

INTERNATIONAL FINANCE CORPORATION OPERATIONS EVALUATION GROUP

Instructions for preparing an Expanded Project Supervision Report (XPSR) Non-Financial Markets Projects (revised 2004)

OEG encourages short and concise XPSRs with no more information than necessary to support evaluative judgments (ratings) and lessons. Five pages usually suffice, and bullet points are welcomed.

If you have any questions, please contact your OEG counterpart or the [OEG Help Desk](#) at (202) 458-2299.

In the XPSR: *operation* refers to IFC's objectives, activities and results in making and administering its investment; *company* refers to the legal entity in which IFC is making its investment and that is undertaking the project; *project* refers to the specific company objectives and related assets or business activity financed by the IFC investment – it is not a legal entity; and *investment* refers to the specific IFC financing instrument (loan, equity, underwriting, etc.) that was selected for an XPSR.

The XPSR's Evaluation Findings, and each of its dimensions and indicators, address a project's contribution to **IFC's purpose and mission**: to promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives. They also evaluate the investment's impact on IFC's financial sustainability, and IFC's work quality in executing the operation. IFC uses XPSR findings to account for accomplishment of its purpose and mission, to learn from past operations, to identify needs for systemic improvements, and to improve selection and execution of new operations and IFC's strategy.

The XPSR assesses performance of the project since its inception, i.e. what has happened until now, and what might happen in the future. Future prospects should be realistically assessed, taking into account past performance as well as any changes (including external factors) that have affected, or are likely to affect, the project and company over the rest of the project's life.

Project Description, Objectives and Rationale: Start the Evaluation Findings with a brief description of the project, its objectives, its rationale and the "without project" counterfactual – a plausible paragraph on what you believe would have happened if the project had not proceeded.

For example, without the project, the project's output would have been imported; the country would have exported less; consumers would have used a substitute; competitors would have produced more; etc. A starting point may be the project documentation at approval, but usually more information about what would have happened without the project is available at the evaluation stage (e.g. knowledge about external factors, etc.). It is not always easy to assess what would have happened without the project, but this section should offer an educated and plausible guess.

Development Outcome

A project's development outcome encompasses all effects on a country's economic and social development. Development impacts are evaluated on a "with versus without project" comparison, i.e. considering (i) what happened with the project and, (ii) counterfactually, what would have happened without it. Distinguish, to the extent possible, the project from the company's performance.

Project Business Performance

Concept

Project business performance measures the project's actual and projected financial impact on the company's financiers i.e. lenders and equity investors. Investors have diverse goals, but ultimately there is only one bottom line: financial returns. Sufficient financial returns are necessary to attract and reward private investment.

Indicator

The principal indicator of a project's business performance is its real (see guidance note on converting nominal to real prices and vice versa), after-tax, financial rate of return, or FRR. Show in an attachment how the FRR was estimated, and include past actual and key assumptions for future prices, sales volumes, margins, terminal value, etc.

FRR calculations are also required for most corporate loans. They are harder to estimate, and suggestions are provided in the Guidance Note on Evaluating Corporate Loans.

Evaluation standard

Project business performance ratings are based on comparing the after-tax FRR to an estimate of each company's real weighted average cost of capital (WACC). OEG provides the WACC-based benchmarks for rating the project's FRR. Where the FRR falls near a rating benchmark, the XPSR should evaluate the sensitivity of the performance rating to the key assumptions. The benchmarks are:

- *Excellent*: $FRR \geq WACC + 2.5\%$
- *Satisfactory*: $FRR \geq WACC$
- *Partly unsatisfactory*: $FRR \geq WACC - 2\%$
- *Unsatisfactory*: $FRR < WACC - 2\%$

For those investments for which an FRR cannot be calculated (e.g. financial restructurings), the guiding principle should remain the project's incremental financial impact on the company's financiers. If the project is a clear failure (e.g. incremental capacity remains unutilized) then there is no need to calculate an FRR. When making a reliable FRR calculation appears extremely difficult, contact OEG and suggest alternatives to assess the project's financial performance. When a company is listed, its stock price performance can give a good indication of the returns to the company's shareholders. However, stock price may be an unreliable indicator for project performance, particularly where the project constituted only a relatively small portion of the company's operations.

Where no relevant quantitative information is available, judge performance relative to the project's business/profit objectives:

- *Excellent*: objectives largely surpassed
- *Satisfactory*: objectives broadly achieved
- *Partly unsatisfactory*: one or more core objectives not met
- *Unsatisfactory*: most objectives not met

Where the project is other than *satisfactory*, explain why, briefly summarizing the main drivers of the FRR, e.g. market; prices and margins; sales volumes, production and capacity utilization; project cost, execution schedule, and contractual/management arrangements for execution; procurement; technology, training and productivity; qualitative factors (e.g. management, labor, or product quality); force majeure events.

Projects are owned by companies, and successful companies can have unsuccessful projects and vice versa. Comment briefly on the project's effects on the company and on the company's prospects as a viable, internationally competitive firm. Focus on any issues that might threaten the company's survival and thus could endanger realization of the projected still-to-go project benefits.

Economic Sustainability

Note: This section of the XPSR must be cleared by the departmental economist. For projects with significant impacts on the local community, the social development specialist should also be consulted.

Concept

IFC's purpose is to "further economic development ... in its member countries" (encouraging private sector development is the means to achieving that purpose). Growth and development are not synonymous, but economic growth provides the resources necessary for development. Projects with high economic returns contribute to a country's economic growth, whereas those with low or negative economic returns detract from it. Not all development aspects can be quantified, and this indicator therefore also considers qualitative aspects, including to what extent a project has contributed to IFC's mission – helping to reduce poverty and improve people's lives.

Indicator

The best single indicator of a project's contribution to economic growth is its economic rate of return (ERR), which measures quantifiable net economic benefits to all of society. To determine the net benefits, consider the project's economic effects on its input and output markets. Consider domestic and international competition and how prices and quantities are determined in relevant markets. What are the principal economic benefits and costs, and how were they estimated? In addition to those identified in the financial analysis, they typically include taxes paid to the government, consumer surplus, effects on competitors, and benefits to suppliers, including labor. Show the economic assumptions and the estimation of the benefits and costs in an attachment. Quantify economic effects where possible, particularly where they are material. However, it is usually not possible to quantify all economic effects. For the overall assessment and rating of a project's economic sustainability, consider both quantitative and qualitative effects.

A good conceptual framework for assessing a project's economic effects and ERR is a stakeholder framework. In your analysis, identify to whom the benefits and costs accrue. For the quantified effects, analyze carefully the difference between the financial cashflows used to calculate the FRR and the net economic benefits used to calculate the ERR. The difference between the two indicates gains or losses to people other than the project financiers – typically taxpayers/government, consumers, workers, suppliers, competitors and the local community. Present these differences as net present values (NPV, discounted at 10%).

Describe the significant non-quantified benefits. In particular state whether the project had any direct impact – positive or negative – on the poor or on living standards in the local community. Refer to IFC's sustainability initiative for examples of a project's possible effects on socio-economic development. Where applicable, also comment on any other contributions to international development goals. Where you believe the non-quantified benefits are sufficient to affect a project's overall assessment, provide a cogent rationale.

Example: The project's ERR is estimated at 17% and net benefits to society at \$53 million (NPV @ 10%). Of those, \$23m accrued to its financiers and \$20m to government in the form of income taxes paid (\$25m) minus foregone import duties (\$5m). Benefits to unskilled workers were estimated at \$8m, in the form of better wages than alternative employment opportunities; they mainly accrued to women, 80% of the workforce. Benefits to the local community (\$2m) were estimated to equal (at least) the company's support for the local hospital and school. The project did not affect domestic prices (it substituted for and somewhat reduced imports). Consumers may have benefited from shorter delivery times, but these benefits are likely to be small and have not been quantified. There was no discernible negative effect on the local community, particularly since the project employs modern equipment resulting in minimal environmental effects (see also below). The project clearly resulted in increased economic activity in the community (e.g. multiplier effects from the company's \$20m annual expenditures for locally purchased supplies and local consumption by the workers), but these have not been quantified. Sensitivity analysis showed that they are likely to be substantial: if only 15% of expenditures for local supplies result in incremental profits, this would increase the ERR beyond 20%. The rating is therefore *excellent*.

Evaluation standard

In determining the rating, consider both quantified and non-quantified benefits and costs. Where non-quantified benefits or costs are material, explain why you believe a higher or lower rating than indicated by the ERR appears justified and if possible demonstrate it (e.g. in form of a sensitivity analysis). Any project rated *satisfactory* or *excellent* should have a demonstrably positive effect on society in the host country. In the absence of significant qualitative effects, economic sustainability should be rated as follows:

- *Excellent*: ERR \geq 20%
- *Satisfactory*: ERR \geq 10%
- *Partly unsatisfactory*: ERR \geq 5%
- *Unsatisfactory*: ERR $<$ 5%

Where there are demonstrably large positive or negative socio-economic effects that could not be quantified, make a case for why you think the rating on economic sustainability should be higher or lower than these benchmarks suggest. If the ERR falls outside the satisfactory range, the XPSR should explain the causes.

Environmental Effects

Note: This section of the XPSR must be cleared by the environmental specialist. For projects with significant social safeguard policy issues (e.g. resettlement), the social development specialist should also be consulted.

Concept

IFC's policy requires that "all its operations are carried out in an environmentally and socially responsible manner". This is not only sound business practice, but also a necessary condition for sustainable development - IFC's Mission.

"Environmental effects" include the project's impacts on the physical environment and social, cultural, and health and safety issues, all of which should be considered if they have entered into project performance or public perceptions of the operation. World Bank Group policies and guidelines should be considered a proxy for what IFC considers acceptable environmental standards, but effects on the ground are what this indicator and the rating should address.

Indicator

Environmental effects should be evaluated relative to:

1. IFC's requirements¹ and guidelines and the local standards that would apply to the same project if appraised today;
2. IFC's requirements¹ and local standards that prevailed at the time of approval;
3. covenanted requirements in the Investment Agreement and its attachments (e.g. reporting requirements, conditions of disbursement, remediation action plans, environmental management plans); and
4. environmental and social management practices that go "beyond compliance" required by IFC.

The evaluation must specifically state if any of IFC's environmental and social safeguard policies (e.g. natural habitats, forestry, indigenous peoples) apply to this project (or would apply, if the project was appraised today) and, if so, whether the project is (or would be) in compliance.

If you require assistance in identifying the correct version of a World Bank Group policy or guideline that applied at the time of approval, please contact CES.

¹ "IFC's requirements" in this context include IFC's policies and guidelines and – to the extent they are applicable in a specific case – World Bank Group policies and guidelines, as well as host country requirements. [IFC's current requirements](#) and the 1993 procedures are online. If you require assistance in identifying the specific at-approvals requirements (e.g. IFC or World Bank Group policies or guidelines), please contact CES.

Evaluation standards

The project's environmental effects should be rated:

- *Excellent*: The project has either materially improved the company's overall environmental performance (e.g. through addressing existing environmental issues or introduction of an EMS or corporate commitment to a program of environmental and social responsibility broader than IFC's requirements) or that of local companies (e.g. by raising industry standards, acting as a good practice example for regulators, etc.). In addition, the project has consistently met IFC's at approval requirements and its environmental effects are deemed acceptable in view of IFC's current requirements. IFC should be able to use projects rated excellent as a role model for positive environmental effects. IFC's sustainability initiative provides examples of demonstrated improvements in environmental management and process efficiency);
- *Satisfactory*: the project is - and was over its lifetime - in material compliance with either IFC's current or at-approval requirements, including World Bank Group environmental, health and safety policies and guidelines;
- *Partly unsatisfactory*: the project is not in material compliance with either IFC's current or at-approval requirements, but deficiencies are being addressed through ongoing and/or planned actions; or earlier non-compliance (meanwhile corrected) resulted in environmental damage;
- *Unsatisfactory*: the project is not in material compliance with either IFC's current or at-approval requirements, and mitigation prospects are uncertain or unlikely, or earlier non-compliance (meanwhile corrected) resulted in substantial and permanent environmental damage.
- *No opinion possible (NOP)*: Where, after best efforts, the relevant information to establish material compliance (or lack thereof) cannot be obtained, a rating of "no opinion possible" (NOP) may be assigned. Use of the NOP rating should be a last resort, after reasonable effort has been made to obtain the necessary information. A sponsor's failure to report should result in a partly unsatisfactory or unsatisfactory rating only if the sponsor has repeatedly refused to cooperate on this issue.

Where the rating is NOP, the PSR (cross-referenced in the Evaluation Addendum) should describe the steps IFC is taking to obtain the necessary information, including a timetable.

A NOP rating may point to a shortcoming in IFC's front-end work quality (e.g. if investment agreements did not allow IFC to get access to the relevant information) and/or to a shortcoming in IFC's supervision (e.g. IFC did not follow up sufficiently to monitor and ensure compliance).

The rating addresses only the project's environmental effects². Comment on the company's environmental performance where it differs from the project's (e.g. because of non-project operations), but consider it only to distinguish between *satisfactory* and *excellent* ratings. The section on IFC's work quality should separately evaluate IFC's influence on environmental performance.

Private Sector Development

Concept

IFC's *Purpose*, specified in IFC's Article I, is "encouraging the growth of productive private enterprises", and to that end, IFC shall "seek to stimulate, and to help create conditions conducive to, the flow of private capital, domestic and foreign, into productive investment". This indicator addresses to what extent the company has developed into a corporate role model – positive or negative – and whether the project has contributed to IFC's purpose by spreading the benefits of growth of productive private enterprise beyond the project company.

² Where the project scope encompassed the environmental effects of existing company operations, they should be included in the project description and rating project performance.

Indicators

Positive project-induced impacts could include:

- significant upstream and downstream supply linkages to local private businesses;
- introduction of new technology, know-how, development of management skills, and employee training; enhanced private ownership;
- stronger local entrepreneurship;
- greater competition and competitiveness;
- broad demonstration effects in the local economy;
- follow-on investments by other investors;
- domestic capital market development (e.g. pioneering listing on stock exchange or significant broadening of listed value);
- first-of-a-kind financing instrument;
- introduction of international accounting standards or enhanced disclosure standards;
- development of infrastructure available to other private users; and
- the company's governance quality, reputation and business practices as a positive corporate role model and quality investment asset. IFC's sustainability initiative provides examples of demonstrated improvements in business leadership, corporate governance and transparency.

Positive effects also include changes in the legal and regulatory framework and its administration that improved the enabling environment, for example by making transactions more secure and flexible and providing economic actors with the freedom, flexibility, and security to acquire, use, and leverage property rights. The enabling environment includes how the laws and regulations are set, administered, enforced and adjudicated. In a positive enabling environment, a nonintrusive, efficient, and respected public administration sets widely understood rules for economic activity, enforces them uniformly and universally in a predictable manner, and changes them through transparent means. Evaluate whether project-related technical assistance or the project's activities, goods and services have brought about changes in the enabling environment and cite changes in laws, regulations, or their administration. For example, the introduction of best practice environmental monitoring standards by the company may, in turn, result in these standards being adopted by the local environmental agency.

Negative impacts could include: negative demonstration effects due to poor performance; poor company reputation leading to a negative effect on private enterprises; project-induced restrictions on competition (including protection, uneven treatment of competitors, forming of a cartel, etc.), delays of reforms or entry by private enterprises, introduction of laws and regulations worsening the enabling environment, etc.

Evaluation standard

Rate the performance according to these standards:

- *Excellent*: considering its size, the project improved the enabling environment or otherwise made a substantial contribution to the growth of private enterprises or efficient financial markets
- *Satisfactory*: the project had some, but no major positive impacts
- *Partly unsatisfactory*: the project had mostly negative impacts, which, however, are not expected to be of long duration or broad applicability (e.g. a failed project without substantial negative demonstration effects)
- *Unsatisfactory*: substantial negative impacts of broad applicability and/or expected to be of long duration

Briefly describe which of the factors described above (or others) were most important in this judgment and why they are the relevant considerations.

Impact of investment climate

Discuss, but do not rate, the impact of investment climate on the project's development outcome and IFC's investment outcome. "Investment climate" refers to country conditions, including legal, regulatory, and judicial framework, rule of law, institutional capacity, investment incentives and barriers, peace and order situation, level of corruption, and access to cost-effective labor, domestic finance, business support services, information, infrastructure, and other productive inputs. You may want to use Institutional Investor Country Credit Ratings (IICCR) and the Heritage Foundation Index of Economic Freedom at project approval and at present as proxies for estimating investment climate characteristics and changes.

DEVELOPMENT OUTCOME RATING

Concept

This rating is a synthesis of the overall impact of the project on the development of its host country, and thus implicitly addresses how well the project has contributed to fulfilling IFC's *purpose* and *mission*.

Indicators

Each of the four development outcome indicators measures a distinct aspect of the operation's performance in fulfillment of IFC's Article 1 purpose and mission. The development outcome rating is a bottom-line assessment of the project's results on-the-ground, and not an "average" of the four indicators.

Evaluation standard

Considering the four indicators, rate the operation's overall impact on the development of its host country on a six-point scale:

- *Highly successful*: A project with overwhelming positive development impacts, with virtually no flaws. Indicates the type of project IFC should use publicly to illustrate the contribution of private sector development to the World Bank Group's mission.
- *Successful*: A project without material shortcomings, or some very strong positive aspects that more than compensate for shortfalls.
- *Mostly successful*: A project which may have some shortcomings, but with a clear preponderance of positive aspects. The guiding principle should be: if all of IFC's projects were mostly successful, we should just be able to justify our existence as development institution.
- *Mostly unsuccessful*: A project with either minor shortcomings across the board, or some egregious shortcoming in one area which outweighs other generally positive aspects.
- *Unsuccessful*: A project with largely negative aspects, clearly outweighing positive aspects.
- *Highly unsuccessful*: A project with material negative development aspects with no material redeeming positive aspects to make up for them.

For any rating of *mostly successful* or better, IFC should be able to convincingly explain (without embarrassment) to a public audience why it rates this project a "success".

IFC Investment's Profitability

Concept

Investment performance is essential to IFC's sustainability and to accomplishing its corporate purpose. This section assesses the extent to which IFC has realized to date, and expects to realize over the remaining life of the investment, the loan income and/or equity returns that were expected at approval. If IFC made both loan and equity investments, they are rated separately, as follows:

Indicators and evaluation standard

Gross Contribution -- Loan

Note: These ratings guidelines refer to senior loans. Other loan-type investments (e.g. convertible loans and other quasi-equity investments) are too diverse to set one evaluation standard. Therefore, please contact OEG. The primary indicator for this rating is whether the company is current on its payments to IFC (interest, fees etc.) It is also important to assess the likely future debt-servicing capacity of the client – for example, recent payments may have been made, but the outlook for future payments is doubtful, whether caused by the deteriorating macroeconomic situation in the country or by deteriorating condition of the project or company.

- *Excellent*: Fully performing and, through sweetener (e.g. income participation), expected to earn significantly more than a loan priced "without sweetener" would have earned if paid-as-scheduled. There is no indication that debt service payments will not remain current in future;
- *Satisfactory*: (i) loan expected to be paid as scheduled or (ii) loan is prepaid and IFC has received at least 65% of the interest (net of prepayment penalties received) expected over the original life of the loan; or (iii) loan has been rescheduled and is expected to be paid as rescheduled with no loss of

originally expected income; or (iv) IFC guarantee: all fees are expected to be received, and guarantee is not called, or called but expected to be fully repaid in accordance with the terms of the guarantee agreement; (v) IFC swap or other risk-management facility: IFC has not suffered any loss and expects no loss due to non-performance of the swap counterparty. There is no indication that debt service payments to IFC will not remain current in future;

- *Partly unsatisfactory*: (i) loan is prepaid and IFC has received less than 65% of the originally expected interest income (net of prepayment penalties received); or (ii) loan has been rescheduled, or guarantee is called and in either case IFC expects to receive sufficient interest income to recover all of its funding cost but less than the full dollar margin originally expected. If all payments to IFC are current, but there is doubt whether payments can remain current in future, then a *partly unsatisfactory* rating may be preferable;
- *Unsatisfactory*: (i) loan is in non-accrual status, or (ii) IFC has established specific loss reserves, or (iii) loan has been rescheduled but IFC does not expect to recover at least 100% of its loan funding cost; or (iv) loan has been or is expected to be wholly or partially converted to equity in restructuring of a "problem" project; or (v) IFC experiences a loss on its guarantee or risk-management facility. In some cases, IFC may establish "flag" loss reserves of modest size ($\leq 10\%$) for reasons such as country conditions, which are not related specifically to IFC's project. In these cases, a *partly unsatisfactory* rating may be used rather than *unsatisfactory*.

Gross Contribution -- Equity

Calculate the nominal equity IRR (also called return on equity or ROE) and compare it to the projected equity IRR. Unless more recent information is available, the equity IRR calculated by the Corporate Portfolio Management Group (CPM) may be used. If the XPSR team recalculates the equity IRR using projected dividends and capital gains, it should explain the reasons for divergences from CPM's estimate and attach the calculations and assumptions.

In projecting equity cash flows, the dividend projections should be based on discussions with company management on dividend timing and payout considerations, and should take into account local company law (e.g. concerning reserve requirements), the company's loan covenants, and its minimum cash constraints. Indicate how and when IFC is likely to sell its investment, and any plans by the company for broadening of ownership. Where IFC's exit is expected to be through a put at a contractually specified price, assess the enforceability of the put and the prospects for timely realization of the put value.

The rating criteria for equity investments are based on the actual (or notional) fixed rate loan interest rate (FR) that was (or would have been) approved. (OEG has placed information on the cost of funds, notional fixed rate loans, and spread ranges for specific projects with equity investments at the following link: Fixed rate loan interest rate.³³)

A. For **closed investments or active investments with put options that specify a minimum return** to IFC (and IFC expects to exercise the option at that value) the following ratings should be assigned:

- *Excellent*: Equity IRR \geq FR + xxx basis points (bp)
- *Satisfactory*: Equity IRR \geq FR + yyy bp⁴
- *Partly unsatisfactory*: Equity IRR \geq FR
- *Unsatisfactory*: Equity IRR $<$ FR

Where IFC's expected equity exit is by means of a put option specifying a minimum return but enforceability is doubtful, the equity investment should be treated as an active investment with more than 50% of undiscounted positive cash flows still-to-go by more than 12 months (scenario C).

³ The "fixed rate" (FR) loan (equivalent) is determined as follows: (1) Investments which have a fixed rate senior loan in addition to the equity: FR is the actual interest rate for the fixed rate loan. (2) Investments which have a variable rate loan in addition to the equity: FR is the Cost of Funds (CoF) plus the spread approved for the variable rate loan. CoF is the 10-year fixed rate swap equivalent of 6-month LIBOR as of the investment's commitment date. Equity-only investments: Notional FR is the CoF plus the country spread (from IFC's Weekly Pricing Guidelines) prevailing as of the investment commitment date.

⁴ For example, if a notional senior loan would have attracted a fixed rate of 10%, the *satisfactory* equity IRR would be xx% to below yy% for a closed equity investment.

B. For **equity investments firmly planned to be fully sold within 12 months of the XPSR date**, such that the exit value is reasonably well-established, zzz bp should be added to the benchmark ranges in A.

C. For **equity not fully sold and more than 50% of undiscounted positive cash flows are still-to-go by more than 12 months**, 2*zzz bp should be added to the benchmark ranges in A.⁵⁵

IFC's Investment Outcome Rating

The investment outcome rating, when both loan and equity gross contribution have the same rating, is the same as the two indicator ratings. In other likely combination cases, the following guidelines should be used.

Investment outcome rating for different gross contribution - loan and equity ratings				
Loan Rating	Equity Rating			
	E	S	PU	U
E	E	E	S	S, PU or U*
S	E	S	S	PU or U**
PU	S	S	PU	PU or U**
U	***	***	U	U

E = *Excellent*, S = *Satisfactory*, PU = *Partly unsatisfactory*, U = *Unsatisfactory*
 * S if weighted average of effective loan interest rate and equity IRR \geq FR + www bp; U if < FR - www bp; otherwise PU.
 ** PU if weighted average of FR and equity IRR \geq FR - www bp; otherwise, U.
 *** For this unlikely event, consult OEG.
 Weights: dollar amounts of IFC's disbursed investment.

If the XPSR team believes the above guidelines to be inappropriate in specific circumstances, they may present the rationale for assignment of a different outcome rating than those indicated above.

IFC's work quality

Concept

This section addresses three areas of IFC's operational performance: (1) screening, appraisal and structuring; (2) supervision and administration; and (3) role and contribution. Did IFC apply good practice standards in these areas, such as those identified in its policies and procedures and guidance notes (e.g., IFC's Credit Notes)? The analysis of appraisal projections against actual outcomes in Section 4 of the Evaluation Findings should help identify the strengths and weaknesses of IFC's operational performance, as well as valuable operational lessons. However, do not let the outcome unduly affect the work quality ratings. An unsatisfactory development and investment outcome can be caused by external factors, unforeseeable (e.g. force majeure), or foreseen (e.g. realized market risk). A satisfactory outcome can be achieved even though IFC did a poor job appraising and supervising the project, had insufficient role and made no contribution. However, if IFC did (or could have and did not) improve the project's development or investment outcome, this should be reflected in this section. For example, if the environmental performance is other than *satisfactory*, the XPSR should specifically address IFC's environmental work quality.

Screening, Appraisal, and Structuring

Concept

Evaluate to what extent IFC has professionally executed its front-end work to a sustainable corporate performance standard. IFC's operating policies and procedures, as well as its credit notes provide guidance on what IFC considers an appropriate professional standard.

⁵ For example, if a notional senior loan would have attracted a fixed rate of 10%, the *satisfactory* equity IRR range would be ww% to below zz% for an equity investment not yet sold.

Indicators

Evaluate IFC's processing of the project at entry. Identify the materially deficient or particularly commendable areas in IFC's screening, appraisal, and structuring.

Screening and appraisal: examine the Board paper and the various supporting documents – CIC meeting minutes, decision meeting memorandum, appraisal reports, BTO reports, etc. Analyze and comment on the effectiveness of IFC's assessment of project risks (risks that the project would fail to meet the intended development objectives or generate adequate returns), using IFC's Credit Notes as the best-practice guidelines for analyzing the assessment at appraisal of the project's creditworthiness. Did the screening/appraisal team adequately identify the main risks? What, if any, were missed? Review the assessment at appraisal of sponsors/company/management (their capacity, character, commitment, experience and reputation), country conditions (political, economic, legal, business environment); project concept (fit with the likely market, competitive strength), market dynamics (competitive forces – principal suppliers, cost structures, financial strength, comparative advantages/disadvantages, pricing, market size and forecasts); project configuration (scope, physical characteristics, location, technology, equipment), project costs (completeness of cost reviews and review of implementation arrangements); and private sector characteristics (size and depth compared to the state-owned enterprises, subsidies and other relevant distortions). Review the financial plan and assumptions used in the project's financial projections for completeness. In hindsight, were the parameters used in the sensitivity analysis at appraisal consistent with market and company situation at the time? Were price/margin assumptions realistic? Also review the effectiveness of implementing IFC's at-approval procedure for environmental appraisal. Did project appraisal assess the adequacy of policies or supervision standards of the local environmental authority? Did the appraisal identify training needs and procedural adjustments? Did IFC take into account available relevant lessons from other operations? (See for example IFC's Lessons of Experience and Lessons Retrieval Network.) If issues or concerns were raised at appraisal – for example in IFC's review process, by the World Bank, civil society or other stakeholder groups – were they appropriately addressed?

Structuring: Were the risks identified at screening/appraisal addressed in the structuring of IFC's project, and was their proposed mitigation adequate? Were the terms, conditions, and security suitable for both company and IFC's needs? Was loan pricing commensurate with market practices and risks? Evaluate whether, in hindsight, IFC's loan covenants were relevant, practical, adapted to the particular country and project, and contributed to mitigating risks and realizing objectives. Were there any conflicts or coordination issues with the terms of co-financiers' loans? Were the identified training needs and procedural adjustments, particularly with respect to environmental matters, reflected in project design?

Evaluate the decision to take equity (if applicable) and the structuring of the equity investment (see also IFC's Equity Investment Strategy). Was there a significant upside potential and a realistic exit option to realize a return commensurate with IFC's risk? Where the expected exit was through a put option, evaluate to what extent it was enforceable, and whether the pricing was adequate. If the anticipated exit was by means of the stock market, evaluate whether this exit was realistic given the depth of that market.

Did IFC consider improvements to the company's governance and operating standards? In case of an equity investment, were the interests of minority shareholders, including IFC, appropriately protected? Note that, even if IFC's loan has appropriate covenants, it is usually preferable to also cover key issues in the shareholders' agreement if applicable (since loans may never disburse or be (p)repaid before the equity is sold). Consider whether this was, or should have been, done within the project reviewed in the XPSR. Was the role of technical advisor (if any) carefully defined?

In summary, did IFC identify the most important risks that could reasonably have been identified at the approval stage, and mitigate them to the extent possible? Keep in mind that not all risks can be mitigated, but the risk-reward profile should be acceptable.

Evaluation standard

Rate IFC's screening, appraisal and structuring:

- *Excellent* if IFC's front-end work could serve as a best-practice example;
- *Satisfactory* if it materially met IFC's good practice standards (see for example IFC's credit notes);
- *Partly unsatisfactory* if there was a material shortfall in at least one important area;
- *Unsatisfactory* if there were material shortfalls in several areas or a glaring mistake or omission bordering on negligence in at least one important area.

Supervision and Administration

Concept

Supervision, for this purpose, starts after commitment of IFC's funding. Evaluate to what extent IFC has professionally executed its supervision, taking into account that the appropriate level of supervision will depend on a project's circumstances. IFC's Operational Procedures provide guidance on what IFC considers an appropriate professional standard.

Indicators

Review previous PSRs prepared on the project/company, compare them to the XPSR findings, and explain any major discrepancies. Assess whether the company's reporting, and IFC staff visits were adequate to monitor developments, manage risks, identify opportunities, ensure compliance with covenants and more generally contribute to the operation's financial and developmental success. Evaluate the adequacy of IFC's monitoring of the company's environmental performance. Did IFC identify emerging problems, and were IFC's responses timely and appropriate?

If IFC has Board representation, did IFC use it to enhance its supervision of the company and to gain better access to market and country intelligence? Did IFC's Board nominee help monitor whether the operating policies and procedures of the FI reflected good practices and were implemented appropriately? (See IFC's Policies and Practices for Directorships for guidance.)

Evaluation standard

Rate IFC's supervision and administration:

- *Excellent* if IFC has always kept itself promptly and fully informed about the project's and company's performance in all material areas and used this knowledge proactively to improve the project's development outcome and/or IFC's investment outcome;
- *Satisfactory* if IFC has kept itself sufficiently informed to react in a timely manner to any material change in the project's and company's performance and took timely action where needed;
- *Partly unsatisfactory* if IFC's supervision was insufficient to monitor the project's and company's performance and/or IFC did not take timely and appropriate action;
- *Unsatisfactory* if IFC missed material developments, and/or did not use information to intervene timely and appropriately.

IFC's Role and Contribution

Concept

IFC's Article I specifies its developmental role, which is captured in three basic operating principles ("IFC's ABC"). This section evaluates how well IFC fulfilled this developmental role.

- **Additionality/Special Contribution Principle** – *"IFC should participate in an investment only when it can make a special contribution not offered or brought to the deal by other investors."* What was IFC's additionality? Highlight any pioneering or innovative dimensions, and evaluate whether IFC's financing could have been replaced by private financing on acceptable terms if the same security had been offered. If IFC has Board representation, to what extent did IFC use it to provide assistance and direction to the company and to improve its governance, financial performance and developmental results? Comment on the effectiveness of project-related technical assistance, if applicable.
- **Business Principle** – *"IFC will function like a business in partnership with the private sector and take the same commercial risks."* Did IFC accept the same commercial risks and earn the same returns as private participants in the same risk categories (e.g. co-equity investors, co-lenders)? If performance materially surpassed IFC's appraisal projections, did IFC receive any upside gain commensurate with its investment risk? If IFC obtained special recourse security, such as a put or guarantee, explain the circumstances and rationale.
- **Catalytic Principle** – *"IFC will seek above all to be a catalyst in facilitating private investors and markets in making good investments."* Did IFC bring private investors and lenders to the project opportunity, mobilize funding, or attract better terms for the company than would otherwise have been the case? (Since IFC's B-loans confer certain advantages to commercial banks, the test is whether they would have entered into the transaction, and on terms as favorable to the company, absent IFC's involvement.)

Consider these three operating principles if and as material to your evaluation, and also consider the following:

- **IFC's Timeliness, Efficiency, and Client Satisfaction** - Were IFC's interactions with the sponsors and company timely and efficient? Comment on any issues relating to staff continuity and whether and how it has affected the operation. Note any positive or negative feedback from the client or suggestions for improvement.
- **Relevance within IFC's Country Strategy** - Was IFC's support for the project relevant in addressing the country's development priorities and consistent with IFC's current country strategy? Where the country strategy has evolved over time, you may also want to comment on changes since the project's approval.
- **Governance:** One of the ways IFC can have an impact on clients is through introducing improved standards of governance. This goes beyond good front-end work in formulating covenants, and can be especially significant where IFC has a board member. IFC's contribution may include assistance with audit committee creation and functioning, formulating policies and procedures, clarifying the distinction between the roles of shareholders/sponsors and management, helping protect minority shareholders, and clarifying the role of technical advisors. Did IFC's involvement encourage the company to improve corporate governance? Did IFC insist on introducing higher standards in policies and procedures and was IFC's effort successful?

Indicators

Assess the operation's genesis, the rationale for IFC's support, and IFC's involvement in the project (at approval and ongoing). As the basis for assessing IFC's role and contribution, consider what would have happened if IFC had not financed this project.

- Would the company have found alternative financing?
- Would the project have been more or less successful?
- Did the company actively seek alternative financing before coming to IFC, and what was the outcome?
- Did IFC maximize opportunities to improve corporate governance?

Consider what IFC added and what possible additional value IFC could have contributed to the project's design, or what IFC could have done differently to improve project or company performance and development impacts. For illustrative examples of what constitutes significant added value by IFC, see IFC and sustainable development.

Evaluation Standard

Apply the following rating guidelines:

- *Excellent:* IFC's role was essential for the project to go ahead and IFC made a major contribution to make it a success;
- *Satisfactory:* IFC's role and contribution were in line with its operating principles;
- *Partly unsatisfactory:* IFC's role or contribution fell short in a material area; and
- *Unsatisfactory:* IFC's role was not plausibly additional and IFC's expected contribution was not delivered.

IFC's work quality Rating

Based on the ratings of the three indicators - (1) appraisal, (2) supervision, and (3) role and contribution - rate IFC's overall work quality on a four-point scale: *excellent*, *satisfactory*, *partly unsatisfactory*, *unsatisfactory*. Bearing in mind that IFC's ability to influence the quality of an operation is greatest between screening and disbursement, this rating should reflect the overall quality of the value added by IFC, at each stage, to the operation's development outcome and to IFC's profitability.

The IFC work quality rating can be no lower than the worst indicator, and no higher than the best indicator. The rating should be:

- *Excellent:* IFC's performance was exemplary;
- *Satisfactory:* IFC's performance was materially up to a high professional standard;
- *Partly unsatisfactory:* There was a material shortfall in at least one area;
- *Unsatisfactory:* There were shortfalls in several areas or an egregious shortfall in one area which led (or could have led, under less favorable circumstances) to a less-than-*satisfactory* development or investment outcome.

Emerging Lessons from Experience To-Date

Issues and Lessons for Improved Performance

From the experience to date, identify the most important issues and the lessons for improving IFC's business in order of priority: focus on how IFC can improve the development and investment outcome of its operations, and its own operational work quality. In particular, identify lessons that illustrate the business case for sustainability: for example, how a good environmental management system or good corporate governance improved the FI's competitiveness or vice versa. Address drivers of ratings other than *satisfactory*. The lessons may be positive (things that worked and should be repeated) or negative (mistakes that should be avoided). Good, well-written lessons: are specific but widely applicable; describe lessons learned rather than general principles; are derived directly and specifically from the experience of the operation and are self-contained. Be responsive to the following guidelines and suggestions.

- Focus on issues and lessons of general relevance to IFC operations that could guide IFC in screening, structuring, appraisal, negotiation, supervision and post-evaluation.
- Consider (i) the issues' materiality and relevance to the operation's outcome, and (ii) what, with hindsight, IFC should have done to improve the operation's overall performance.
- Consider lessons relating to the three performance dimensions addressed in the XPSR: development outcome; IFC's investment outcome; and IFC's contribution and operational work quality.
- Be specific and focus on suggestions to improve quality. For example:
 - If company management was weak, consider how IFC could have (i) discovered this weakness at appraisal, (ii) better mitigated the risk, and (iii) intervened more effectively when the problem was detected. It is not a helpful lesson to write "ensure that company management is strong;"
 - If the financial projections proved materially optimistic, consider the underlying reasons (e.g. flawed forecasting models, little experience of the forecasters, poor training, and too little skepticism) and formulate the lessons and recommendations for achieving a better forecast next time. It is not a helpful lesson to write "make realistic projections;"
 - If the project featured negative sociological or environmental effects, consider whether and how IFC's procedures should be adapted to address these potential effects in the appraisal, covenant formulation, disbursement and supervision stages. It is not helpful to write "make sure that adequate account is taken of environmental effects;"
 - If IFC's investment featured essentially equity risk but limited upside potential, consider (i) whether the screening tools should be sharpened to make this prospect more evident, or (ii) whether and how IFC might have structured its investment to better balance the risk and reward prospect.
 - Avoid repeating what happened, and be concise in elaborating the underlying issues.

Bearing in mind that these lessons will be added to IFC's on-line lessons database ([LRN](#)), the lessons should be self-standing, transparent, prescriptive, and operationally oriented with a view to providing guidance for improving future performance. They should be presented in the format of the following example:

- **What IFC expected at approval** – The railroad operation could be turned around quickly following privatization.
- **What actually happened** – Six years after approval, the project was significantly behind projections in all important areas, traffic, financials, etc.
- **Why things turned out the way they did** – Railroad turnarounds take a lot of time: Resistance from the former state-owned enterprise (that remained the regulator and still operated the passenger traffic) and its employees as well as fierce competition from trucks took a lot of resources, effort and a long time to overcome.
- **Lesson for future operations** - In privatizations, IFC should carefully analyze the likely response of the former SOE and its employees, particularly where the SOE remains a regulator and competitor. Railroad privatizations should anticipate intense and prolonged competition by truckers. Projections should allow for a slow buildup in prices and volume, which should also be reflected in an appropriately conservative financial structure.

Example of a sustainability-related lesson:

- **What IFC expected at approval** – When IFC invested in one production facility in a petrochemical complex, IFC expected that its operations would benefit from the vertical integration at the complex.
- **What actually happened** – The production facility benefited from the integrated complex not only in terms of production efficiency but also in terms of environmental and social performance.
- **Why things turned out the way they did** – Since the production facility shares the same site as other IFC clients, it has adapted and adhered to environmental standards that are higher than those of its competitors. In addition, its location in the complex has enabled the facility to implement an innovative Corporate Social Responsibility initiative by learning from the extensive social programs of its neighbors and by working together with them.
- **Lesson for future operations** - By investing in one or more petrochemical companies sharing the same site and common facilities, IFC can achieve significant environmental and social synergies in the implementation of its sustainability initiative.