Tracking development effectiveness indicators for private sector operations

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Introduction

The Addis Ababa conference on Financing for Development in 2015 clearly emphasized the need to leverage private sector financing to achieve the Sustainable Development Goals (SDGs). This is all the more important as concessional financing is limited due to structural budgetary challenges in many traditional donor countries. Indeed, there are only a handful of countries that have officially committed to maintaining the 0.7 percent of national income target dedicated to ODA. The global trend is therefore shifting away from ODA to leveraging private sector operations as a means of achieving the SDGs. While MDBs have long experience in measuring the development effectiveness of public sector operations, they are often weak at tracking the development effectiveness of private sector operations.

This paper focuses on four main areas. It:

1. discusses the rationale for private sector operations in MDBs;
2. examines some of the main challenges of integrating development effectiveness monitoring tools in private sector operations;
3. reviews how MDBs track private sector development effectiveness indicators, both at corporate level and in the project cycle; and
4. discusses some of the emerging issues and trends.

Rationale for MDB private sector operations

Most MDBs have private sector operations – referred to as Non-Sovereign Operations – that facilitate private sector investment to creditworthy projects and have a positive impact on development (AfDB, 2014)[3]. To ensure a positive impact of the private sector in developing countries, MDBs emphasize five principles for their non-sovereign operations:

1. additionality;
2. crowding-in;
3. commercial sustainability;
4. reinforcing markets; and
5. promoting high standards (DFI, 2013).

For emerging developing countries, MDB financing can have a catalytic impact on private-sector funding, which can help finance long-term investments or address short term liquidity challenges. These financial constraints are particularly evident for Small and Medium size Enterprises (SMEs) – which typically create jobs and are a major source of innovation – and are considered riskier than established national or multinational corporations (IFC, 2009). This leads to a "missing middle" syndrome whereby the real sector is dominated by a few large multinational or national corporations on one side, and many small enterprises that operate in the informal sector on the other side (Perry, 2011). One of the main reasons for this "missing middle" is that small companies lack collateral and have to operate in an environment with unfavorable regulation (Ardic et al, 2011; Hsieh and Olken, 2014).

The rationale for MDB private sector engagement in emerging countries is therefore to alleviate some of the financial constraints which hinder firms from investing and expanding. In turn, these investments can have positive externalities such as addressing infrastructure gaps and generating employment. If these private sector operations are combined with policy advice, technical assistance and budget support operations, then regulatory issues that hamper business development can equally be addressed. Other justifications for private sector operations in specific industries are that it addresses negative externalities at a global level, such as investment in climate change resilience or cleaner energy sources. This means that the MDB private sector cannot only help financially constrained firms; it must also contribute to positive externalities such as job creation, environmental protection, and critical infrastructure, and promote exports.

It is equally important that private sector operations are a source of internal financing for MDBs. These institutions therefore have an incentive to provide loans. This is reinforced by the reduction in the concessional financing of traditional donors. As a result, many MDBs are refocusing their efforts and use private sector operations to leverage resources and enhance the impact of their interventions through, for example, PPPs, or combining

[3] MDBs have similar criteria for Non-Sovereign operations which are: (a) the borrower is a private enterprise or an eligible public sector enterprise; (b) the proposed operation is commercially viable; (c) there is at least a good expectation of positive development outcomes, including strengthening opportunities for private sector development; and (d) the Bank has positive additionality (AfDB, 2014).

them with policy advice and budget support operations. This leads to the need for results tools and instruments to capture the results of private sector operations as MDB shareholders require public accountability. In practical terms, this means the introduction of development effectiveness indicators in the corporate score cards and the project cycle of private sector operations. The advantage of this approach is that MDB stakeholders can see the development impact of private sector operations and how it contributes to achieving the SDGs.

Challenges for measuring private sector development results

The need to improve development results reporting is part of a global trend to promote accountability and better manage the achievement of development outcomes. This includes not only MDBs, but also private sector companies – such as commercial banks and equity firms – which support the drive to report on social and environmental impact. This was part of the broader social corporate responsibility agenda, which started with the adoption in 2003 of the Equator Principles that were used to determine, assess, and manage environmental and social risk by the private sector (Morra and Rist 2009). In 2008, the Impact Reporting and Investment Standards (IRIS) were created by a group of leading investors. The standards were aimed at improving consistency, transparency, and credibility in how funds define, track, and report on social and environmental performance. The IRIS indicators and standards are also used by the Inter-American Development Bank (IaDB, 2012; IaDB, 2013).

The challenge for Monitoring and Evaluation (M&E) systems for private sector operations is that they have traditionally been focused on tracking financial performance and risk management. More fundamentally, MDBs need to strike a balance between long term financial stability and national development objectives, on the one hand, and

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the short term financial objectives of their client companies that they fund, on the other hand (IEG-World Bank, 2012). It should also be emphasized that some investment instruments – for example, unfunded risk participation – do not have clear development objectives or a clear theory of change. This is in contrast with public sector operations which generally emphasize development outcomes, while risk management is considered less of a challenge.

Only in the beginning of the 21st century did some MDBs emphasize development – or in the case of the EBRD transition – outcomes of private sector operations. These monitoring systems have often been used to track socioeconomic and environmental issues as part of a broader safeguard policy, but not necessary development effectiveness. The difference is that safeguard policies focus on minimizing the possible negative effect of investments in the project area on people and the environment, while development effectiveness emphasizes the macro level impact such as reducing electricity prices for households, improving revenue generation for the government and increasing competitiveness of businesses. Despite some progress there are still challenges in gathering the necessary data from client firms that receive MDB financing. Often the internal audit and monitoring systems are geared toward the tracking of financial performance, risk management and if need be, safeguard policies. However, private sector companies rarely track development effectiveness and this imposes additional operational costs for data collection.

The challenge for a comprehensive results monitoring system for private sector operations is in stark contrast with the one for public sector operations that have coherent and comprehensive systems for collecting, tracking and measuring development impact. This is also easier because in general public sector operations' overarching goal is to achieve development outcomes, rather than financial performance and risk management. Moreover, at the national level, public sector operations are often integrated in national development plans and assessed by national M&E frameworks. With the global trend of leveraging private sector development as highlighted by the Financing for Development conference in 2015, the national M&E frameworks will likely gradually evolve and monitor the development impact of private sector operations.

Tracking the development effectiveness of private sector operations will therefore become more important in the near future. This can only be done efficiently by focusing on a few key development indicators that will limit financial costs for client firms. The advantage is that such a system will generate information for strategic planning, improve development impact, increase the efficiency of business processes and enhance accountability and learning. Moreover, the basic data enhances the understanding of the contribution or limitation of the private sector operations in achieving overarching development objectives or addressing externalities.

Tracking private sector development effectiveness indicators

MDBs have improved the tracking of the development effectiveness indicators of their non-sovereign operations in the last decade – with the paradigm shift towards leveraging resources and supporting development outcomes through private sector operations. Different results tools have been integrated in the corporate reporting system and in the in various stages of the project cycle. A review of the results reporting systems

and tools of MDBs[4] highlights the following issues and trends:

- **Corporate scorecards and results reporting.** Corporate scorecards are macro indicators that are used at corporate level to report on results and track progress on strategic priorities. They are also used as accountability tools to report to shareholders on achievements by MDBs. An effective reporting system requires an IT platform to ensure that results are not only reported at completion but can also be tracked during implementation of projects. Both the EBRD and IFC – through the Transition Impact Monitoring System (TIMS) and the Development Outcome Tracking System (DOTS), respectively – have implemented systems for "live" reporting of results (EBRD, 2013; IFC, 2011). MDBs with a large public sector portfolio – such as the AsDB, AfDB and

[4] African Development Bank (AfDB), Asian Development Bank (AsDB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), International Finance Corporation (IFC) and Inter-American Development Bank (IaDB)

IaDB – generally use the same development effectiveness indicators for public and private sector operations in their corporate scorecards. The advantage of this approach is that it allows the tracking of common indicators as part of a "One Bank" system with the objective of fostering synergies.

- **Harmonization of development effectiveness indicators for private sector projects.** Indicators used to monitor development effectiveness through the project cycle should be similar to the ones in an institution's corporate scorecard. Despite the specific mandates of MDBs, there are attempts to harmonize private sector indicators among 25 MDBs and other financial institutions under the Harmonized Indicators for Private Sector Operations (HIPSO) initiative. This initiative proposes to integrate 38 indicators across 15 different sectors among all institutions (MoU, 2013). Equally important is the harmonization of indicators with private sector financiers that are applying the IRIS indicators. As mentioned above, a good example is the IaDB, which already applied the IRIS in their operations (IaDB, 2012, 2013). The harmonization of indicators is important as private sector financing is often undertaken jointly with MDBs and other commercial banks and will therefore limit the costs for client companies that they would otherwise be obliged to monitor and report on.

- **Ex-ante simulation of project's development impact.** The EBRD and AfDB are the only institutions that undertake an ex-ante simulation of the likely outcomes and additionalities of operations prior to Board approval. In practice, this means that their respective economic research departments undertake an independent assessment and simulation of the likely development impact of private sector operations, in terms of, for example, job creation, government revenue or competitiveness. Other MDBs have a more limited approach and the assessment is undertaken by the appraisal teams themselves. The advantage of the ex-ante simulation, which is undertaken by the independent research department, is that it provides comfort to the Board that private sector investments will indeed have a positive development impact.

- **Indicators in project appraisal reports.** Most MDBs have a pre-defined set of indicators that should be integrated in the appraisal reports based on generic sectors such as financial services, infrastructure, manufacturing, etc. In short, investment officers have to select some of the development effectiveness indicators from a set "menu" alongside more customized indicators directly related to the project. The EIB is the only institution that has indicators by specific financing instrument. The challenge is that there is a trade-off between relevance and standardization of indicators in results monitoring. On the one hand, relevant indicators are often specific to individual projects, but will be difficult to aggregate at corporate level. On the other hand, standardized indicators are key to track progress at corporate level, but are not necessarily relevant for the project.

- **Tracking of progress during implementation.** Ideally, the monitoring of the development effectiveness indicators that were identified at

appraisal should be tracked during implementation. The EBRD tracks the same indicators identified ex-ante by the independent research department, while most other MDBs monitor the indicators as identified in the results log-frameworks. These development effectiveness indicators are subsequently tracked alongside financial performance and risk indicators in the extended supervision reports which are normally undertaken every year. The IFC's DOTS, undertakes annual surveys on the active portfolio of the private sector and these results feed into their corporate scorecard. The challenge for investment officers is that client companies sometimes do not always have sufficient human or financial resources to track all the necessary development indicators adequately.

- **Results reporting at completion. At completion,** MDBs undertake an internal assessment of the achieved development and financial performance of projects, which is part of the extended supervision reports. These reports are generally prepared 18 months after the last disbursement and when the final audit reports have been received. Often these assessments focus on outcomes and outputs. Impact evaluations are undertaken selectively by an independent department often because of the time and costs involved in conducting these evaluations. Only the EIB systematically undertakes an impact evaluation five years after the initial extended supervision reports.

Conclusion and emerging issues

In line with the global trend to leverage private sector investment to enhance development effectiveness, many MDBs are improving the tracking of development effectiveness indicators, both at corporate level and in the project cycle. Some MDB results reporting systems are comprehensive, automated and track development effectiveness indicators through the whole project cycle; others have their independent research departments only undertake ex-ante simulations on likely impact. A review of the various approaches taken by various MDBs to integrate development effectiveness indicators highlight the following observations and emerging trends:

- First, the EBRD is the only institution that has completely integrated development and transition effectiveness indicators throughout the whole project cycle. The TIMS tracks the same indicators that were identified in the ex-ante simulation assessment in the annual supervision and completion reports. Indeed, the EBRD had already designed methodology in 1997 and integrated it in its operations in 2003 (Perry, 2011). The reason for being the "first" is most likely that the EBRD is solely focused on private sector operations and was only established in 1991 and therefore did not have any institutional or policy legacy issues. The advantage of this completely integrated approach is that the ex-ante simulation can gradually be improved as there is a system of feedback on the actual realized results at completion. This is one of the

limitations of the AfDB's current ex-ante ADOA system, which only focusses on ex-ante simulation without looking at the actual impact during implementation or completion.

- Second, there are clear attempts to harmonize private sector indicators among public and private sector financial institutions. This is evident from both the HIPSO and IRIS initiatives that aim at a common set of indicators so that client companies are not burdened by the different reporting requirement of different MDBs and private financiers. This is all the more important as private transactions often include various MDBs and commercial banks. At the corporate level, this also means that indicators will be similar among MDBs.
- Third, private sector projects should have indicators at impact, outcome, output and input levels. This would demonstrate the "theory of chain" in projects. However, some MDBs – such as the DOTS of the IFC – have opted to implement systems that track only outputs and outcomes. Most likely this is linked to the fact that the DOTS is an annual survey that "extracts" results from the active portfolio, which is time-consuming for individual investment officers and client companies. This is less of a challenge if these development effectiveness indicators are integrated in the extended supervision reports, which means that they are tracked at the same time as financial performance and risk monitoring of the project.
- Fourth, there needs to be a balance between the standardization of indicators for corporate reporting and the needs for flexibility to tailor-make indicators when projects are designed. Corporate reporting requires a few indicators that can be easily aggregated, while project level indicators require flexibility to ensure that they are relevant. Any reporting system will therefore need to have a mix of mandatory and non-mandatory indicators.

These emerging issues will have to be considered to ensure that development effectiveness indicators are adequately tracked both at corporate level and in the project cycle of private sector operations. This will lead to a more effective and efficient leveraging of private sector operations by MDBs with the ultimate objective of achieving the SDGs.

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Author's Profile

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