

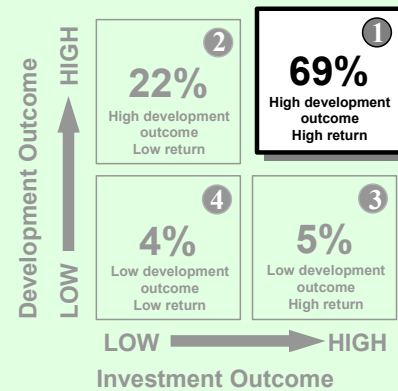
OEG Findings

July 2001

Annual Review of IFC’s Evaluation Findings: FY 2000

The *Annual Review 2000* presents the cumulative findings from four years of evaluating IFC’s investments. It draws from evaluations of 176 randomly-selected IFC operations that were approved in 1991-94 and evaluated in 1996-99. It describes IFC’s evaluation system, the significant performance patterns within the sample, and the implications for IFC’s current strategy. Based on these findings, it offers recommendations to improve IFC’s results. Its principal focus is learning, and its secondary theme is corporate accountability. Its findings indicate that:

- IFC’s operations have generated substantially greater benefits for others – customers, employees, suppliers and taxpayers – than they have for the owners and financiers;
- IFC’s effectiveness – how well IFC does its job throughout the project cycle – is strongly associated with good outcomes. When IFC’s effectiveness was consistently good, it achieved good development results in 91% of cases (square 1 + square 2), and good development *and* investment results in over two-thirds of cases (square 1).
- Among IFC’s strategically important sectors, infrastructure projects yielded significantly better than average development results. Similarly, investments in targeted high-risk countries performed better developmentally. This finding may not hold for the future, as fewer countries are currently designated high-risk and these may be more challenging environments to work in.



How IFC evaluates investments

Each year IFC evaluates a random sample of investments that have reached early operating maturity (typically five years following approval by which time the projects have been established and built up a track record of operating performance). Within statistical limits the sample is representative of each year’s entire approvals. Self-evaluations of the investments selected in the sample are first undertaken by IFC’s investment department staff. They complete the research and analysis necessary to rate each investment on 11 distinct indicators. They rate each indicator on a four-point scale: *unsatisfactory*, *partly unsatisfactory*, *satisfactory*, and *excellent* using corporate guidelines. These guidelines are accessible on OEG’s web-site: <http://www.ifc.org/oeg/>. OEG then conducts independent research, verifies each rating to ensure that evaluation standards are applied consistently throughout IFC, and then synthesizes its findings in each year’s *Annual Review*. The *Annual Review 2000* is based on evaluations conducted during 1996-99 of investments approved during 1991-94. It also draws on findings from previous *Annual Reviews* as well as four years of OEG

evaluation research.

Performance dimensions and indicators

Each of the 11 performance indicators relates to one of three outcome ratings:

- **development outcome** – a project’s contribution to a country’s economic development and improved living standards;
- **investment outcome** – an investment’s contribution to IFC’s profitability; and
- **IFC’s effectiveness** – how well IFC did its job throughout the project cycle.

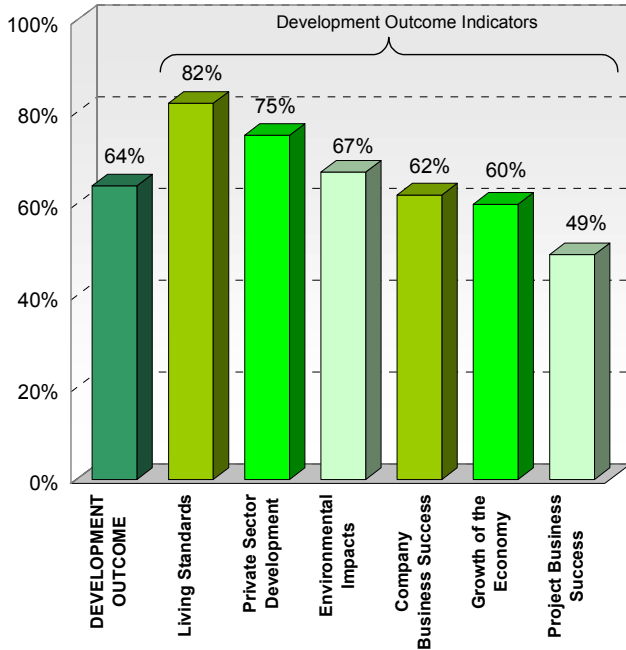
IFC’s effectiveness is, ultimately, a means to an end, and the end is good development *and* investment outcomes. These “win-win” operations are the ones that simultaneously foster development and are sufficiently profitable relative to their risk to contribute to IFC’s own sustainability for supporting development.

Development Outcomes – results on the ground

Two-thirds of the evaluated operations had successful development outcomes. Development outcome ratings

are a judgmental synthesis of the six indicators – see Figure 1 below.

Figure 1: Success rates for project development outcomes and related performance indicators (based on 176 investments approved in 1991-94 and evaluated in 1996-99).



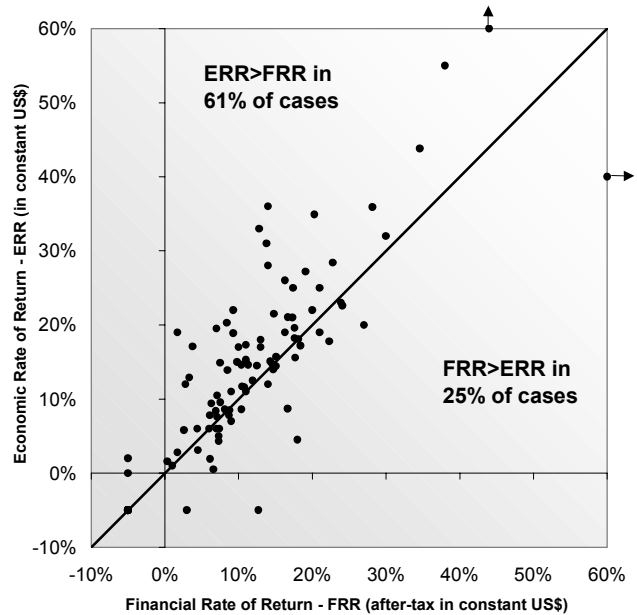
From highest- to lowest-rated indicator, significant findings are:

- Living standards* – IFC’s operations have generated substantially greater benefits for others – customers, employees, suppliers, and taxpayers – than they have for the projects’ owners and financiers. This is measured by the difference in projects’ economic (social) and financial (private) rates of return – see Figure 2. For 102 investments where analysis was possible, OEG estimated that they generated net present values of approximately \$1.4 - \$1.6 billion in direct net benefits in developing countries – \$0.9 billion more than that received by the owners and financiers. For example, a mine in an isolated area has considerably improved the standard of living for 3,000 local inhabitants through the provision of well-paid jobs, housing, health care, schooling, better communications and amenities.
- Private sector development* – Three-quarters of IFC’s projects have contributed to the development of local private sectors through linkages supporting other private enterprises, demonstration effects, privatizations, or regulatory changes. A hydropower plant, which was the first grid-based project in the

country, served as a model for private sector hydro projects and accelerated the development of the sector.

- Environmental impacts* – Two-thirds of operations, including many whose profitability for their owners fell short, met IFC’s high standards for environmental sustainability. For example, an IFC investment in an expansion project helped reduce effluent and air emissions from a wood pulp and paper company’s existing operations. Moreover, biomass from the plant was used as a replacement for coal at an adjacent power station.

Figure 2: Benefits to society usually exceeded benefits to financiers.



- Growth of the economy* – Economic growth provides the resources necessary for development, and provides societies and individuals with more choices and better services. Nearly two-thirds of evaluated projects yielded tangible benefits to the economy. For example, a project to modernize the production facilities of a beverage company allowed it to respond efficiently to an unforeseen increase in consumer demand and at the same time realize economies of scale as labor productivity increased.
- Project business success* – This indicator, reflecting whether a company earned an attractive profit on its investment, was the lowest-rated. When a project’s financial returns are less than the cost of capital, the business success is rated less-than-satisfactory. This was the case in about half the projects. This finding is

fully consistent with the results of a survey of multinational companies operating in the same regions as IFC, as recently conducted by an independent consulting firm. Based on ratings standards that mirror those IFC uses, they judged their projects as financially successful in 44% to 74% of cases, depending on the region. IFC achieved project business success rates of between 35% and 63% across these same regions but in a higher-risk mix of countries.

- *Company business success* – Notwithstanding the success or otherwise of their projects, a higher proportion of companies, particularly those which were established enterprises with proven expertise, remained clearly viable going-concerns.

IFC’s Investment Outcome

IFC is a corporation and as such its ability to finance future investments and fulfill its development mandate depends on profits from investments. The IFC investment outcome rating is a synthesis of up to two indicators (one for loan, one for equity) that address the investment’s gross contribution performance. Each is evaluated and rated according to standard benchmarks that reflect corporate investment policy. Based on the four-year sample, there is a close association between positive development outcomes and good investment outcomes.

IFC’s Effectiveness – How well IFC does its work

OEG rates three indicators of IFC’s effectiveness: appraisal and structuring; supervision; and additionality. Judged against the high professional standards expected, 67% of operations were rated overall as satisfactory or better.

IFC’s effectiveness is strongly associated with outcomes. Where performance was below IFC’s expected high standards in one or more of the effectiveness indicators, then “lose-lose” outcomes (those where both the development and investment results of a project were low), outnumbered the “win-win” by 41% to 31%, and more than half the development outcomes were considered less than satisfactory. By contrast, where IFC had done its job consistently well throughout the project cycle (as reflected in all three indicator ratings), 69% of the outcomes were “win-win”, and only 4% were “lose-lose.” Most important, 91% of projects were successful developmentally.

These data point to the potential for IFC to improve both its impacts within developing countries and its profitability, through strengthening its core processes. Keeping in mind that these results relate to 1991-94 approvals, it is also important to note that IFC has since

taken steps to do this. These have included:

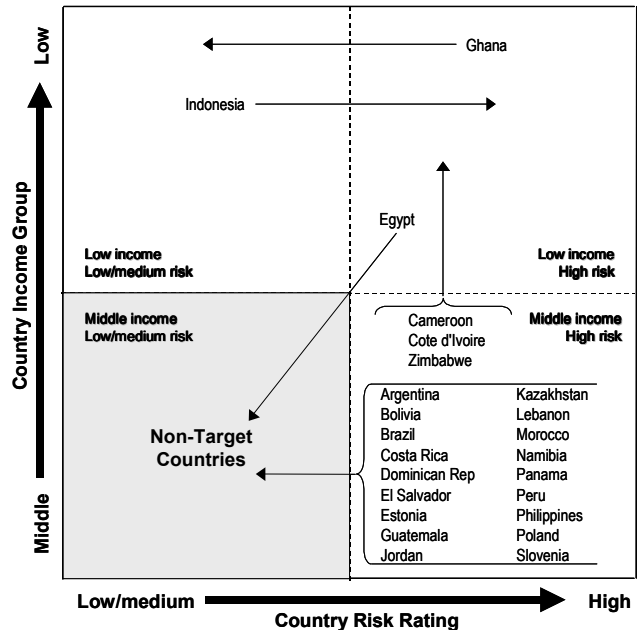
- building up its environmental review capacity;
- creating a credit review department;
- upgrading staff training programs;
- introducing a performance measurement system to track project development impacts, operational outcomes and internal effectiveness; and
- expanding the coverage, scope and rigor of evaluation – the system described here was introduced in 1996.

IFC’s strategy

IFC’s strategy focuses on (i) high-risk or low-income countries and “frontier” regions or sectors within countries; and (ii) targeted sectors (mainly financial markets and infrastructure). In 2000, 80% of IFC’s approvals were in targeted sectors and 40% were in high-risk or low-income countries.

- In targeted sectors, the evaluation results were mixed. Infrastructure projects performed better, but some credit lines to financial institutions lacked a clear IFC role or contribution to needed capacity-building.
- In low-income countries, there was no discernable difference in performance of IFC’s operations, other than on average poorer environmental impacts.

Figure 3: Changes in the risk and income profile of countries from the time of investment (1991-94) to March 2000.



- Operations in countries that were regarded by institutional investors as high-risk at the time of

approval (between 1991 and 1994), had a significantly higher proportion of “win-win” outcomes than did projects in other countries. In addition, OEG looked at all of IFC’s equity investments approved during the ten years between 1985 and 1995, and found that IFC had significantly better returns in countries that were high-risk at investment approval.

- Of the countries represented in the evaluative sample, the number designated high-risk has fallen significantly during the 1990s – see Figure 3. For example, IFC’s two largest portfolio countries (Argentina and Brazil) were no longer regarded as high-risk as of March 2000. Evaluated results for past approvals in today’s high-risk countries indicate that they present an increasingly challenging environment in which to achieve “win-win” outcomes.

Lessons learned

A central objective of evaluation is to learn from operation successes and shortfalls. For evaluated investments, operations staff reflect on favorable or unfavorable outcomes and derive lessons for improving IFC’s effectiveness in the future. OEG’s on-line database, the Lessons Retrieval Network, now contains over 1,000

of these lessons, which can be searched by country or topic. Most relate to early stages of the project cycle. For example, the quality of market assessments, sponsors and management, and project and investment structuring have been highlighted as key determinants of project outcomes. The importance of “getting it right” at the outset is confirmed by the evaluation results, which show a close association between IFC’s front-end effectiveness and the quality of project outcomes some five years later. Of the projects evaluated in 1996-99 that had poor business outcomes, many also had low ratings for IFC’s effectiveness at the project appraisal stage. Effectiveness was rated low primarily because of shortcomings in market and/or sponsor and management assessment, or because of weaknesses in project structuring.

Environmental issues featured prominently in supervision-related lessons, but also in lessons relating to project structuring. This reflects investment staff’s increasing focus on projects’ environmental impacts. This focus will likely continue as IFC emphasizes sustainability in its operating procedures and internal corporate scorecard reporting.

Recommendations

OEG’s recommendations in the *Annual Review 2000* aim to improve IFC’s effectiveness in order to get more “win-win” outcomes and fewer “lose-lose” outcomes. In view of the findings in this report, together with its other evaluation studies, OEG recommended that IFC should...

- ...enhance measurement of its performance against its mission by introducing a system that tracks the portfolio’s development and investment outcomes and IFC’s operational effectiveness. As it relates to development outcome measures, this system’s measures and IFC’s evaluation methodology should be closely aligned.
- ...pursue a corporate objective function that focuses on achieving successful investment outcomes *and* development outcomes. Strategies and strategy-linked budget allocations should therefore consider investment and development results patterns by sector and country risk/income group.
- ...expand training programs for core investment and development skills in project screening, appraisal and structuring, and project supervision. This should improve the rigor of economic analysis and the appraisal of sponsors, markets and competition, and should help increase the profitability of equity investments (e.g. through greater use of quasi-equity in financial structuring).
- ...extend credit lines to financial intermediaries where IFC’s role is strong and it can contribute to needed capacity building that is identified at appraisal.

OEG **Findings** is designed to inform World Bank Group managers and staff of new evaluation findings and recommendations. It is produced by IFC’s Operations Evaluation Group, which acts independently from IFC management. It is distributed to IFC’s Board of Directors and staff as well as to interested parties outside the World Bank Group. The views expressed here are those of OEG and should not be attributed to IFC or its affiliated organizations. OEG **Findings** is distributed free of charge by IFC, 2121 Pennsylvania Avenue NW, Washington, DC 20433, USA. For more information, contact IFC’s Corporate Relations Unit at Tel. (1-202) 473-7711 Fax: (1-202) 974-4384 or consult OEG’s website at <http://www.ifc.org/oeg>.