

OEG *Findings*

October 2000

Annual Review of IFC's Evaluation Findings: FY99

The *Annual Review* analyzes the independently validated results from self-evaluations carried out by the International Finance Corporation's investment departments between 1996–98. The review is based on a random sample of 114 projects approved in 1991–93. The *Annual Review's* findings, which represent the independent views of IFC's Operations Evaluation Group, indicate that:

- society at large tended to reap greater benefits than project financiers, and development outcomes were better than IFC's investment outcomes;
- good development outcomes closely corresponded with good investment results for IFC, indicating that there has been little tradeoff between the two;
- pursuing a corporate strategy that emphasizes high-risk countries and targeted sectors appears likely to yield better development outcomes *and* improve IFC's investment outcomes. However, today's high-risk countries have smaller economies that offer fewer investment opportunities; hence the scope for improving results may prove limited;
- IFC's effectiveness is closely associated with project development outcomes and IFC's investment outcomes. The quality of IFC's screening, appraisal and structuring was particularly important.

Scope and Sample

The *Annual Review* is an analysis of evaluation reports—in-depth investment assessment reports (IARs) and more concise expanded project supervision reports (XPSRs)—prepared by IFC's investment departments and reviewed and synthesized by OEG. In FY99, a random sample of 54 operations approved by IFC's board in 1993 was evaluated. The analysis combines the results with the sample of 60 IARs that covered 1991 and 1992 approvals. The entire review analyzes 114 operations comprising 39% of the mature 1991–93 approvals. The samples are representative, within statistical limits, of the performance profile of all IFC's operations approved in the 1991–93 period.

Performance Dimensions and Indicators

Each IAR and XPSR rates each operation based on 11 indicators grouped under three performance dimensions:

- Development outcome (6 indicators)
- IFC's investment outcome (2 indicators)
- IFC's effectiveness (3 indicators)

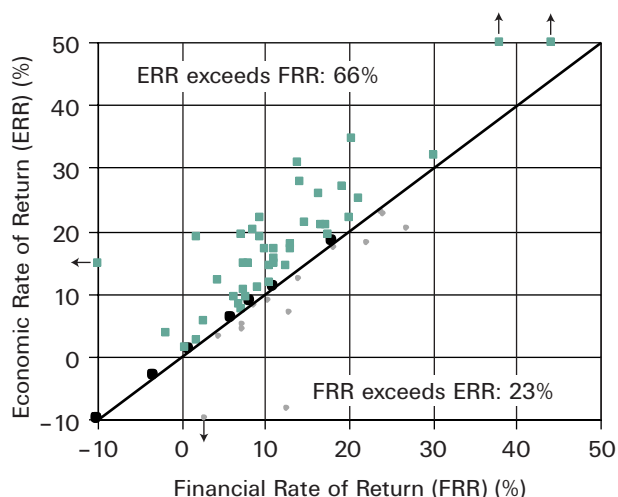
Each performance indicator addresses a distinct aspect of performance, rated on a four-point scale: *excellent, satisfactory, partly unsatisfactory, and unsatisfactory*.

Development Outcome

The development outcome rating is a bottom-line assessment of a project's on-the-ground impact relative to what would have happened without the project. It is rated on a six-point scale: *highly successful, successful, mostly successful, mostly unsuccessful, unsuccessful and highly unsuccessful*. Projects considered to have achieved "success" received ratings of *mostly successful* and better.

The development outcome rating reflects a project's contribution to the country's development,

Figure 1: Benefits to society usually exceeded benefits to financiers.



65 IARs and XPSRs with re-estimated FRRs and ERRs at evaluation.

based on six indicators: project and company business success, the project's contribution to private sector development, economic growth, improved living standards and its environmental effects.

Two thirds of the operations were *mostly successful* or better. Among the development impact indicators, living standards ranked highest with 85% of the sample rated *satisfactory* or *excellent*, followed by growth of productive private enterprise (74%), environmental sustainability (71%), company business success (67%), growth of the economy (62 percent) and project business success (49%).

Society tended to reap greater net benefits than the projects' owners and other financiers: the median economic rate of return was 15% and the median financial rate of return 10%. The reason is that customers, suppliers, employees, and the public at large (via taxes) benefit from a project's success before the owners and financiers, who risk their capital. Project business success (returns to financiers) was the indicator with the lowest success rate in the development outcome dimension. Nevertheless, all projects that were business successes also had positive development outcomes, whereas 34% of projects with disappointing business results still had successful development outcomes.

Factors that improve a project's business prospects also drive its development outcome and IFC's investment returns. Improved outcomes should follow from

better IFC work in key areas. They are assessment of sponsors, management and markets; credit analysis and structuring; financial projections and risk analysis; and environmental structuring, monitoring and supervision.

IFC's Investment Outcome

IFC's ability to finance future investments and fulfill its development mandate depends on profits from investments. The investment outcome rating is a synthesis of up to two indicators (one for loan, one for equity) that address the gross contribution of IFC's investment. Each is evaluated and rated according to standard corporate benchmarks that reflect corporate investment policy. Based on the three-year sample, there is a close association between positive development outcomes and good investment outcomes. (*Under its disclosure policy, IFC does not release partial information on its investment portfolio's performance.*)

IFC's Effectiveness

The effectiveness rating synthesizes the evaluation of three indicators that are also rated individually:

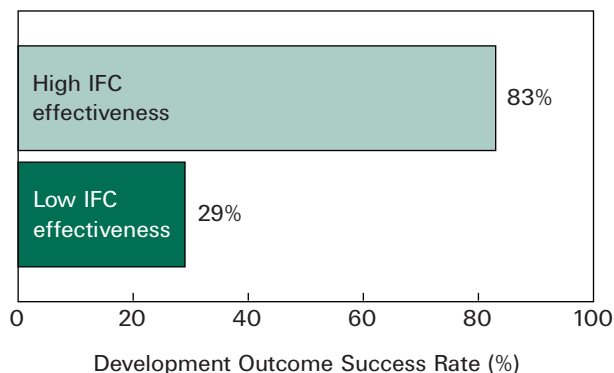
- (1) project screening, appraisal, and structuring
- (2) supervision and administration
- (3) role and contribution

The ratings derive in part from analyzing outcomes against expectations at approval, focusing on the reasons for material variances. A rating of *satisfactory* defines the high professional standards expected for IFC's sustainability; *excellent* is reserved for exceptional performance in the case of (1) and (2), or pioneering or unusually strong contribution in the case of (3). A *partly unsatisfactory* rating indicates a materially flawed performance in at least one area, and *unsatisfactory* denotes seriously flawed performance in more than one area.

IFC's effectiveness was rated *satisfactory* or *excellent* in 70% of the operations. The quality of IFC's work counts: there is a significant positive association between IFC's effectiveness and outcomes. With *satisfactory* or *excellent* effectiveness the incidence of good development outcomes rises by 54 percentage points (Figure 2), and that of good investment outcomes also increases by a substantial margin. In the evaluated operations the scope for improving development outcomes was greater than for improving investment outcomes.

In general, IFC's projections at approval featured significant appraisal optimism. Median financial rates of return of 18% estimated at appraisal compared to

Figure 2: IFC's effectiveness is closely associated with development results.



10% at evaluation five years later. The optimistic bias resulted from limitations in forecasting technique, shortcomings in sponsor or market assessment, weaknesses in contractual structuring, and unbalanced IFC performance incentives.

Bunching—a concentration of approvals in June and December—was associated with poor performance. Operations approved in these two months featured significantly worse development outcomes (55% successes vs. 74% in other months) and environmental impacts (52% vs. 75%). These findings suggest weaker quality control during peak approval periods, which also featured higher incidences of approved projects being dropped by IFC before signing the investment agreement. These results are similar to those found in OEG's evaluation of the Africa Enterprise Fund, IFC's small enterprise program in Sub-Saharan Africa.

IFC's effectiveness, particularly IFC's role and contribution, was better in high-risk countries. IFC was also more effective with larger investments. IFC's supervision was worse in low-income countries, in part due to insufficient attention to environmental compliance in countries with weaker regulations.

Evaluation and IFC's New Strategic Directions

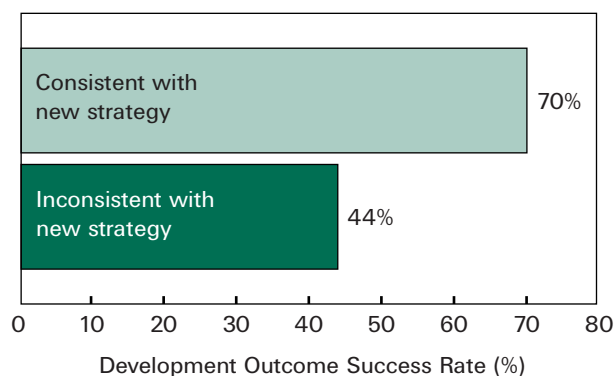
IFC's 1998 strategy sought to improve development effectiveness by pursuing high development impact, high investment return operations. The strategy also suggests using low impact, high return operations to cross-subsidize high impact, low return operations. In the evaluated operations there was no such tradeoff, and thus little rationale for cross-subsidization. IFC's

investment outcomes were best where development outcomes were best. This finding supports IFC's current strategy, to pursue only those operations that combine prospectively high impacts with acceptable returns.

A consistent strategic theme has been to seek investments in frontier countries, sectors or client groups, where IFC's value-added is greatest. We found that 85% of our sample, approved in 1991–93, fit this strategy. They were either in frontier markets (high risk or low income) or frontier sectors (financial markets or infrastructure), or both. These projects had a development outcome success rate of 70%, compared to 44% of projects not among those targeted groups.

- *Frontier countries*: Development outcomes and IFC's role and contribution were significantly better in high-risk countries.
- *Frontier sectors*: Some of the targeted sectors (i.e., health and education) have only recently been introduced into IFC's portfolio and so could not be evaluated. Results were available only for infrastructure and financial markets projects.
- *Infrastructure* projects had significantly better development outcomes (91percent positive) than other projects (64%).
- *Financial markets* projects' development outcomes were not different from those of other projects (two-thirds positive). However, where IFC's effectiveness was *satisfactory* or *excellent* the incidence of positive development outcomes was substantially higher for financial markets projects (92%) than for other projects (78%).

Figure 3: Development results are better in strategic priority areas.



In summary, the evaluation findings suggest that IFC's strategic focus on the 'frontier' is likely to yield better long-term results. However, today's high-risk countries are smaller economies that offer fewer investment opportunities than those defined as high-risk in 1991–93. Hence, the strategic scope for improving development and investment results by tilting resources towards those countries may be limited. At the same time, there is significant scope for improving development outcomes by working to improve IFC's effectiveness in execution.

Lessons Learned

A central objective of evaluation is to learn from the mature operations' successes and shortfalls. This year's sample of 54 IARs and XPSRs added 212 lessons to OEG's on-line database, the Lessons Retrieval Net-

work (LRN), to 212. Most lessons—86%—relate to front-end stages of the project cycle: screening (14%), appraisal and project structuring (57%), and investment structuring and agreements (15%). The other lessons (14%) apply to supervision and evaluation. This profile illustrates that for projects to achieve successful outcomes IFC's work must be of an especially high quality before projects enter the portfolio.

By subject matter, the lessons were closely aligned with the causes of *less than satisfactory* IFC effectiveness ratings:

- market assessments
- sponsors and management quality
- project financing and investment structuring.

Environmental issues featured prominently among both structuring and supervision-related lessons.

RECOMMENDATIONS

IFC underwent rapid change during 1999 and has made substantial progress since our last Annual Review. Building on that progress, our findings suggest several recommendations for action by IFC's management. The full report offers a series of specific recommendations for addressing the three areas for improvement that emerged from these three-year evaluation results. In summary, it makes the following recommendations:

- Select only financially and economically viable projects, and pursue IFC's current strategic focus on: (i) frontier markets, or (ii) targeted sectors in middle-income markets, and (iii) a limited number of other sectors, such as those featuring high development value-added by IFC or pioneering attributes, or catering to specific country needs.
- Continue to improve staff skills, and shift the incentives from approvals to successful development and investment outcomes.
- Since what gets measured gets done, develop an integrated performance measurement system, upgrade investment and portfolio profitability measures, and strengthen the corporate focus on the development quality of the portfolio.

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.

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