 3.22 **The majority of projects were positively rated for *IDB's Role and Contribution*,** as a result of consistency with the Bank's country strategy and satisfactory feedback from client surveys. The exception was *one project, which obtained PU due to the lack of a client survey* to assess satisfaction.

⁹ Until the date the XPSR was issued the client was still in noncompliance with IDB's Short-Term Debt to EBITDA Ratio and Total Debt to EBITDA Ratio.

- 3.23 **A negative aspect of *Work Quality* was the failure in most projects to develop 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.

E. Trends in Validated XPSRs

1. Trend Analysis of the Projects General Performance

- 3.24 **Figures 1 and 2 show the evolution in performance of projects in the last three XPSR exercises (2007, 2008-09, 2010).** OVE left aside 2006 projects from the analysis as it was not carried out in a comparable manner and in accordance with ECG/GPS guidelines¹⁰.
- 3.25 **There was a decrease in *Development Outcome* between the third and the fourth exercise.** The third exercise obtained 69% positive ratings, whereas those projects included in the fourth exercise achieved just 53%.¹¹ The second exercise attained the worst performance, with 43% positive ratings (none E and 43% S).¹²
- 3.26 **With regard to *Profitability*, the fourth exercise reached the highest performance, with 86% positive ratings,** followed by the third exercise with 77%. The second exercise obtained only 29% positive ratings due to several downgrades related to project prepayments.
- 3.27 **In terms of *Additionality*, project performance has improved steadily.** This report shows the highest percentage of positive ratings (73%), an improvement over the third (69%) and the second report (64%). However, it is worth noting that the second exercise was the only one where some projects had excellent ratings (7% of the total projects).
- 3.28 **Finally, regarding *Work Quality*, Figure 1 shows that the projects included in the current exercise attained the best performance** (87% positive ratings), followed by the projects of the third exercise (85%). The second exercise had the worst performance and had only 43% positive ratings. When considering the distribution of projects by approved amounts, the third exercise (83%) outperformed the current one (73%).

¹⁰ 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.”

¹¹ The results are similar when projects are distributed by approved amount: 70% in the third exercise and 43% in the current one.

¹² The average of positive ratings percentage obtained by SCF's projects in the last three validation exercises (2008, 2009, 2010) in *Development Outcome* (55%) is particularly lower than the IIC's (70%) and IFC's (73%) averages in the same dimension. See *Eighth Annual Independent Validation Report - IIC Projects Matured during Calendar Year 2010* (page 5) and *IEG Annual Report 2011: Results and Performance of the World Bank Group* (pg. 26 & 32).

2. Performance Correlations

- 3.29 **OVE analyzed the long-term relationship between both *Work Quality* and *Additionality* and *Development Outcome* since the first XPSR validation report.** The objective was to provide some insights into the linkage between the Bank's work and projects' development performance.¹³
- 3.30 **Table 9 shows a significant positive association between *Work Quality* and *Development Outcome* when other factors are controlled for.** OVE tested three different linear probability model specifications -- a naive model that does not include any control, an intermediate model which only controls for country fixed effects, and a fully controlled model that includes controls for country, sector, operation type, operation amount and the report when the project was validated.

Table 9. Estimated Correlation between *Work Quality* and *Development Outcome*

		Dependent Variable: Development Outcome		
		Naive Model	Intermediate Model	Controlled Model
Independent Variable	IDB Work Quality	0.46*** (0.17)	0.56** (0.21)	0.52* (0.27)
Controls	Country	NO	YES	YES
	Sector	NO	NO	YES
	Operation Type	NO	NO	YES
	Operation Amount	NO	NO	YES
	Report	NO	NO	YES
Observations		47	47	47
R-squared		0.14	0.41	0.60

Note: *Significant at 10%, **Significant at 5%, ***Significant at 1%

- 3.31 **The positive correlation between *Work Quality* and *Development Outcome* is significant for the three models.** In all of them the coefficient of IDB *Work Quality* is similar and about 0.5.¹⁴ It means that if a project rating changes from negative to positive in *Work Quality* it becomes about 50 percentage points more likely to show *Development Outcome*.
- 3.32 **Table 10 shows that, as expected, the positive correlation between *Additionality* and *Development Outcome* is also significant for the three models.** In all of them, the coefficient of *Additionality* is similar and about 0.5. Again, it suggests that if a project rating changes from negative to positive in *Additionality* it becomes about 50 percentage points more likely to show *Development Outcome*.¹⁵

¹³ Several project characteristics were controlled in order 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, OVE needed to analyze them separately to avoid multicollinearity problems during the estimation.

¹⁴ OVE tested the null hypothesis that the value of *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.

¹⁵ The similarity of the effects of *Additionality* and *Work Quality* supports OVE's decision of running the analysis separately.

Table 10. Estimated Correlation between *Additionality* and *Development Outcome*

		Dependent Variable: Development Outcome		
		Naive Model	Intermediate Model	Controlled Model
Independent Variable	IDB Additionality	0.44*** (0.15)	0.57*** (0.16)	0.55** (0.21)
Controls	Country	NO	YES	YES
	Sector	NO	NO	YES
	Operation Type	NO	NO	YES
	Operation Amount	NO	NO	YES
	Report	NO	NO	YES
Observations		47	47	47
R-squared		0.17	0.5	0.65

Note: *Significant at 10%, **Significant at 5%, ***Significant at 1%

3.33 Finally, when testing the effect of Bank Performance dimensions on *Profitability*, OVE found a positive and significant association only for *Additionality*. In the three aforementioned models, the coefficient of *Additionality* is similar and oscillates between 0.56 and 0.58.

Figure 1. Trends in General Performance by Number of Projects

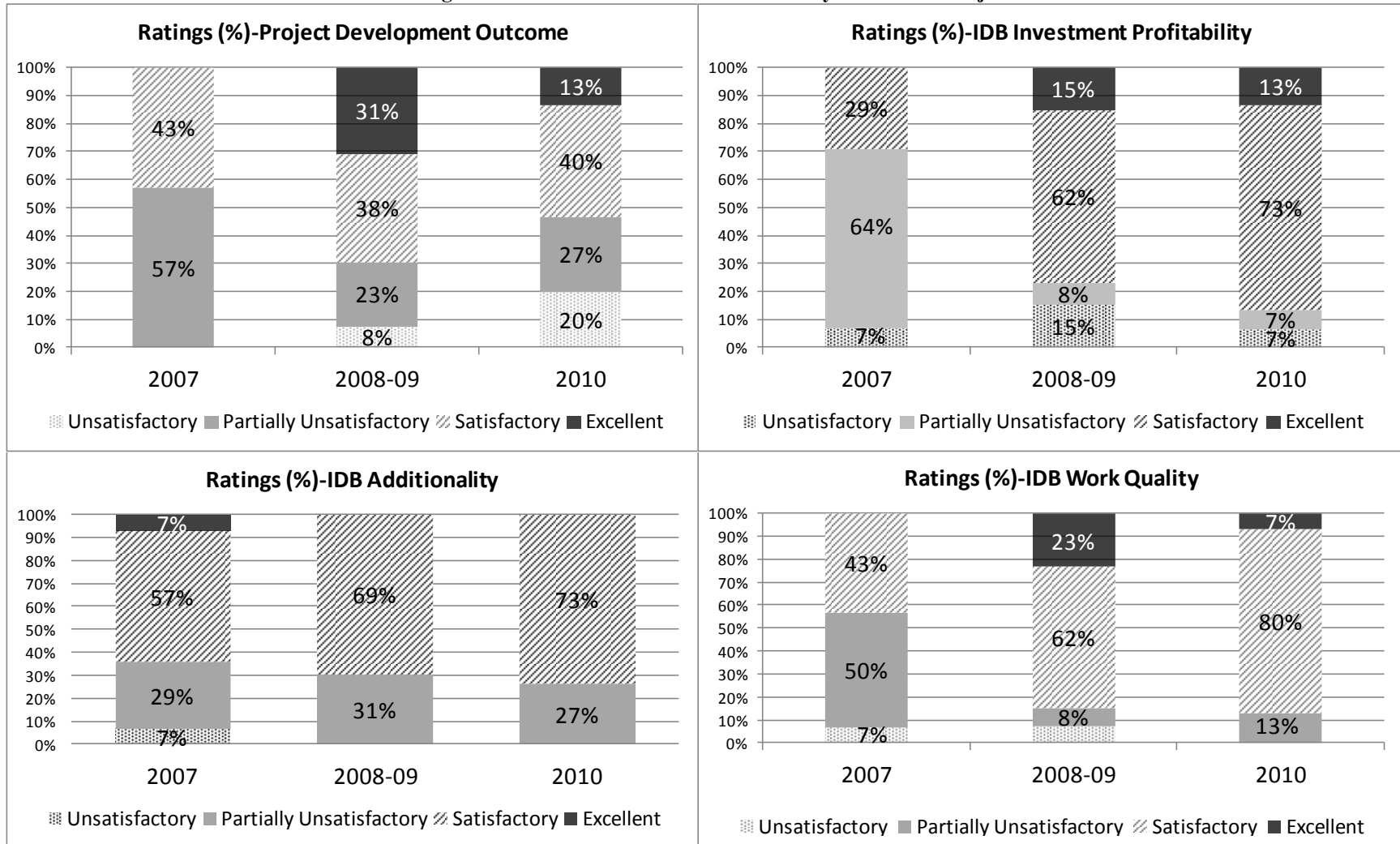
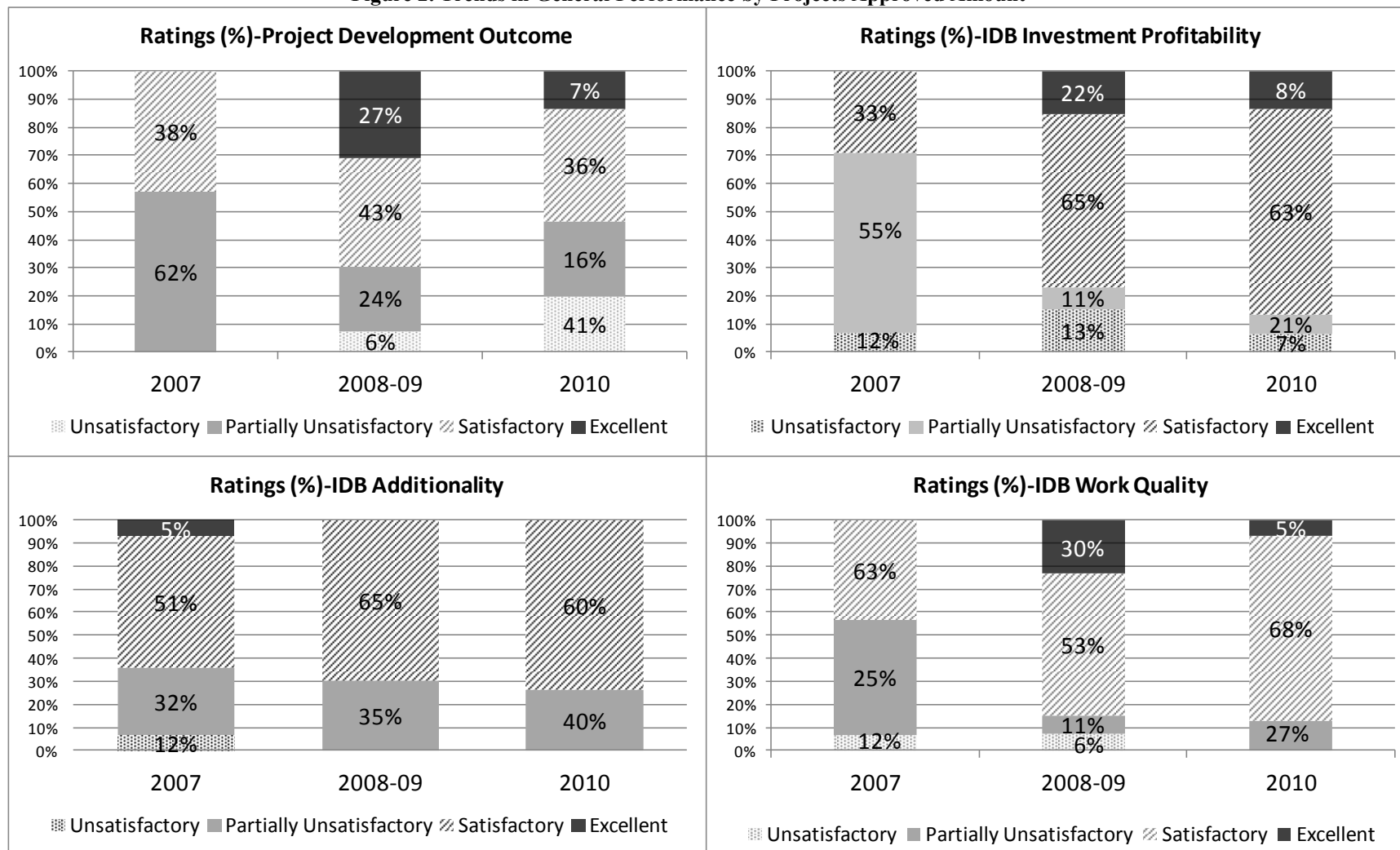


Figure 2. Trends in General Performance by Projects Approved Amount



IV. LESSONS LEARNED AND IMPLEMENTATION OF RECOMMENDATIONS

- 4.1 **This section presents the main lessons identified by SCF from 14 out of 15 XPSRs.** The section also assesses the implementation status of OVE's recommendations. The ECG-Guidelines require that the lessons learned should be concise, prescriptive and easily derived from the self-evaluation.¹⁶ To assess the lessons, OVE classified them into three dimensions, as follows: (i) *Development Outcome*; (ii) *Investment Profitability* and; (iii) *Work Quality*. No lessons related to *Additionality* were provided by SCF.
- A. **Development Outcome**
- 4.2 **OVE identified a decline in the quality of the *Development Outcome*'s Lessons Learned provided by the XPSRs.** A few lessons were prescriptive and derived from the self-evaluation:
- i. ***Enhance project evaluability.*** Although only indirectly, this recommendation was stressed in the fourth consecutive time in the XPSR exercise, highlighting its importance. The lack of measurable and tracked indicators impaired the assessment of project development objectives. There is a single XPSR with a lesson in this area, in which the difficulty of measuring development results was explained by the lack of definition of specific performance indicators.
 - ii. ***Promote the collaboration of local development banks to improve and expand lending to areas with less access to finance.*** The support to a *national* development bank, brings a good example of the benefits of working with local development banks to address specific regions.
 - iii. ***Encourage demonstration effects and scalability.*** Some XPSRs identified particular positive experiences that could be implemented by similar projects and/or help to promote market expansion in the particular region.
- 4.3 **Most of the XPSR lessons learned were not aligned with ECG Guidelines, as they were directed mainly to justifying the lack of tracked indicators (ERR and other benefits and costs to stakeholders) and the provision of ROIC/EROIC even for projects with CAPEX programs.** Yet, some lessons learned sections of the XPSRs tried to justify, without evidence, that indicators other than ERR might be accepted as adequate to assess project's contributions. These lessons did not align with those from previous reports.
- 4.4 **The XPSRs did not incorporate previous lessons and recommendations related to the importance of designing contractual mechanisms to ensure both tracking and measuring of projects' objectives and results, specifically at the subproject level.** For instance, no suggestion was made to include affirmative covenants in the Loan Agreement related to the provision of

¹⁶ As ECG-GPS std. 6 recommends, OVE assessed to which extent XPSR Lessons Learned are concise, prescriptive and can be easily derived from the self-evaluation.

development outcomes indicators or information about sub-projects.¹⁷ It raises the issue to what extent the lessons learned from the XPSR exercises have been disseminated to staff.

B. Profitability

4.5 Two prescriptive lessons were raised from the analysis of *Profitability*:

- i. ***Adequately assess the effects of fees on the Bank's profitability and possibility of loan prepayment.*** The XPSR suggested that clients' supervision fees should be calculated on a project-by-project basis instead of generically. Also related to fees, the XPSR addressed the issue that, in cases of underutilization of a PCG facility, the IDB's profitability could be affected by the higher priority given to fees against premium payments.
- ii. ***Adequately assess the profitability analysis during early operating stage of the projects.*** The XPSR addressed the issue from the experience of one financial market operation.

C. Work Quality

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

- i. ***Enhance feasibility studies during appraisal work.*** As the previous two exercises, the XPSRs stressed the need for better identification of risk mitigation mechanisms and project sensitivity analysis during the projects' appraisal work in order to avoid expected outcomes being unmet.
- ii. ***Improve the loan agreement by the inclusion of covenants that allows tracking of execution of projects' expected investments.*** The XPSRs highlighted the need to include in the contract terms a periodic update of the activities planned in the project's CAPEX Program.
- iii. ***Develop new models for structuring Public Private Partnership (PPP) programs.*** The XPSRs raised the need for new products to better structure projects in infrastructure as PPP programs.
- iv. ***Monitor work improvement.*** The XPSRs raised the need to revise the Bank's policy of charging simultaneous fees in response to a failure in the compliance of conditions set at approval. If not revised, it can lead to loan prepayment even when the client's financial performance is improving. The XPSRs also highlighted the relevance of co-lenders' intervention in the classification of risks between systemic and company-specific during the monitoring phase.

¹⁷ For instance, for the projects related to housing sector, a clear indicator of the number housing units constructed as a result of the projects might have been included in the projects contractual terms.

- v. ***Improvement of coordination within the IDB.*** Like the two previous exercises, the XPSR stressed the importance of coordination among the private and public sector branches of IDB to achieve project results.

D. Implementation Status of OVE's Recommendations

- 4.7 **Implementation of OVE's recommendations for the third Exercise is still a work in progress.** SCF fully implemented only the recommendation regarding the strengthening of the peer reviews' role in XPSR's quality control by encouraging objectivity and evidence-based requests from their participants. A brief description of the implementation status of OVE's recommendations from the third exercise is contained in Table 11.
- 4.8 **SCF also partially implemented recommendations regarding "Lessons Learned", "Evaluability" and "Design of Contractual Mechanisms".** There is a mismatch between the period in which projects were sampled and the time that the previous reports were prepared, but OVE looked for evidence in new loan agreements and SCF's database. Lessons learned Database was developed but there is no evidence that their incorporation in new projects has been tracked. The DEM was implemented but improvements are needed to improve evaluability. New contractual clauses were designed in the loan agreements to require DEM indicators and information about FRR/ERR and project contribution to private sector development.
- 4.9 **Finally, two recommendations have not been implemented yet by SCF:** efforts to better understand the SCF's models of interventions and improvements in XPSR preparation.

Table 11. Implementation Status of OVE's Recommendations

OVE's Recommendation (Third Exercise)	Implementation Status informed by SCF	OVE Assessment
<p>1. Improvement of project's evaluability: (i) improve the project's design by identifying project's development objectives with measurable outcome indicators as well as clear diagnostics with identification of market failures the project aims to address;</p>	<p>The NSG DEM was revised and evaluability elements were incorporated into DEM, based on the Evaluability Guidelines for the NSG Operations. The revised DEM was proposed and approved by the Board in February 2011 (GN-2489-4). DEM Worksheet specified the timing and responsibility of information provision for each DEM indicator. Monitoring and Evaluation Plan has been included in the Loan Proposal under the revised DEM framework as well.</p>	<p>Partially implemented. SCF implemented the DEM in order to improve evaluability. There is no project in this current exercise that adopted the DEM as an evaluability tool hindering the possibility of assessment whether the tool fulfill OVE recommendations. However, there is room for improvement as stated in OVE report, it "<i>was unable to validate the NSG project's DEM as the tool currently used does not properly measure evaluability, and OVE found serious evaluability problems in the project analyzed</i>". (See OVE 2011 Evaluability Review of Bank Projects, April 2012).</p>
<p>ii) design contractual mechanisms in order to: a) ensure both tracking and measurement of project's economic and financial indicators and financial and non-financial additionalities; b) reach information about financial market transactions subprojects, in order to identify indirect effects of the Bank's intervention; c) define monitoring and evaluation system as well as the need of client's participation in SCF surveys.</p>	<p>The Loan agreement now includes clauses which require the client to cooperate for the self-evaluation by providing information and to provide specific information annually by Annual Review of Operations. SCF has been collaborating with SPD to systematically carry out client survey.</p>	<p>Partially implemented. From the analysis of the cohort of projects that are part of the current exercise of XPSRs, there is no evidence that contractual mechanisms were introduced in order to ensure both tracking and measurement of SCF's results. However, by the analysis of a sampling of loan agreements recently signed with SCF clients, OVE found that these agreements partially fulfill OVE's recommendations by requiring DEM indicators and information about FRR/ERR and project contribution to private sector development .</p>
<p>2. Need for better understanding of SCF's models of intervention. Need for conducting impact evaluations studies regarding the most relevant type of interventions supported by SCF non-financial and financial market operations. The aim is to measure development impact on beneficiaries, going beyond to individual project analysis, and by doing so, learning about Bank's additionality and project's development outcomes.</p>	<p>As a part of the XPSR exercise of this batch, SCF intended to carry out impact evaluation for a few projects. However, due to the constraints associated with methodologies and resources, SCF did not move forward with evaluations. SCF still explores the possibility of carrying out impact evaluation and/or in depth evaluation as a part of the following XPSR exercises.</p>	<p>Not implemented, as informed by SCF in the implementation status column.</p>

OVE's Recommendation (Third Exercise)	Implementation Status informed by SCF	OVE Assessment
<p>3. Improvement in the XPSR's preparation. Specifically, SCF should</p> <p>(i) continue developing efforts in order to assure more accurate information available to do better calculation of ex-ante/ex-post FRR/ERR calculation for all projects and for a sampling of sub-projects, if necessary.</p> <p>(ii) provide measurable assessment of project's contribution to private sector development and financial and non-financial additionality.</p>	<p>For this batch of XPSRs, availability of information at the time of evaluation has been constrained by the limited information at the time of ex-ante analysis.</p> <p>Under the new NSG DE framework, economic analysis has been systematically prepared in accordance with the stakeholder approach of IFC. This is expected to improve the quality of both ex-ante and ex-post calculation of FRR/ERR.</p> <p>Under the new DEE format with evaluability, the project teams have been trying to specify the baseline and expected results with numeric indicators for PSD outcome to the extent feasible. Although the evaluability sections are not included for the new DEM format, the same rigor has been applied in terms of identification of demonstrating expected results.</p>	<p>Not implemented. As stated in the report above, the XSPR did not show improvements regarding the provision of both FRR/ERR indicators and measurable assessment of projects' contribution to private sector development.</p>
<p>(iii) systematically improve the quality of XPSR's Lessons Learned, by addressing prescriptive recommendations of IDB's operational improvements.</p> <p>(iv) identify whether recommendations raised by its staff in this report have been implemented and what their results have been;</p>	<p>In July 2011, the lessons learned databases was developed in the SCF internal website, where all the lessons learned identified by from the 1st exercise to the 3rd exercise were included, so that the project team can look for relevant lessons learned and incorporate them to their new projects.</p>	<p>Partially Implemented. SCF developed lessons learned database in the SCF internal website. However, there is no tracked evidence that the recommendations raised by its staff in the XPSRs have been implemented and what their results have been.</p>
<p>(v) enhance Peer Reviews' role in XPSR's quality control by encouraging objectivity and evidence-based requests from their participants.</p>		<p>Implemented. SCF conducted peer reviews for 14 of 15 XPSRs and there is evidence in the minutes that the staff is performing a quality control role in the XPSRs.</p>

(*) The implementation status of the OVE's recommendations was rated based on: (i) fully implemented; (ii) partially implemented; (iii) not implemented.

V. CONCLUSIONS AND RECOMMENDATIONS

- 5.1 **The XPSR validation was an interactive process. As a result, the level of agreement between OVE and SCF increased during the exercise (from 59% to 84% of the total ratings). However, the percentage of disagreements (16%) rose in comparison with the previous exercise (only 5%), mainly on *Development Outcome* and *Work Quality* dimensions.** The main explanation is that, unlike previous exercises, SCF did not agree to adjust its ratings where OVE identified inadequate indicators -- lack of ERR and FRR for assessment of CAPEX contributions. Neither did SCF agree to downgrade project ratings when they obtained quantitative rating indicators below the threshold established by ECG to justify the original XPSR ratings.
- 5.2 ***Work Quality* was the dimension where the projects received the highest percentage (87%) of positive ratings (E or S), followed by *Profitability* (86%), *Additionality* (73%) and *Development Outcome* (53%).**
- 5.3 **The trend analysis reveals concerns about progress in achieving *Development Outcomes*.** In the current exercise projects obtained just 53% of positive ratings, a percentage that is better only than the second exercise, where they obtained 43%. These results are explained by both low performance of projects and lack of adequate indicators.
- 5.4 **On the positive side, the projects included in the current exercise reached the best performance yet regarding *Work Quality*.** OVE also ran some correlation analyses and found a positive association between both *Work Quality* and *Additionality* and *Development Outcome*. When the effect on *Profitability* was considered, only *Additionality* showed a significant association.
- 5.5 **The quality of the lessons learned was mixed.** ECG-Guidelines require that the lessons learned should be concise, prescriptive and easily derived from the self-evaluation. The lessons related to *Development Outcome* declined in quality. No lessons for *Additionality* were provided. On the positive side, several lessons recommended improvements in *Screening, Structuring and Monitoring Work* by enhancing coordination among the private and public windows of the Bank, by improving risk mitigation mechanisms, by defining new intervention's models and by adopting new fee policies to the clients.
- 5.6 **Based on the analysis of the XPSRs, OVE has the following recommendations to the Management:**
1. **Improve the measurement of SCF's development effectiveness:**
 - i. Strengthen project evaluability. Due to its importance for the assessment of project results in XPSRs, OVE reinforces the recommendations of previous reports, some of them also underscored by Staff recommendations in the XPSRs:
 - a. Diagnose the market failure the project aims to address and the means through which the project will address that market failure;

- b. Identify each project's development objectives using measurable outcome indicators;
 - c. Ensure measuring and tracking of projects' economic and financial indicators and financial and non-financial additionalities.
 - ii. Seek to build in prospective impact evaluation designs at project conception in selected cases.
- 2. Continue improving the quality and timeliness of XPSR preparation:**
 - iii. Fully comply with the ECG Guidelines on timing of XPSR preparation. Including allocating resources to prepare one additional XPSR exercise before December 2013 to meet ECG Guidelines;
 - iv. Calculate ex-ante/ex-post FRR/ERR for all projects that have a clearly identifiable CAPEX program, as required by ECG Guidelines.
- 3. Continue improving the quality of XPSRs lessons learned and convey them in a concise and prescriptive way.**