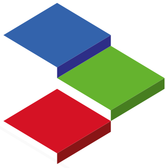

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Do Lines of Credit Attain their Development Objectives?

An Evaluation Synthesis 2010-2017

AFRICAN DEVELOPMENT BANK GROUP

November 2018

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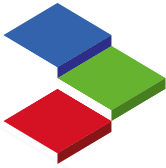

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ACKNOWLEDGMENTS	
Task manager	**Albert-Enéas Gakusi,** Chief Evaluation Officer
Team members	**Mohamed Coulibaly, Laura Delponte,** Evaluation Consultants
Internal peer reviewers	**Akua Arthur-Kissi,** Senior Evaluation Officer and **Khaled Samir,** Principal Evaluation Officer
External peer reviewers	**Nicholas Burke, John Eriksson**
Internal Bank reference group	**Stefan Nalletamby, Mohamed Kalif, Samuel Mivedor, Yaw Kuffor, Mohamed Ndiaye, Mohamed Rachid, Karine Nadege Gondjout, Ahou Eleonor Catherine Brou, Tijani Babatunde, Dennis Ansah, Hachem Rajhi**
Knowledge management officers	**Magdaline Nkando,** Knowledge Management Consultant and **Aminata Kouma,** Junior consultant, Knowledge Management and Communication
Other assistance/contributions provided by	**Karen Rot-Münstermann, Madhusoodhanan Mampuzhasseril, Ruby E. Adzobu-Agyare, Henda Ayari, Blandine A. Gomez**
Special thanks to	**Tim Turner, Josselyne Ahogny, Thouraya Triki, Cecile Ambert, Louis Kouakou, André Portella, El-Hadj Mamadou Bah, Somen Dash, Magor Ndiaye, Mansour Hamza, Mbaye Gueye, Hervé Zouzou, Haithem Karoui, Silke Müffelmann, Nathalie Le Denmat, Thomas Gietzen, Céline Payet, Emmanuel Haye, Estelle Lahaye, Corinne Riquet – Bamba, Augustin Adom Kouadio, Philippe Luhata Mutombo, Samuel Blazyk, Gloria Uwingabiye**
Division manager	**Foday Turay** (Officer in Charge)
Evaluator-General	**Rakesh Nangia** (Retired); **Karen Rot-Münstermann** (Acting)

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The overarching objective of the African Development Bank Group is to spur sustainable economic development and social progress in its regional member countries (RMCs), thus contributing to poverty reduction. The Bank Group achieves this objective by mobilizing and allocating resources for investment in RMCs and providing policy advice and technical assistance to support development efforts.

About Independent Development Evaluation (IDEV)

The mission of Independent Development Evaluation at the AfDB is to enhance the development effectiveness of the institution in its regional member countries through independent and instrumental evaluations and partnerships for sharing knowledge.

Independent Development Evaluation (IDEV)

African Development Bank Group
Avenue Joseph Anoma, 01 BP 1387, Abidjan 01, Côte d'Ivoire
Phone: +225 20 26 20 41
E-mail: idevhelpdesk@afdb.org
idev.afdb.org

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Contents

Acknowledgments ii
Abbreviations and Acronyms v
Executive Summary 1

Introduction 7

Context of the Evaluation Synthesis 7
Objectives and Scope of the Evaluation Synthesis 8
Methodology and Limitations 8

IFIs' Development Objectives and Delivery Channels of LOCs 9

Clarification of the Concept of LOCs 9
Intervention Logic of LOCs 10
LOC Delivery Channels 10

Overview of AfDB's Assistance Through LOCs 15

Policies and Strategies 15
Trends, Structure and Coverage of the Operations 16

LOCs Monitoring and Evaluation Challenges 23

Inadequate Information Collection and the Problem of Attribution 23
LOC Design Approaches 24
AfDB's Experience with the Monitoring and Evaluation of LOCs 26

Performance of LOCs 27

Relevance 27
Design of LOCs 28
Effectiveness 30
Efficiency 34
Sustainability 34
Environmental and Social Standards 35

Conclusions 39

Points for Consideration by IFIs 43

Annexes 47

Contents

List of figures

Figure 1 :	The Intervention Logic Model of LOCs	11
Figure 2 :	LOCs Intervention Channels	11
Figure 3 :	AfDB's LOCs Delivery Channels, 2000-2017	13
Figure 4 :	Geographic Distribution of the Approval for LOCs, 1969-2017	19
Figure 5 :	Pipeline Approach vs Portfolio Approach	24

List of tables

Table 1 :	Advantages and Disadvantages of LOCs Delivery Models	14
Table 2 :	LOCs in AfDBs' Private Sector Policies and Strategies	15
Table 3 :	Amount Approved for LOCs, 1969-2017	17
Table 4 :	Amount Approved by Financial Sector Instruments	17
Table 5 :	Country Coverage, 1969-2017	18
Table 6 :	Geographical Distribution of LOCs	20
Table 7 :	Trends in Approvals of LOCs in AfDB, EIB and IFC, 2008-2017	20
Table 8 :	Summary of Reasons for Cancellation of LOCs in 2000-2016	21
Table 9 :	Advantages and Disadvantages of the Two Approaches	25
Table 10 :	SME Definitions Adopted IFIs	29
Table 11 :	Expected LOCs Benefits for FIs	31

List of boxes

Box 1 :	AfDB's Experience in Supplying LOCs to Regional Development Banks	12
Box 2 :	SME Targeting in the AfDB LOCs	30

Abbreviations and Acronyms

ADB	Asian Development Bank
ADOA	Additionality and Development Outcome Assessment
AFD	Agence Française de Développement
AfDB	African Development Bank
CGAP	Consultative Group to Assist the Poor
EBRD	European Bank for Reconstruction and Development
ECG	Evaluation Cooperation Group
EIB	European Investment Bank
EIFI	European Development Finance Institutions
E&S	Environmental and Safety Standards
EU	European Union
FAPA	Fund for African Private Sector Assistance
FIs	Financial Intermediaries
IADB	Inter-American Development Bank
IFC	International Finance Corporation
IFIs	International Financial Institutions
LOCs	Lines of Credit
M&E	Monitoring and Evaluation
MSMEs	Micro, Small and Medium Enterprises
PFIs	Private Financial Institutions
PROPARCO	Promotion et Participation pour la Coopération Économique
REC	Regional Economic Community
SEMS	Social and Environmental Management Systems
SME	Small and Medium Enterprises
SONATEL	Société Nationale des Télécommunications / Senegal

Executive Summary

Context, Objectives and Methodology

This evaluation synthesis (the synthesis) was prepared in response to a request made in February 2017 by Board members of the African Development Bank (AfDB) to be informed on the performance and effectiveness of the lines of credit (LOCs) extended by AfDB, in the context of an increasing volume of LOCs approvals. The Independent Development Evaluation (IDEV) has prepared this evaluation synthesis covering IDEV's past evaluations and those of peer institutions both to respond to the request and to contribute to the evaluation knowledge in this area.

LOCs are long term loans, either in local or hard currency, provided by an International Financial Institution (IFI) to a Financial Intermediary (FI) for on-lending to their customers, also referred to as sub-borrowers, or end-beneficiaries. These LOCs aim to improve access to finance for the private sector by enhancing the financial and technical capacity of FIs. However, because of the lack of well-documented impact on development, they have become the object of increasing scrutiny in recent years.

By looking at 12 recent evaluations of LOCs, this synthesis assesses the extent to which LOCs are a relevant, cost-effective, and sustainable instrument in increasing access to finance and fostering inclusive growth. It suggests points for consideration by IFIs which employ LOCs in terms of design, implementation and evaluation.

The synthesis builds on: (i) findings from evaluations of LOCs carried out by IFIs between 2010 and 2017, and from a broader literature review of relevant publications; (ii) interviews with subject-matter experts both within and outside AfDB; (iii) focus group interviews with AfDB's task managers and higher-level managers; and (iv) an internal workshop with the staff from the Financial Sector and the Private Sector Development Departments, the Additionality and Development Outcome Assessment Division of the Chief Economist Complex, and Treasury Risk Management, organised on June 5, 2018, to present and discuss emerging findings and the points worthy of further consideration.

Findings

Evaluations reviewed and subject-matter experts interviewed in operational departments of AfDB, AFD, and PROPARCO, consider LOCs to be relevant for IFIs and client FIs. The relevance of LOCs to the end beneficiaries is more open to debate. LOCs are well aligned with IFI strategies for private sector and financial sector development. LOCs are considered by IFIs to be an appropriate instrument for reaching a large number of beneficiaries in underserved market segments, while also keeping project origination and supervision costs at an acceptable level, for the following reasons:

- Most IFIs have a limited field presence and transactional capacity on the ground within their countries of operations, which makes the use of financial intermediation necessary.
- By working through financial intermediaries, IFIs can leverage their budgetary resources with those of other IFIs, or private investors, and take advantage of FIs' knowledge of the local market.
- LOCs can also be used flexibly to pursue different development objectives and can be easily combined with other support measures utilizing FIs.

- The individual financing needs of the large majority of micro, small and medium-sized enterprises (MSMEs) are lower than the direct-lending thresholds of most IFIs.

- LOCs are financially profitable for the IFIs and contribute to their financial sustainability, while limiting their risk exposure, which does not extend to the individual sub-loans

LOCs respond to the FIs' need to secure long-term loans. The literature emphasizes that the demand for LOCs is driven by the need of FIs to secure long-term loans, given that in most developing countries bank financing is limited to providing short-term loans. However, to minimize the risks, IFIs often favour larger commercial banks or subsidiaries of international banking groups.

The relevance of LOCs to the end-beneficiaries is more open to debate. Evaluations show that, in the design of LOCs, it can be a challenge to find a balance between achieving risk and profitability in IFIs and client FIs on the one hand, and providing financial services to underserved but riskier market segments on the other hand. The selection of client FIs is driven by a need for fiduciary integrity, due diligence, and credit-risk considerations. This has typically led to the prioritizing of top banks and more developed financial systems, thereby reducing the potential for LOCs additionality. For this reason, CGAP and some evaluations, including those of AfDB, question whether LOCs are the most appropriate instruments for addressing financial access constraints for underserved market segments, including MSMEs.

The design of LOCs is often not underpinned by sufficient analytical work. The use of LOCs is generally justified by the need to address market failures in financial markets, but evaluations indicate that most LOCs designs are not underpinned by sufficient analytical work to carefully explore the constraints to access to finance for specific market segments in specific country contexts. The selection of the partner FIs does not always match well with the LOCs' intended objectives. This happens, for instance, when LOCs targeting the SME market are provided to FIs that have little commitment, or no strategy, to operate in such markets. The eligibility criteria for sub-loans are based on definitions of what is an SME, which differ from one IFI to another IFI, implying that client FIs receiving funds from several IFIs need to use different parameters to identify their SME client base in each case. LOCs also lack consistent metrics for measuring and reporting development impact at both the levels of the FIs and of the sub-borrowers. This poses an obstacle to drawing robust conclusions on the development impact of LOCs.

The effectiveness of LOCs is often questionable because information at the end-beneficiary level for analysing the development results through the evaluation criteria are missing. A common challenge in LOCs evaluations is the lack of reliable and complete information on LOCs sub-borrowers, and the difficulty of attributing development results to LOCs. Because money is fungible and FIs raise funding from several sources, it is not possible to trace to the end-beneficiary level. Most IFIs have adopted a portfolio approach, which consists in setting expectations and tracking changes in the composition of client FIs' portfolios, and determining to what extent the LOCs provided have induced the desired changes in sectors or themes agreed upon with the FIs. This, however, does not address the daunting task of attributing the impact to LOCs at the end-beneficiary level. This is also the case with the pipeline approach (also called the projects list) applied by some IFIs, including AfDB.

Impact on FIs. The main impact of LOCs is to provide FIs with long-term loans to on-lend to sub-borrowers. While the reviewed evaluations conclude that FIs are able to achieve better financial performance, such as profitability, diversification of sources of funding, mitigation of liability maturity mismatches, capital adequacy and asset quality, the attribution of these impact to LOCs remains difficult, especially when an LOCs is provided to a large FI in which the LOCs only accounts for a small percentage of the FI's total long-term liabilities. This finding is also applicable to non-financial performance, including improved internal procedures and corporate governance.

Impact on end-beneficiaries. There are no reliable data on the impact of LOCs on the final beneficiaries in terms of improved profitability or employment levels. Similarly, there are no data on the impact of green LOCs on energy efficiency and energy consumption. This is because: (i) FIs typically do not collect data on the impact of their loans; (ii) FIs do not have management information systems in place to perform such tasks; and (iii) the IFIs exercise poor oversight during LOCs disbursement.

Impact on countries' financial systems. The attribution of impact to LOCs is not possible, especially when they are delivered to middle- or upper middle-income countries. Attribution is only really possible when a financial market is severely undersupplied with credit. Thus far, the impact of LOCs in promoting financial inclusion in terms of extending access to financial services to unbanked people still has to be demonstrated. Neither has the capacity of LOCs to introduce financial innovation in FIs been documented.

The efficiency of LOCs is satisfactory when measured in terms of LOCs profitability for the IFIs, disbursement rates, and time. LOCs positively contribute to the performance of IFIs' portfolios by increasing their margins and reducing risk, which also creates strong internal incentives in favour of LOCs. LOCs can be more cost-effective than other instruments because they allow the packaging of a large amount of financial aid into a limited number of operations that are then channelled through existing institutions that do not require the setting-up of separate administrative systems. However, there is a trade-off between LOCs efficiency, and the rigour of eligibility criteria and oversight requirements. Disbursement of an LOCs is more rapid when eligibility criteria are broader. As a result, the tightening-up of eligibility criteria and controls can significantly slow down the delivery of LOCs.

The sustainability of LOCs is not well investigated in the literature. This is linked to the difficulties in assessing LOCs effectiveness at the end-beneficiary level. But it is also due to the fact that the concept of sustainability deals with the likelihood of development impact that continue after the closure of a project and the withdrawal of the IFI. This requires some forward-looking analysis to be conducted, at the same time as the IFI has ceased to earn any revenue from the project and is seeking to redeploy its funding elsewhere. Hence, there is little incentive to address the issue of sustainability beyond some fairly perfunctory statements recording the status quo at the time of closure.

Enforcement of environmental and social standards considerations is problematic. While the vast majority of countries have adopted environmental, social, health and safety standards in line with those of IFIs, the quality and consistency of enforcement of the standards remain a problem. Inadequate monitoring and reporting on the effective implementation of such standards are a source of issues relating to the accountability and transparency of LOCs. They also can lead to significant reputational damage to the IFIs.

Points for Consideration

The reporting obligations on development results. IFIs need to be more accountable and transparent in their reporting on LOCs effectiveness. IFIs should also be more proactive in holding FIs to account for reporting on LOCs development objective obligations. This implies improving the assessment capacity of the FIs to deploy LOCs in accordance with the IFIs' target beneficiaries.

Ex-ante scrutiny of the business case for LOCs approvals. IFIs need to underpin the rationale and design of LOCs by analytical work to make more realistic assumptions about how LOCs will contribute to improving access to finance for underserved market segments. IFIs' funding additionality to the market needs to be determined, implying that LOCs should primarily go to FIs that cannot easily obtain such funding elsewhere. Second, IFIs should tighten up LOCs covenants to identify eligibility criteria that can be consistently implemented by the

partner FIs and are aligned to the LOCs objectives. Finally, the selection of FIs should be based on clearly determined parameters that measure the commitment and performance of an FI in serving a specific market segment.

Resources for other instruments to address the binding constraints of the demand-side of access to finance, in parallel with the LOCs. LOCs are not sufficient on their own to create an efficient and effective financial intermediation system to support private sector development. Evaluations emphasize that LOCs require complementary measures provided to the partner FIs. Technical assistance could be used to help FIs to enter new market segments, such as green lending, to assess the risk of lending to MSMEs, and to fulfil their reporting obligations. For instance, Technical Assistance (TA) accompanying green LOCs could develop standardized financial products for supporting energy-saving investments. In parallel with LOCs, it is imperative for IFIs to promote and support reforms of the regulatory environment of financial systems, and of the financial information system, for instance in setting up effective credit bureaus.

The need for an effective monitoring and evaluation (M&E) system. Overall, it is important to address LOCs transparency and accountability problems. Reporting requirements on sub-loan and sub-borrower performance should be defined ex-ante and followed through closely during the disbursement of sub-loans. More effective checks are needed to verify that funds are used as originally agreed. Evidence shows that eligibility criteria alone will not give the IFIs assurance on the desired deployment of LOCs. It is necessary to identify key performance indicators that better reflect what can be reasonably monitored and attributed to LOCs without overburdening the client FIs with administrative requirements. In parallel, FIs need to receive adequate assistance to ensure that they can set up management information systems (MIS) that produce information on development results at the sub-borrower level. Finally, it is important to consider that conducting more proactive supervision will have an impact on the cost-effectiveness of LOCs from an IFI perspective. IFIs could consider using new information and technology tools using mobile phones to collect information on outputs, outcomes, and impact directly from end-beneficiaries.

IFIs' capacity. Staff competence requires strengthening expertise in: (i) banking and the private sector on financial needs and how to address them; (ii) ex-ante assessment, including compliance with E&S standards within FIs; and (iii) monitoring and evaluation. As part of the IFIs' due diligence on their FIs, IFIs' investment officers should carefully screen FIs' existing portfolios to identify areas of the highest value-added and where to intervene. To this end, IFIs need to carry out economic and sector work on the financial sector to develop a solid understanding of the needs and how to address them. For AfDB, this will require increased collaboration between investment officers of the financial sector department and country economists in analysing local financial markets.

Harmonizing of IFIs' approaches towards LOCs. As one FI might partner with more than one IFI, harmonization of procedures would be beneficial in reducing transaction costs for beneficiary FIs. Because the IFIs' monitoring requirements can add a substantial administrative burden to FIs, IFIs should work with a shared definition of what constitutes an SME and apply the same indicators for the M&E of LOCs outcomes at the sub-borrower level. There is a need to support initiatives to harmonize SME definitions among stakeholders to facilitate the collecting and comparing of data (Dalberg, 2011).

Pipeline approach vs portfolio approach. Good practice in providing LOCs still needs to be prepared to guide investment officers in their daily work. A portfolio approach is appropriate in assessing whether an LOCs has had any impact on an FI business model entering new market segments. The portfolio approach also tends to reduce administrative costs for both FIs and IFIs. The portfolio approach is based on assessing changes in the composition of an FI's portfolio following the implementation of the LOC. The attribution problem can be overcome by benchmarking data on the trends of the market segment of the portfolio of an FI that has received an LOCs with data from a comparable FI that did not receive an LOC. The evaluations reviewed by this synthesis did not show any evidence that the portfolio approach was superior to the pipeline approach in measuring development outcomes of LOCs at the end-beneficiary level. A further study to determine when to use either approach is therefore recommended.

Environmental and social standards considerations. IFIs should ensure that, where required, the client FIs have appropriate and effective environmental and social management systems in place, and the necessary capacity for E&S monitoring and compliance at the sub-borrower level.

Communication of the LOCs lending policy. IFIs are advised to widely communicate their LOCs lending policy, which would help to foster competition between FIs and provide information to MSMEs to make them aware of the IFIs' LOCs funding policies. This should contribute to better results in terms of complying with loan covenants and the development results at the end-beneficiary level.

Dealing with fragile situations. The analysis of the portfolio of AfDB over the period 1969-2017 shows that 11 countries out of 54 were never provided with LOCs, and that 17 countries did not use LOCs instrument after 2000. Most of those countries were small in size and were coping with the challenges of fragile situations. The objective of universal access to finance implies that IFIs should find ways to extend their financing instruments to MSMEs in fragile situations, including by supporting microfinance bank branches (Horus Development Finance, 2014; AfDB, 2015). This would require reviewing non-sovereign operations guidelines to accommodate more high-risk situations.

Introduction

Context of the Evaluation Synthesis

This evaluation synthesis (the synthesis) was prepared in response to a request by the African Development Bank (AfDB)'s Board members, on February 21, 2017, to be informed of the performance and effectiveness of lines of credit (LOCs) extended by AfDB, given the increasing volume of LOCs approvals. Because the Independent Development Evaluation (IDEV) had recently completed several evaluations relating to LOCs (Annex 1) and the implementation of their recommendations was recent, IDEV proposed to prepare an evaluation synthesis covering IDEV's past evaluations and those of peer institutions.

The use of LOCs by International Finance Institutions (IFIs), as well as of other financial instruments delivered through Financial Intermediaries (FIs), has been increasingly questioned across the development community because of the lack of well-established and documented impact on development, including access to finance and job creation, together with poverty reduction and inequality alleviation (Beck, Demirgüç-Kunt and Levine, 2005; Dalberg, 2011; Bertrand Savoye, 2013).

The concerns of Board members are reflected in the findings of several evaluations that have identified the following issues:

- LOCs are just one of the many instruments employed by IFIs to support access to finance and private sector development objectives. The largest body of evidence on the performance of LOCs is dispersed in evaluations addressingIFIs' work with FIs including SME-related assistance, non-sovereign operations, and financial inclusion. Therefore, there is limited evaluative evidence focusing solely on the performance of LOCs.

- The use of LOCs incurs problems of transparency and weak accountability for the results. As the development impact of LOCs is delivered through FIs and, in turn, the sub-borrower enterprises, their development impact are difficult to assess. This is compounded by a lack of adequate monitoring and evaluation (M&E), and poor reporting by the FIs and the IFIs.

- The lack of consistent metrics for measuring and reporting development impact at both the levels of the FIs and the sub-borrowers is also an obstacle to the drawing of general and robust conclusions regarding the development impact of LOCs.

- It has been noted that IFIs' commitments to financial markets through LOCs are too skewed towards strengthening the supply side, with unclear implications for improving financial inclusion (CGAP, 2017; ADB, 2013).

- Several evaluations highlight the possibility that LOCs crowd out other domestic sources of financing and that they can lead to macroeconomic imbalances and over-indebtedness in foreign currencies (Eurodad, 2014). Distortionary effects on domestic finance markets can also occur, especially when IFIs predominantly partner with larger commercial banks or subsidiaries of international banking groups (IaDB, 2016).

Objectives and Scope of the Evaluation Synthesis

The objectives of this evaluation synthesis are twofold:

- Highlight and disseminate good practice from the experience of AfDB and peer institutions regarding the extent to which LOCs achieve their objectives, such as strengthening the financial sector, and improving access to finance for MSMEs and other underserved market segments[1].

- Draw strategic and operational lessons to inform the design and implementation of AfDB LOCs going forward.

This synthesis responds to the following guiding evaluation questions:

- To what extent are LOCs a relevant instrument for increasing access to finance and fostering inclusive growth?
- To what extent do LOCs attain the intended development objectives in a cost-effective and sustainable way?
- What lessons can be learnt for improving AfDB's financial strategy and operations in terms of design and implementation of LOCs?

The synthesis investigates the use of LOCs in AfDB and in other IFIs operating in Africa from the existing evidence in evaluations carried out in the period 2010-17. It also provides the context of AfDB's own LOCs activities through the presentation of how LOCs feature in AfDB's relevant strategy documents, as well as a review of the trends and structure of LOCs in its portfolio.

Methodology and Limitations

This synthesis draws on the following:

- Findings from 12 selected recent evaluations (Annex 4);
- A literature review covering IFI policy, strategy and procedural reports that provide additional insights on LOCs objectives and business models in terms of design, management and organisational aspects (Annexe 4);
- An analysis of AfDB's LOCs portfolio;
- Three focus groups with AfDB's investment officers; individual interviews with task managers, higher-level managers and other subject-matter experts in AfDB;
- Interviews with LOCs experts of l'Agence Française de Développement (AFD) and its subsidiary La Promotion et Participation pour la Coopération Économique (PROPARCO), and discussion with experts at the Frankfurt School of Finance & Management, and the Consultative Group to Assist the Poor (CGAP); and
- A workshop organized with AfDB's LOCs experts held on June 5, 2018, to discuss emerging findings and conclusions.

A detailed checklist of evaluation questions used to collect relevant information on the evaluation criteria of relevance, effectiveness, efficiency, impact and sustainability of LOCs, is provided in Annex 2, which presents a comprehensive methodology note of the synthesis.

There are limits to any synthesis stemming from the existence of only a limited number of evaluations focusing on LOCs. Also, by definition, the synthesis depends on the quality of the evaluation reports selected. However, the evaluation findings were complemented by information collected through: (i) a literature review of IFIs' policies, strategies, and procedures that provide additional insights into LOCs objectives and business models in terms of design and implementation models; and (ii) interviews conducted with task managers, higher-level managers, and other subject-matter experts both inside and outside AfDB.

IFIs’ Development Objectives and Delivery Channels of LOCs

Clarification of the Concept of LOCs

LOCs are a form of intermediation whereby an IFI provides a loan to an FI for on-lending to sub-borrowers based on criteria, which are defined in the LOCs agreement. For this financing arrangement, the FIs bear the credit risk of the sub-loans, whereas the IFIs bear the credit risk of their loans to the FIs. In some cases, the IFI may provide a global or a partial guarantee for the sub-loans, and therefore in this case the IFI bears direct exposure on the sub-borrowers.

The FIs are usually local private commercial banks or local subsidiaries of international banking groups, although the IFI sometimes also intermediates its funding support through national or regional development banks. While the LOCs and the related sub-loans are intended to be priced in line with typical risk-weighted, market-based criteria, the IFIs may provide concessional support in the form of subsidised technical assistance where this is delivered to national or regional development banks, or microfinance organisations. This subsidised TA can help build capacity in the FIs in the areas of credit control and portfolio management, management information systems (MIS), reporting and transparency, corporate governance, and social and environmental management systems (SEMS).

LOCs are one of several financing instruments of IFI interventions that provide access to finance for the private sector through financial intermediaries[2]. LOCs are long-term loans, either in local or hard currency, provided by an IFI to a participating FI for on-lending to their customers. The terms of LOCs define the conditions under which the IFI funding is to be provided to the FI. These can include sub-loan maximum and minimum size thresholds, and/or the types of borrower or project to be financed (AfDB, 1998). Eligibility criteria for the sub-loans are attached to LOCs to ensure that these are used to pursue the intended development objectives. Participating FIs can either be commercial banks, microfinance banks, housing finance institutions, trade-finance bodies, national or regional development banks, and agricultural credit providers. LOCs are a liability for the intermediary organisation (i.e., the FI) that is responsible for reimbursing interest and principal to the IFI, in accordance with the loan agreement.

LOCs are considered by IFIs to be a cost-effective mechanism for reaching a large number of beneficiaries in underserved market segments, while also keeping project origination and supervision costs at a low level. By targeting a limited number of financial institutions in developing countries, IFIs can provide support while minimizing their transaction and administrative costs. Most IFIs have a limited field presence and transactional capacity on the ground within their countries of operations, which makes the use of financial intermediation necessary. The individual financing needs of a large majority of MSMEs in developing countries are substantially lower than the direct-lending thresholds of most IFIs. Moreover, the use of LOCs is based on the hypothesis that IFIs lack the knowledge, appetite, or capacity to serve the MSME market segment. Furthermore, by working through FIs, IFIs can leverage their budgetary resources with those of other IFIs or private investors, and take advantage of FIs’ knowledge of the local market (World Bank, 2014; IaDB, 2016; EIB, 2017; AfDB, 2018). IFIs can also introduce a new asset class to the FIs (for example, untapped MSME borrowers) in which the FIs may have limited or no experience. However, this could entail providing additional resources and advisory support by the IFIs. Therefore, one rationale for LOCs is that the involvement of IFIs can help FIs to overcome their lack of interest in extending credit to MSMEs.

Most LOCs address constraints to finance for MSMEs, but LOCs can also be used for other development objectives, such as encouraging green growth and housing. LOCs can be targeted at MSMEs owned by women or located in rural areas, or to support green investments. These often have less certain returns and help address the need to develop specific financial products for energy-efficiency and carbon-reduction projects in developing countries. The financing of green projects is a niche market and, in some countries, FIs are willing to sponsor green projects for reputational reasons and to secure additional financing from IFIs (IADB, 2016).

LOCs are a source of significant and stable income for IFIs. In addition to potentially producing development results by financing MSMEs and corporates through the FIs, LOCs are profitable for IFIs and can contribute towards their financial sustainability (Dalberg, 2011; IADB, 2016; AfDB, 2018).

Intervention Logic of LOCs

The policy rationale for using LOCs rests on IFIs' strategies for private sector development or financial sector development, or both. LOCs are generally used to support: (i) the development of financial markets and institutions; and (ii) growth of real-sector enterprises that leads to job creation, economic growth and poverty reduction. These expected positive impact are related to the opportunities generated by expanding the availability of credit. A simplified intervention logic of LOCs is provided in Figure 1.

LOCs can also be used flexibly in combination with other support measures, such as TA and equity investment, to target FIs to pursue different development objectives. In addition to LOCs loans, IFIs can offer TA for capacity building. They can also provide support and interventions to strengthen the lending environment and thereby reducing the probability and impact of loan defaults by reducing the transaction costs to investors/lenders. This can be achieved by decreasing information asymmetry through investing in financial infrastructure, including well-functioning credit bureaus, to collect and support adequate and accurate information flows to foster the efficient functioning of markets (Dalberg, 2011; Thorne, 2011).

While it is not one of their stated objectives, LOCs also help in improving IFIs' staff understanding of banking and private sector financial needs, which should be considered as an outcome at the IFI level, in addition to increasing their profitability and financial sustainability (EIB, 2017).

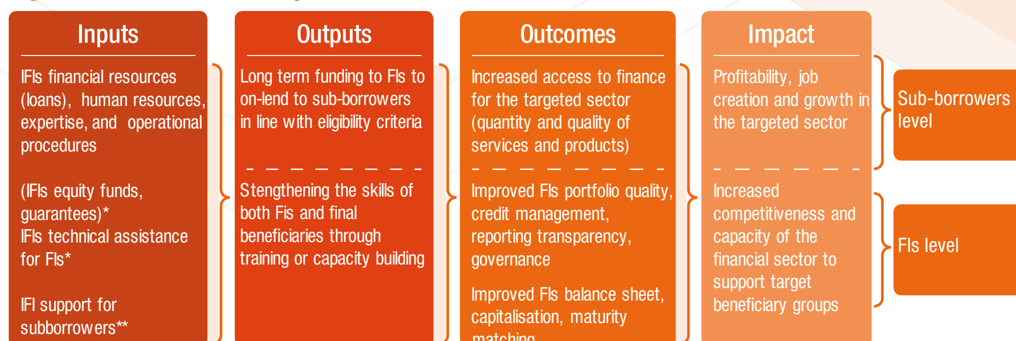
LOC Delivery Channels

LOCs can be disbursed through different channels depending on the specific objectives they pursue and the capacity of the IFs (Figure 2).

These include the following:

- LOCs can be channelled to commercial banks or microfinance institutions to on-lend to end-beneficiaries.
- LOCs can be delivered to development banks, either national or regional, that in turn on-lend to a number of selected FIs or directly to end-beneficiaries. LOCs to commercial banks are usually non-sovereign operations, while those provided to development banks tend to be supported by a sovereign guarantee.
- LOCs can also be provided through MSME programs or umbrella operations with delegated approval to streamline individual LOCs approvals and disbursements.

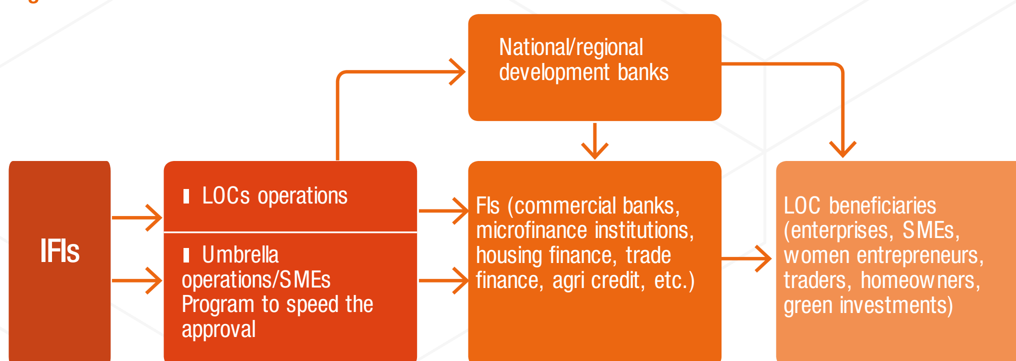
Figure 1 : The Intervention Logic Model of LOCs



* Additional products and services that can be attached to a LOC.

** Rarely provided.

Figure 2 : LOCs Intervention Channels



The increased use of LOCs by IFIs to support MSMEs has gained prominence since the end of the 1990s. LOCs are supposed to be cost-effective instruments for channelling support for private sector development, once the models based on direct financing of MSMEs through specific financing facilities proved to be unsustainable and unsuitable for achieving broader support to the MSME sector. Examples of these latter models include the IFC Africa Enterprise Fund and the Small Enterprise Fund. They proved to have very poor portfolio performance and delivered poor outcomes (IFC, 2008; World Bank, 2014).

There is some variation within this model, whereby an IFI can appoint another party as an agent responsible for originating and transacting on its behalf, known as the "agency lines". The agency lines, in theory, addressed some of the transactional constraints for the IFI but, unlike an LOC, the loans would be direct agreements between the IFI and the end-beneficiaries. The challenge was in identifying an agent with the knowledge and capability to build a viable portfolio on the IFI's behalf (AfDB, 1998). AfDB's financial sector portfolio does not contain any agency line operations.

LOC delivery to national or regional development banks was more common in the 1970s and 1980s[3]. Many of these operations did not fulfil their original expectations, especially when the recipient development banks proved unable to ring fence their lending activities from political interference (Thorne, 2011). Results were reported to be positive only when substantial efforts were made to improve the

effectiveness and governance of these institutions. Box 1 below illustrates this situation from AfDB's own experience. As more commercially astute financial institutions started to emerge in developing countries towards the beginning of the 1990s[4], partnering with commercial banks has become preferable. Nevertheless, the third international conference on financing for development held in Addis Ababa in July 2015 called upon well-functioning national and regional development banks to expand their contributions in financing sustainable development, "particularly in credit market segments in which commercial banks are not fully engaged and where large financing gaps exist". It urged relevant international public and private actors to support such banks in developing countries (AAAA, 2015; Griffith-Jones, 2016).

Figure 3 shows that, during the period 2000-17, most AfDB LOCs were delivered through commercial banks and development finance institutions, comprising 32 national and 26 regional banks. Other financial institutions comprise infrastructure finance cooperation in South Africa, housing finance bank limited in Uganda, SME apex in Tunisia, and support for SMEs in Mozambique. Leasing operations are composed of a Tunisia leasing company, Mauritania leasing, Burkina Faso Fidelis Finance, Africa leasing company Cameroon, and Tunisia Hannibal leasing.

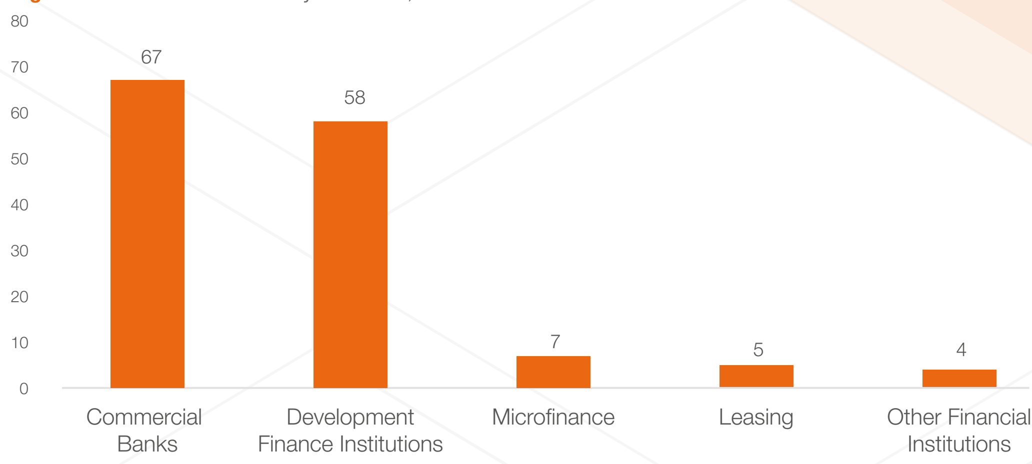
Box 1 : AfDB's Experience in Supplying LOCs to Regional Development Banks

In 2010, AfDB reviewed the LOCs delivered to the Eastern and Southern African Trade and Development Bank (PTA Bank), the East African Development Bank (EADB) and the Development Bank of Southern Africa (DBSA) over the period 1969 - 2008. This LOCs delivery modality furthers the mandate of AfDB to promote regional integration by supporting the development of intra-regional trade. The choice of development bank with which to partner is based upon their own mandate, which focuses on socio-economic development and poverty reduction. For instance, these banks are in principle more inclined to support businesses with higher development potential, albeit riskier from a credit standpoint, such as start-ups.

The review found that two banks (PTA and DBSA) improved their financial performance, while EADB performed poorly because of an internal governance crisis and weak risk management system. While the LOCs contributed to the improvement of financial performance, none of the partner banks tracked development indicators or reported them in their supervision reports. Borrowers were in principle required to provide quarterly management accounts to enable the assessment of performance, but this rarely happened. As a consequence, conclusions on the LOCs development outcomes are not underpinned by solid evidence and data are sometimes inconsistent. The review concludes that while 46 percent of funds were earmarked for SMEs, only 3 percent actually funded SMEs. It found that LOCs oversight in AfDB to be generally weak and most of the sub-projects reviewed did not comply with the Environmental health and Safety- related standards, despite declaring otherwise.

Source: AfDB, 2010. Unlocking the Potential of Africa's Sub-Regions. Review of Bank Group Assistance to Sub-Regional Development Banks.

Figure 3 : AfDB's LOCs Delivery Channels, 2000-2017



The so-called "umbrella operations" are used by the EIB. For this delivery model, the client FIs can be identified at the time of the approval of the operation, or at a later stage, either on a first-come-first-served basis (based on allocation requests submitted and approved), or on a contractual basis (each intermediary commits to borrow and allocate a specific share of the available funds). These facilities can be used in single countries, reaching out to a certain number of local banks, or can simultaneously be multi-country and multi-bank, as in the case the EIB Private Enterprise Facility for West and Central Africa.

In July 2013, AfDB approved a program similar to umbrella operations, called the "Inclusive Growth and Job Creation Africa SME Program", with a streamlined approval processing approach[5]. This streamlined approval process is based on program descriptions, limits, and criteria and other safeguards. It is valued at USD125 million, programmed to finance LOCs to a set of financial institutions serving MSMEs, accompanied by a dedicated African Private Sector Assistance fund (FAPA). It incorporates streamlined procedures while mitigating risks. The streamlined process aimed to address the issue of limited incentives to fund small projects, so the processing procedures were more appropriately in line with project size (IDEV, 2013; AfDB, 2013). The advantages and disadvantages of LOCs delivery models are presented in Table 1.

Table 1 : Advantages and Disadvantages of LOCs Delivery Models

Delivery modality	Advantages	Disadvantages
Intermediation operations via a commercial or microfinance banks	▌Superior efficiency of commercial banks, which have to be financially robust. ▌Streamlined sub-loan approval procedures. ▌Support the development of healthy and competitive local financial markets. ▌When the loan is provided to a regional bank (e.g., a pan-African bank, such as Ecobank) countries with a less developed financial sector can be reached through the FI subsidiary branches.	▌Do not have a sovereign guarantee. ▌Commercial banks are not familiar with the concept and practice of tracking development effects at the sub-project level. Microfinance institutions perform better in this respect.
Intermediation operations via a regional/national development bank	▌Mandate of development banks focuses on socio-economic development and poverty reduction. These banks are, in principle, more inclined to support businesses with higher development potential albeit riskier from a credit standpoint. ▌Reach to clients in low-income countries and fragile states, while limiting the exposure of the IFI. ▌When the LOCs is delivered to a regional development bank (e.g., West African Development Bank), regional integration outcomes can also be pursued.	▌Development banks, especially those owned by governments, are more prone to inefficiency and recurrent losses that result in large amounts of non-performing loans and poor-quality portfolios. ▌Moving from first-tier to second-tier lending can be difficult and may take too much time to be achieved, implying a reduced efficiency of LOCs. ▌Exchanging of information on development outcomes between the IFI and the development bank is not systematic even if, in principle, these banks are supposed to keep track of development outcomes as part of their mandate.
Umbrella operations/ SMEs program	▌By the delegated authority, shorten the timeline of approval of individual operations, as well as the approval time for FIs, which is commensurate to the size of the individual operation (usually less than EUR 30 million). ▌Increase outreach to frontier countries with smaller LOCs. These countries have large untapped demand for credit and less absorptive capacity, hence requiring smaller-sized LOCs.	▌Particularly difficult to assess ex-ante results because financial intermediaries may not be known at the time of approval. ▌Higher market failure experience.
IFIs direct lending to end-beneficiaries	Appraisal is directly carried out on operations by the IFIs. Those operations are known in detail and they are not subject to changes before they are implemented because of changing market conditions.	▌The lack of familiarity and knowledge of local markets and SMEs, which entails that direct financing, is costly and ineffective in meeting the needs of clients (IFC 2002). ▌Possibility of adverse selection in which riskier SMEs seek the support of IFIs. ▌The individual financing needs of the large majority of small and medium enterprises (SMEs) are lower than the direct lending threshold of most IFIs. ▌The fact that IFIs have a stringent approval process makes them unable to provide the same level of flexibility as domestic commercial banks to changes in the economic environment and needs of the clients.
Agency lines	A FI acts as an agent for an IFI to identify, appraise and implement operations on behalf of the IFI.	The risks are supported by the IFI.

Source: Literature review.

Overview of AfDB's Assistance Through LOCs

Policies and Strategies

A review of the pertinence of AfDB's policies and strategies is beyond the scope of this synthesis. Instead, Table 2 presents an overview of AfDB's main policy and the strategy documents for the private and the financial sectors referring to the objectives that AfDB hopes to achieve through LOCs.

While AfDB started financing LOCs in 1969, prior to 1998 AfDB had no coherent strategy for its financial sector operations (AfDB, 2003). Since then, several documents have been adopted (Table 2). These emphasized the need to develop deep and robust financial institutions and capital markets for the purpose of better serving African enterprises. LOCs were planned to be delivered to the larger, lower-risk, first-tier FIs, while LOCs together with capacity-building were to be delivered to second-tier banks. The 2003 financial policy acknowledged that: "for LOCs objectives to be achieved in full, the internal management of LOCs operations must be refined". To this end, it promised to "… develop new operational guidelines for the LOCs instrument to clarify, among others, issues of design, conditionalities, subsidies, and internal controls". However, apart from the 1998 guidelines, new operational LOCs guidelines remain to be prepared.

Table 2 : LOCs in AfDBs' Private Sector Policies and Strategies

Year	Type of documents	Objectives
1998	Policies for lines of credit to private sector financial institutions	▪ Provide specific policy guidance for AfDB operations, which involve private financial institutions (PFI), including explicit parameter for LOCs, agency lines and guarantees. ▪ To be eligible for AfDB assistance, a PFI must be located and incorporated in a regional member country (RMC) and authorized to carry out business in the financial sector. ▪ Essential aspects of each loan to a sub-borrower will be compiled and forwarded to AfDB on a quarterly basis for monitoring and record-keeping purpose.
2003	Bank Group financial sector policy	Address the following financial intermediation gaps: ▪ The fragility of the financial system; ▪ The shortage of long-term finance for investment; and ▪ The unmet demand for financial services by MSMEs, the economically active poor, and the disadvantaged, including women.
2004	Private Sector Development Strategy	▪ AfDB will continue extending lines of credit to financial institutions that demonstrate the capacity to deliver quality service to SME clients. ▪ To reach the second-tier financial institutions with less stellar performance and operational strength, AfDB interventions will largely be in the form of financial support complemented with institutional capacity-building programs, involving training, installation of improved processes, project appraisal capabilities, risk assessment skills and information technology systems. ▪ AfDB will develop specialized TA packages to improve the performance and growth of assisted financial institutions.

Year	Type of documents	Objectives
2005	Operational Guidelines for Agency Lines	▌Financial intermediation, through lines of credit and agency lines, have been identified as one of the ways for AfDB to respond to a broad range of specific needs of private enterprises and to fulfil its development objectives in ways that cannot be met through direct lending. ▌Through local financial and non-financial institutions, AfDB mobilizes funding for projects that are too small for it to handle directly, or are difficult to identify and assess from AfDB's headquarters.
2006	Policy Framework for Bank Lending in RMC currencies	Lend in the currencies of regional member countries (RMCs) of AfDB to reduce the exposure of borrowers to foreign-exchange risk, particularly as many projects have expenditures and revenues denominated in local currency.
2007	Strategy update for AfDB's private sector operations	No new options explored.
2012	Private Sector Development Policy 2013-17	Support for MSMEs' financing will be primarily through promoting the development of financial intermediaries, including microfinance, and providing catalytic financing to viable institutions to expand their MSME financing portfolios
2014	Financial Sector Development Policy and Strategy 2014-19	▌Extend LOCs to creditworthy financial intermediaries that explicitly target MSMEs that have the potential for significantly strong impact on job creation and women's economic empowerment. ▌As appropriate, AfDB's LOCs operations will include capacity-building and business development services for targeted MSMEs, embedding rigorous evaluations to compare the cost-effectiveness of its alternative approaches.
2017	New approach for working with African development finance institutions	Given AfDB's own constraints, it is now critical to restructure its support to go beyond the provision of LOCs by assisting African IFIs to mobilize additional funding from other sources, such as the private sector.
2018	Policies for non-sovereign operations	The scope of domicile was extended from only Regional Member Countries to Non-Regional Member Countries.

From Table 2, it appears that AfDB has continuously placed an emphasis on financing LOCs. Some innovations are noteworthy. AfDB introduced local currencies as a better means of providing financing to the domestic private sector, including MSMEs, through financial intermediation. However, apart from the South African rand, which is the third lending currency of AfDB (in addition to the US dollar and the euro) and for which AfDB manages a treasury pool, the use of local currencies has been very limited, notably only in Botswana, Mali, Uganda, Nigeria, and Mozambique. Reasons for this include constraints in AfDB's local currency framework, but mainly inefficiencies in most of the local financial markets in Africa (AfDB, 2006).

Other recent innovations include the setting-up of a specialised department in charge of supporting the financial sector in Africa in 2014, the approval of an SME program in 2013, and the extension of domiciliation status to non-regional member countries in 2018. These initiatives have not yet been evaluated.

Trends, Structure and Coverage of the Operations

AfDB has supported financial intermediation in its regional member countries through LOCs since the first UA 2 million LOCs was set up to finance the East African Development Bank (EADB) in 1969. This LOCs aimed to finance part of the foreign exchange costs of three sub-loan projects, two in Tanzania and one in Uganda. As of the end of 2017, AfDB had approved 314 LOCs for a total UA 10.5 billion, representing 10.3 percent of the total amount approved by AfDB and 49.1 percent of the approvals of the private sector over the period 1969-2017.

LOCs received the lion's share of the amount approved for the private sector until the end of the 1990s, when this share drastically decreased despite significant increases in the amount approved (Table 4). The assumption in AfDB is that the total amount approved for LOCs has tremendously increased in recent years. In reality, however, the amount has increased less than the sum approved for the entire private sector and it has increased in proportion with the amount approved for the entire AfDB. During 2009-17, the amount approved for LOCs increased by 2.1 times the amount approved during 1999-2008. Meanwhile, the amount increased by 2.8 times for the private sector and by 2.2 times for AfDB as a whole (Table 3). The sharp increase in amount approved for LOCs was sustained by the introduction of the trade finance facility in 2009 to help FIs mitigate the impact of the global financial crisis, which mainly affected African countries through their trade channels. The design of trade LOCs was supposed to ensure the competitiveness and operational efficiency of beneficiary FIs (AfDB, 2010). They are designed for a period of a maximum 3 years of maturity.

Table 3 : Amount Approved for LOCs, 1969-2017

Years	All approvals of AfDB (UA million)	Private sector (UA million)*	LOCs (UA million)**	Share of LOCs in all AfDB (%)	Share of LOCs in the private sector (%)
1969-1978	1,133.7	83.6	72.4	6.4	86.6
1979-1988	9,366.5	1,109.4	1,098.9	11.7	99.1
1989-1998	15,801.5	2,096.0	1,845.3	11.7	88.0
1999-2008	23,756.8	4,688.5	2,417.9	10.2	51.6
2009-2017	52,019.5	13,346.1	5,029.6	9.7	37.7
Total	**102,078.0**	**21,323.6**	**10,464.1**	**10.3**	**49.1**

* The private sector covers different instruments: loans, equity funds, guarantees, LOCs, etc.

**AfDB started financing LOCs to a private FI with the credit of USD50 million provided to Citibank of Nigeria in 1999. Before this date, LOCs financed FIs belonging to the public sector. After 1999, LOCs comprise both private sector and public sector operations.

Table 4 : Amount Approved by Financial Sector Instruments

Years	Private sector (UA million)*	Total LOCs (UA million)		Guarantees (UA million)	Equity (UA million)	Total LOCs (%)		Guarantees (%)	Equity (%)
		LOCs without TFLOC	TFLOC			LOCs without TFLOC	TFLOC		
1969-1978	83.6	72.4	0	0	11.2	86.6	0	0.0	13.4
1979-1988	1,109.4	1,098.9	0	0	10.5	99.1	0	0.0	0.9
1989-1998	2,096.0	1,845.3	0	0	105.2	88.0	0	0.0	5.0
1999-2008	4,688.5	2,417.9	0	304.3	376.1	51.6	0	6.5	8.0
2009-2017	13,346.1	3,805.9	1,223.7	1,936.20	1,097.50	28.5	9.1	14.5	8.2
Total	**21,323.6**	**9,240.4**	**1,223.7**	**2,240.5**	**1,600.5**	**43.3**	**5.7**	**10.5**	**7.5**

*The private sector covers more than financial instruments.

Table 4 presents the amount approved by 10-year period[6] and by instruments used by the private sector (details in Annex 3). It shows a dramatic decrease in the share approved for LOCs since the early 1990s. This was due to the increase of the amount approved for other financing instruments, including equity and guarantees, which were approved for the first time in 2000. When trade LOCs are excluded, the approval for the most recent decade is almost half the amount approved during the previous decade. Table 4 shows that, between the periods 1999-2008 and 2009-17, the amount approved for LOCs increased by 2.1 times, guarantees increased by 6.4 times, and equity funds increased by 2.9 times, while the private sector as a whole increased by 2.8 times.

Over the whole period, apart from multinational operations, which were ranked second in terms of amount approved, five countries captured two-thirds of the total LOCs funding: Nigeria (UA 2048.4 million), Tunisia (UA 1,485.0 million), South Africa (UA 1,014.3 million), Morocco (UA 542.8 million), and Egypt (UA 496.2 million).

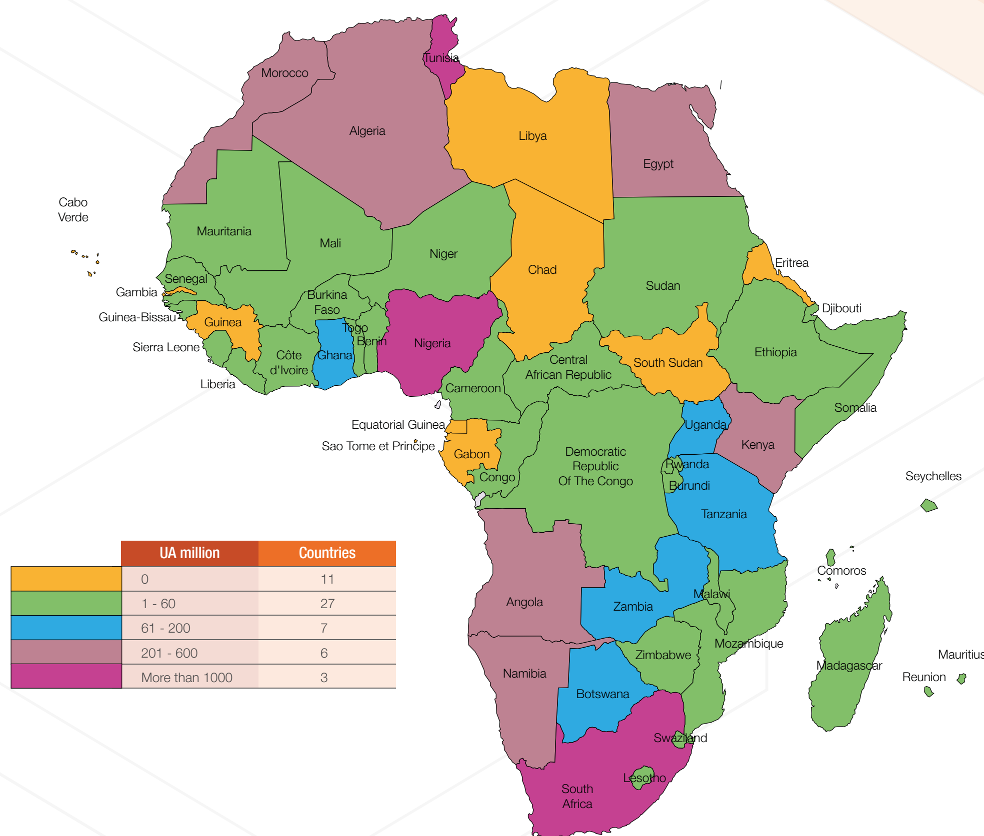
Over the period 1969-2017, LOCs were approved in 43 countries (Figure 4 and Table 5). Of the total of 54 African countries, 11 did not use during the entire period. There are several reasons for this geographical distribution, including the strategic choices of AfDB, the high risks for some countries, the size of markets, the quality of counterparts, the competitiveness of AfDB pricing, etc. In 2013, AfDB set up an SME program to reach out to small countries and small banks. So far, operations of the SME program have been approved in Benin, Burkina Faso, Cameroon, Kenya, Mauritania, Mozambique, Sierra Leone, Tanzania and Zambia.

Between 2000 and 2017, LOCs operations were approved in 26 countries. Multinational LOCs operations were ranked first for the amount approved. This was mainly due to the introduction of trade finance LOCs since 2009. Three countries captured 42 percent of the total LOC's funding over the period: Nigeria (UA 1614.4 million), South Africa (UA 830.6 million), and Tunisia (UA 523.3 million).

Table 5 : Country Coverage, 1969-2017

Status	Countries	Number of LOCs
Never used LOCs	Cabo Verde, Guinea, Gambia, Libya, Eritrea, South Sudan, Comoros, Gabon, Chad, Sao-Tome & Principe, Equatorial Guinea	11
Did not use LOCs after 2000	Côte d'Ivoire, Guinea Bissau, Senegal, Liberia, Madagascar, Lesotho, Malawi, Algeria, Ethiopia, Djibouti, Seychelles, Sudan, Somalia, Burundi, Congo, DR Congo, Central African Republic	17
Used LOCs after 2000	Nigeria, South Africa, Tunisia, Egypt, Kenya, Namibia, Angola, Mauritius, Tanzania, Botswana, Zambia, Ghana, Morocco, Rwanda, Burkina Faso, Mauritania, Mali, Swaziland, Zimbabwe, Togo, Uganda, Niger, Mozambique, Sierra Leone, Cameroon, Benin	26
Used LOCs over the whole period	Egypt, Kenya, Morocco, Nigeria, South Africa, Tunisia	6

Figure 4 : Geographic Distribution of the Approval for LOCs, 1969-2017



	UA million	Countries
(orange)	0	11
(green)	1 - 60	27
(blue)	61 - 200	7
(mauve)	201 - 600	6
(magenta)	More than 1000	3

In terms of regions, Table 6 shows that, over the period 1969-2017, North Africa received the highest volume of LOCs, followed by West Africa, multinational operations, Southern Africa, East Africa and Central Africa. It is worth noting that there was a strong increase of the approvals of LOCs after 2008 for all regions, apart from North Africa, where the average amount approved for the recent period was 6 times less than the average of the previous period. The increase should be seen in the context of the strong emphasis on private sector operations following the approval of AfDB's mid-term strategy 2008-12. The decrease in the amount approved in North Africa should be seen in the context of the Arab Spring, from early 2011 onwards (Table 6).

Table 7 presents a comparative view of the approvals of the three largest providers of LOCs in Africa, namely AfDB, EIB and IFC (IEB, 2017). The information from EIB and IFC is available on the internet. It appears that the average size of the approved amounts of LOCs by AfDB are twice those of EIB and those of IFC. This situation can be explained by the fact that, with more investment officers, more flexible transaction origination, and more accommodative investment criteria, EIB and IFC can focus on smaller operations, while AfDB deals mainly with larger operations with well-established banks, which are therefore less risky.

Table 6 : Geographical Distribution of LOCs

Amount (UA million)

Regions	1969-1978	1979-1988	1989-1998	1999-2008	2009-2017	1969-2017
North	23.0	494.1	1216.8	1021.7	160	2 915.60
West	20.6	212.1	328.7	331.1	1488.8	2 381.30
Multinational	7.0	112.2	49.7	257.5	1884.3	2,310.70
South	5.3	91.6	186.9	779.8	1029.3	2,092.90
East	11.5	140	43.2	27.8	465.1	687.6
Centre	5.0	48.9	20.0	0.0	2.1	76.0
Total	**72.4**	**1,098.9**	**1,845.3**	**2,417.9**	**5,029.6**	**10,464.1**

Percentage

Regions	1969-1978	1979-1988	1989-1998	1999-2008	2009-2017
Multinational	9.7	10.2	2.7	10.6	37.5
West	28.5	19.3	17.8	13.7	29.6
South	7.3	8.3	10.1	32.3	20.5
East	15.9	12.7	2.3	1.1	9.2
North	31.8	45.0	65.9	42.3	3.2
Centre	6.9	4.4	1.1	0.0	0.04
Total region	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Table 7 : Trends in Approvals of LOCs in AfDB, EIB and IFC, 2008-2017

Years	AfDB			EIB			IFC		
	Approved amount (million USD)	Nr of projects	Average size (million USD)	Approved amount (million USD)	Nr of projects	Average size (million USD)	Approved amount (million USD)	Nr of projects	Average size (million USD)
2008	470.4	9	52	59	3	20	817	18	45
2009	760.0	7	109	167*	4	42	717	20	36
2010	570.0	7	81	182*	4	46	1,476	17	87
2011	615.6	7	88	185	9	21	221	12	18
2012	480.5	5	96	400	8	50	473	11	43
2013	412.5	10	41	655	14	47	499	12	42
2014	774.1	13	60	822	17	48	684	20	34
2015	822.9	8	103	433	14	31	555	13	43
2016	1,614.4	19	85	1,056	21	50	528	10	53
2017	806.5**	12	67	1,145	16	72	894	10	89
Total	**7,327.0**	**97**	**76**	**5,105**	**110**	**46**	**6,864**	**143**	**48**

* Covers also Caribbean and Pacific States.

** Incomplete reporting of operations

Table 8 : Summary of Reasons for Cancellation of LOCs in 2000-2016

Reasons for cancellation	Number of cancellations
Financing request withdrawn by borrower	10
Not signed for more than 365 days after Board approval	7
Closing date expired	4
Project completed	2
Renegotiated terms	2
Undisbursed balance less than UA 20	1
Borrower in long-term sanctions	1
Total	**27**

Table 8 indicates that during the period 2000-17, 27 LOCs amounting to UC 486 million or 8.3 percent of the total volume approved by AfDB for LOCs were cancelled. The cancellations covered all or part of the approved amounts. There are several explanations, including that the market pricing was considered to be expensive, including other costs linked to loan agreements, together with demanding M&E requirements and the long delay between the origination and the approval of LOCs. These delays took 12 to 13 months for AfDB but only 3 months for IFC and 6 months for EIB (OFSD, 2015).

Cancellations were more prevalent during the early 2000s and more recent years. Of the 27 cancelled operations, 14 occurred in 2000-2004 and 10 in 2014-2016. Of the 15 LOCs of the SME program approved in 2013, five have been cancelled. Over the 16-year period, most cancellations occurred in Tunisia (4), Nigeria (4), and South Africa (3), followed by Kenya (2), Cameroon (2) and two multinational LOCs.

LOCs Monitoring and Evaluation Challenges

Inadequate Information Collection and the Problem of Attribution

Delivery through FIs makes the assessment of LOCs effectiveness difficult, as it is upon incomplete or unreliable evidence. Evaluations explain that most sub-loan reports lack essential information on the sub-borrowers, such as baseline information on key financial parameters. FIs are reluctant to collect this type of information, as this process entails additional administrative costs. At the same time, end-beneficiaries are generally reluctant to disclose information that is not usually needed to obtain a loan. However, more importantly, the quality of reporting is also undermined by inconsistencies in instructions provided by the IFIs. There are differences between what is expected to be monitored with reference to information on sub-loan end-beneficiaries, what is required to be collected by the client FIs, and what is actually collected. Evaluations also point out that LOCs lack continuous monitoring and that the exchange of information between IFIs and FIs during the LOC's implementation is minimal. When LOCs are intended to change an FI's business model or practices (e.g., to open up the market for lending to female borrowers), there are no mechanisms in place to monitor that such changes are actually implemented (AfDB 2015; EIB 2017).

The evaluation of LOCs poses several challenges, because the IFIs have to rely on information gathered by their client FIs, which often do not accurately report results at the end-beneficiary level according to IFIs' requirements. In this respect, the SME direct-financing model of past credit facilities was significantly better than the wholesaling approach. With this direct-financing model, IFIs could directly collect quality and reliable data on operations and borrowers' performance (Dalberg, 2001; EIB, 2017; AfDB, 2018). M&E of LOCs is confronted with three main challenges: (i) the ex-ante identification of expected development results and attendant monitorable indicators; (ii) the traceability of the final beneficiaries; and (iii) the quality of results reported by the FIs.

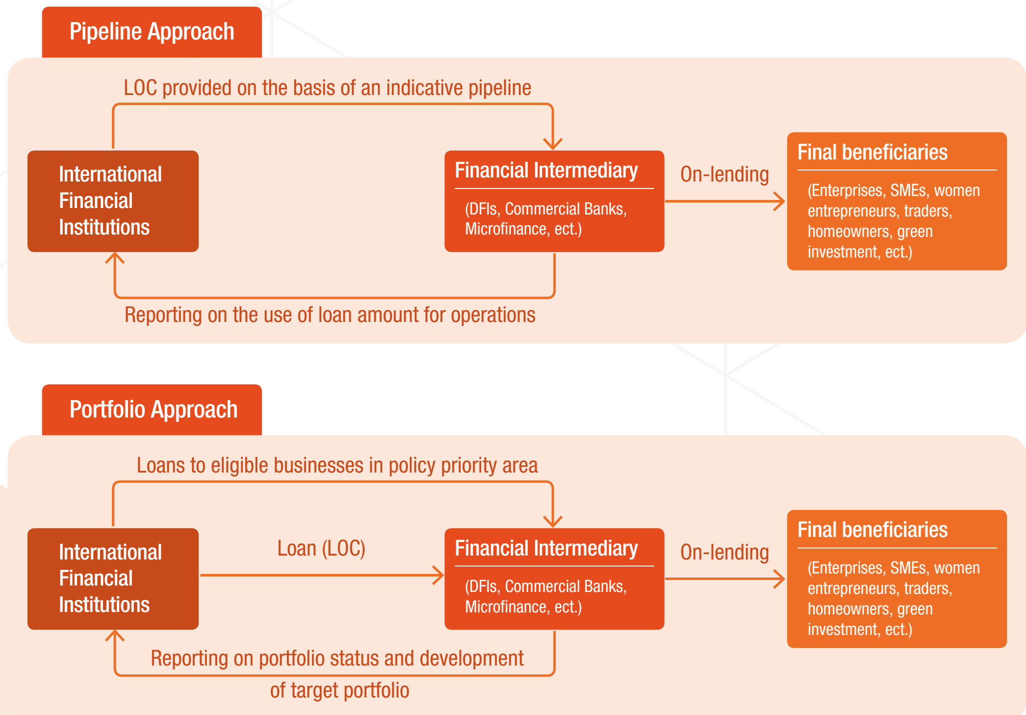
Attributing development impact at the sub-project level to IFI funding is a daunting task. Usually, FIs consider their overall capital structure and liquidity when approving loans, rather than referring to a particular source of funding. Evaluations show that, while a client FI can provide a list of ostensible beneficiaries, these lists are too easily manipulated to suit the requirements of the IFI. Moreover, there is no guarantee that the same list is not submitted to each of the IFIs that partner with the same FI. The 2017 evaluation of LOCs by EIB reported an isolated example where the same SME received evaluation visits from both AfDB and EIB for the same investment. Moreover, when LOCs evaluations focus on a sample of sub-projects, the risk is that the client FI may cherry pick its best clients, or those projects that best fit into the IFI's development requirements. For SME-targeted LOCs, an additional challenge is the identification of end-beneficiaries because of the varying definitions of SMEs, depending on country banking regulations, or FIs internal standards. Definitions rarely match with those used by the IFIs and that are applied in the LOCs covenants for M&E purposes.

Evaluations point to the fact that a complete assessment of LOCs development outcomes needs to look beyond eligibility criteria to assess the development outcomes as defined by most LOCs results frameworks, including increased jobs, reduced green-house gas (GHG) emissions, and energy efficiency. An LOCs may well serve the type of end-beneficiaries that it was intended to serve, but this is no guarantee of higher performance or increased jobs in the sub-borrowers. This would imply identification of key performance indicators that better reflect what can be reasonably monitored and attributed to LOCs, without overburdening client FIs with costly administrative requirements (AfDB 2015; EIB 2017).

LOC Design Approaches

As indicated in Figure 5 below, there are two possible approaches for the approval of LOCs. In the pipeline approach (also known in the literature as project lists), IFIs approve operations presented by FIs on the basis of eligibility criteria. However, evaluations point out that when this approach is used it is difficult to establish a connection between the LOCs and the sub-borrowers, as project lists are just a sample of existing clients that fulfil the LOCs eligibility criteria. At the same time, it is also difficult to assess ex-post to what extent an LOCs has had an impact in improving the FI's capacity to serve a specific market segment (EIB 2017; IaDB 2016).

Figure 5 : Pipeline Approach vs Portfolio Approach



Source: Adapted from EIB (2017).

In 2009, AfDB adopted the Additionality and Development Outcome Assessment (ADOA) Framework to improve the quality at entry in terms of design and selection of private sector operations. The issue with this approach is that, because of market conditions, the list of operations at approval and at disbursement can vary significantly, which decreases the usefulness of the ADOA Framework. The 2017 Ghana CSPE undertaken by AfDB noted that the "ongoing LOCs were not disbursed to the targeted number of SMEs. For instance, the Second LOCs to CAL Bank was disbursed to three SMEs against a target of 30, whereas the Trade Finance Line of Credit to UT Bank has been disbursed to 15 SMEs against a target of 100." Based on the pipeline approach, many evaluations lament the lack of effective monitoring of progress towards achieving expected results of each operation set out in the logical framework (AFD 2012; AfDB 2015; IaDB 2016; EIB 2017).

The portfolio approach has been adopted by most IFIs, including EIB, IADB, IFC, EDFI, and KfW. This approach consists in identifying and assessing how LOCs are used by FIs by looking at changes in FIs' portfolio composition against the objectives set by the LOCs. Different from the pipeline approach, which focuses on individual sub-borrowers, the portfolio approach focuses on progress and changes in business areas (e.g., SME or green lending). With this approach, when consistent and well-designed eligibility criteria are in place, evaluations can assess to what extent an LOCs has contributed to achieving expected results in terms of increasing financing for targeted sectors, themes or groups (SMEs, women, urban or rural, green, industry, etc.). This is done by looking at the share or total volume of financing to those market segments, as against other business areas (EIB, 2002; EIB 2017).

In March 2002, EIB carried out an assessment of the advantages and disadvantages of the portfolio approach, comparing the pros and cons of the portfolio approach with the pipeline approach. The results are provided in Table 9, with some adaptations. The 2017 evaluation of the LOCs of EIB called for a new study on the same topic (EIB, 2017). Clearly, the issue is not to choose one approach over another, but to determine the conditions in which each approach is most suitable. Likewise, the evaluation emphasized that: "It should be noted that the need for monitoring progress toward expected results is independent of whether an allocation and/or portfolio approach is used. Progress towards achieving expected results in terms of increasing financing for target groups (SMEs, MidCaps, women, longer term loans etc.) can also be monitored at the portfolio level by looking at the share or total volume of financing to those groups."

Table 9 : Advantages and Disadvantages of the Two Approaches

	Portfolio Approach	List Procedure/Pipeline Approach
Advantages	▌Generally preferred by FIs – with more participating FIs there would be greater competition and thus more value-added. ▌Forces IFIs to appraise the FI's total SME term lending activity. ▌Tends to reduce administrative costs for both the FI and the IFI. ▌Allows for the tracking of changes in the overall lending behaviour of intermediaries and therefore having a better view on the sustainability of the operation's results.	▌High probability that all allocations will be eligible. ▌Regular IFI contact with the FIs may strengthen relationships. ▌Allows individual final beneficiaries to be identified for loan security and checks on double financing. ▌IFI funding advantages go only to IFI sub-loans.
Disadvantages	▌Less certainty of eligibility. ▌Does not provide basis for security. ▌IFI funding advantages go to the whole SME portfolio, and are therefore diluted.	▌Distorts the FIs' normal operating procedures. ▌IFI funding advantages must go arbitrarily to some SMEs and not to others.
Comments	▌Alternative loan security structures could be based on ring-fenced portfolios (Special Purpose Vehicles).	▌Where FIs have a suitably advanced IT system, the distortion, and hence the administrative cost disadvantage, is minimal.

Source: Adapted from EIB (2002, 2017).

AfDB's Experience with the Monitoring and Evaluation of LOCs

AfDB has experienced acute difficulties in obtaining information from FIs on the deployment of LOCs, as well as on the outcomes and impact on end-beneficiaries. This issue is compounded by the fact that portfolio officers have generally paid limited attention to this aspect. According to some expanded supervision report evaluation notes, at times there has been a lack of will on the part of AfDB in holding to account those FIs that did not comply with the information requirements on development outcomes (AfDB, 2015).

Below are the conclusions from some of the evaluations conducted by IDEV and that illustrate the extent of the problem:

- The actual materialization and dimensions of similar indirect, positive impact on SMEs remain completely anecdotal, given the total lack of quantified data measuring such indirect impact (e.g., see Togo case study-SME evaluation).
- Given the lack of detailed information on the SME loans portfolio, the improvement in the provision of SME lending on the part of the CAL Bank in Ghana could not be assessed (Ghana case study-SME evaluation).
- There was a difference between the stated objectives of AfDB in LOCs appraisal documents, and what the loan agreements stated. This made it difficult to monitor the results against original objectives (CSPE South Africa, 2017).

While AfDB has been successful in internalizing the practice of producing expanded supervision reports, this is not systematic, as it depends on the availability of resources. Furthermore, these reports focus more on outputs (i.e., the number of sub-loans) rather than the outcomes (i.e., sub-borrower performance).

Performance of LOCs

Relevance

The relevance of LOCs is widely acknowledged, not only in the evaluations examined but also by the experts interviewed in the operational departments of AfDB, AFD, and PROPARCO. This is explained by the fact that in developing countries, and particularly in Africa, LOCs provide long-term financing where there are no other alternatives. This is because private banks and private investors are unwilling to risk their capital in long-term investments, as they fear that those investments may not be financially or economically viable (Griffith-Jones, 2016). This key role of development banks in addressing a market failure was recently underscored by the Addis Ababa Action Agenda (AAAA) of the international conference on financing for development, which aims to mobilise sustainable private investment and public-private partnerships (AAAA, 2015)[7]. Furthermore, LOCs allow IFIs to finance MSMEs that would otherwise be difficult to serve directly due to their small size and higher risks.

LOCs are aligned with both IFIs' strategies and recipient countries' strategies. Both types of strategy aim to foster economic and social development at the country and regional levels, and they view the private sector as an important driver to attain this goal. To this end, LOCs are used to support the financial inclusion of MSMEs and the development of the private sector overall at the country level. LOCs are also used to support regional integration in financing integrating multinational operations. They are used for innovative development programs, such as financing of renewable energy, as illustrated by the experience of KfW, which initially funded the introduction of solar energy in Germany that was later financed by the private sector (Griffith-Jones, 2016). LOCs are also an important component of IFIs' business models. Given that they are less risky for IFIs than other investments (e.g., equity funds or venture capital) and that they are rewarded at market rates, they are key drivers of IFIs' profitability and sustainability.

LOCs are highly relevant to FIs. The literature emphasizes that the demand for LOCs is very much driven by the need of FIs to secure long-term loans, given that in most developing countries bank financing is concentrated on providing short-term borrowing. In a survey undertaken by AfDB in 2017, liquidity support emerges as the most sought-after form of support. Within commercial banks, LOCs largely prevail as the most demanded financial product. This high demand relates to the simplicity and well-established history of using LOCs compared with other financial products. This apparent simplicity could be explained as follows: either FIs are choosing to ignore the extensive reporting requirements on sub-loan/sub-borrower performance, or the IFIs are not specifying such requirements ex-ante and there is no effective mechanism to enforce the reporting requirements. The implication is that to do a better job, IFIs need to tighten up the terms of their LOCs contracts, including their reporting systems.

The relevance of LOCs to the intended end-beneficiaries is more open to debate. While access to finance is undeniably a constraint in recipient countries, evaluations question whether LOCs are the most appropriate instruments for addressing such constraints compared with other types of intervention[8]. This is because limited access to credit can also be caused by other prevailing demand constraints, such as underdeveloped financial infrastructure and services, weak regulatory environments and legislation, and a lack of competition (EIB, 2017). The use of LOCs is

generally justified by the need to address market failures in financial markets. However, evaluations show that most LOCs designs are not underpinned by sufficient analytical work that carefully explores the constraints to access to finance for specific market segments in specific country contexts. A systematic analysis of alternative interventions that would bring about the same results as LOCs is often missing, which undermines the justification for using LOCs (BAD 2015).

The 2015 evaluation of AfDB's assistance to SMEs found the relevance of the support for end-beneficiaries to be mixed. This is because background analysis of the SME sector was absent in the majority of appraisal reports, which rarely contained an assessment of the SMEs' financing gap and/or other needs. SME financing was often justified on the basis of the indicative pipeline presented by the partner financial institutions, or on a review of secondary sources based on the World Bank's Enterprise Surveys, for example (AFDB, 2015). The evaluation also found that in Ghana some of AfDB's operations that were classified as SME-specific should have been classified as general private sector support initiatives.

Against the high relevance of LOCs, some IFIs, such as IFC, have recognized the problems with the LOCs model, such as low utilization, non-transparent reporting of results, and incentives to use LOCs as volume drivers in the institution. Thus, several IFIs are currently re-examining how to use intermediation in a more effective way.

Also, the high relevance of LOCs is nuanced, given some concerns that have been expressed by interviewees. Against the high-demand argument used to justify LOCs, it is also said that LOCs are often supply-driven from the IFIs, which repeatedly provide LOCs to partner FIs on a regular basis as a means for their investment staff to achieve annual volume targets. Consequently, many LOCs only achieve low levels of utilization in terms of stimulating sub-lending by the FIs, or are cancelled outright. Furthermore, local commercial banks are more often in need of Tier-1 or Tier-2 capital to bolster their balance sheets and comply with regulatory standards for capital adequacy, etc. Equity or subordinated long-term debts are more commonly used in this case and LOCs do not qualify.

Design of LOCs

LOCs design concerns the identification and articulation of expected development results, and the demonstration of causality through the structural features of the LOCs and its attendant monitorable indicators. Evidence shows that LOCs design needs to find a balance between two different objectives: (i) achieving risk mitigation and profitability in IFIs and client FIs; and (ii) providing financial services to underserved and riskier market segments. In this respect, evaluations identify the following inconsistencies in establishing an LOCs theory-of-change (TOC): the selection of FIs, eligibility criteria, and the definition of LOCs terms and conditions (Dalberg 2011; EIB 2017).

Inconsistencies in LOCs design. Evaluations highlight that the design of LOCs pays little attention to the transmission channels that would ensure that LOCs achieve their expected results. More often than not, there is a disconnect between the stated objectives of LOCs, and LOCs provisions and eligibility criteria. Examples of this include those LOCs that are nominally targeting the SME sector without including specific provisions for actually serving this market segment (Horus Development Finance, 2014; AfDB, 2013; AfDB, 2015). When TA is provided, this is not necessarily geared towards the specific sector objectives of LOCs, but it is more often related to improving the general performance of the client FIs. Apart from smaller banks and microfinance institutions, client FIs show less interest in TA than in receiving other financial instruments.

The assumption that LOCs will strengthen the partner FIs and make them more inclined to serve SMEs is very weak. The mere provision of financing is unlikely to induce significant changes in the FIs' behaviour. A more credible TOC for LOCs should preferably be based upon their contribution to developing financial markets rather than delivering benefits to a specific group of end-beneficiaries. The magnitude of the gap in SME financing in developing countries is so large that it is only by improving financial institutions and financial market ecosystems that access to finance can be substantially improved.

Eligibility criteria for end-beneficiaries are based on inappropriate definitions. The literature suggests that IFI targeted support for SMEs through LOCs is not grounded in a clear and appropriate definition of SMEs. This raises the risk that LOCs will not necessarily serve the intended end-beneficiaries. When SMEs are defined, these definitions rarely reflect country-specific conditions. When IFI definitions apply, it is more likely that larger corporate entities will benefit from LOCs, often to the detriment of SMEs. Definitions of what is an SME also differ from one IFI to another IFI, implying that client FIs receiving funds from several IFIs need to use different parameters to identify their SME client base in each case (Table 10). Furthermore, FIs are rarely able to collect all the necessary information that is needed to classify an SME according to standard IFI definitions and usually defer to the loan size as the sole criterion for classifying their portfolio. For this reason, some IFIs, such as IFC, use the size of loans as a proxy for identifying the loans that reached SMEs[9].

The literature also discusses cases when LOCs targeting SMEs were provided without a definition of what constitutes an SME, or without provisions for SME targeting (Box 2).

Table 10 : SME Definitions Adopted IFIs

IFIs	Various SME definitions applied for LOCs
World Bank	Applies different definitions depending upon the type of product and individual projects.
AfDB	No definition, leave it to client FIs to apply their own criteria.
IFC	Number of employees below 300, total assets below USD15 million and annual sales below USD15 million.
EIB and bilateral European IFIs	The same as used in the European Union. Enterprises having fewer than 250 persons employed, an annual turnover of up to EUR 50 million, or a balance sheet total of no more than EUR 43 million.
IADB	Based on loan size and country classification. For countries in categories A and B, SME receives a loan below USD1,000,000. For countries in categories C and D, SME receives a loan below USD500,000.

Source: Elaboration from different IFIs' reports.

Box 2 : SME Targeting in the AfDB LOCs

The Independent Evaluation of Non-Sovereign Operations (2006-11) and the Evaluation of Bank Group Assistance to Small and Medium Enterprises (2006-13) raised serious concerns about the relevance of AfDB's LOCs for the intended beneficiaries. The financing agreements with the client FIs did not include specific eligibility criteria for the sub-loans. AfDB's LOCs generally lacked a definition of what constitutes an SME, which left excessive room for interpretation by FIs. The selected FIs also showed limited interest in the SME market segment. Moreover, AfDB's LOCs were not based on a deep understanding of SMEs' access-to-credit constraints. The evaluations concluded that some of AfDB's operations that were classified as SME-specific should have been classified as general private sector support initiatives. For example, AfDB was approached by CAL Bank Ghana to access foreign currency funds to serve large borrowers and move beyond the SME segment. The lack of dialogue between the AfDB and CAL Bank with regard to reaching a working definition of SME, coupled with the provision of funds denominated in hard currency, translated into a limited alignment of the AfDB operation with SME needs, although the LOCs was intended to expand access to finance for SMEs.

The selection of client FIs is driven by a primary focus on integrity due diligence and credit-risk considerations, which has led to the prioritizing of top banks. FIs need to have in place sufficiently developed and transparent financial management systems and a sound financial situation to pass the IFIs' due diligence. While in the past the dominant approach has been to partner with well-established and large FIs, the selection of partner FIs is currently more inclined to balance the need to adhere to the IFIs' conservative risk management strategies with the need to serve riskier markets. Channelling LOCs through well-established microfinance institutions is proposed as a suitable model for targeting the actual SME market segment (ADB, 2013). Similarly, for green LOCs, evaluations found that partnering with FIs that had already developed financial services for serving this market niche increased the capacity of LOCs to achieve the intended development outcomes. For instance, in Latin America, green LOCs were provided to banks that already had green business niches and that were working with a well-defined business strategy. The existence of a green portfolio resulted in a high absorption rate and the projects financed were actually linked to renewable-energy and energy-saving projects (IADB, 2016).

The IFIs' propensity to select solid banks and mature financial markets is also visible in the geographical distribution of LOCs. Evaluations question whether LOCs are disproportionally serving countries and financial institutions that do not have problems with liquidity (World Bank, 2014). This finding has important implications with respect to the possibility of LOCs crowding out other private financers, even if LOCs are priced in line with the market (Naudet and Oktar, 2012)[10].

LOCs' main features struggle to meet the needs of FIs and the end-beneficiaries. An important feature of LOCs that target SMEs is the currency in which the loans are denominated. Evaluations found that lending in a hard currency does not serve the SME market segment very well, because SMEs tend to have domestic markets and incomes denominated in the local currency, and hence have limited ability to bear the exchange rate risk (Horus Development Finance, 2014; AfDB, 2015). However, locally-denominated LOCs are less attractive to FIs, which would then have to bear the currency exchange risk. Under this scenario, it is key to help client FIs manage the currency risk with appropriate instruments, so that the sub-loans can be delivered in local currencies. This example shows that LOCs that are intended to benefit both FIs and SMEs can be contradictory in their objectives. Hence there is a need for IFIs to structure their LOCs with a view to resolving such conflicts.

Effectiveness

Delivery through FIs makes the assessment of LOCs effectiveness difficult and based upon incomplete or unreliable evidence. The ability to assess results critically depends on the availability

of information generated by an IFI's monitoring system, the quality of reporting from the FIs, and the resources deployed for the evaluation. The achievement of LOCs outputs is generally well-documented and measured in financial terms, including the number of sub-loans disbursed, albeit not always with assurance that the recipients are target beneficiaries. Generally, LOCs effectiveness is assessed at three levels: (i) the client FIs; (ii) the country financial system; and (ii) the targeted end-beneficiaries. However, LOCs also have impact on the IFIs themselves.

FIs claim both financial and non-financial benefits, but attribution is difficult. When evaluations report that client FIs have better financial performance in terms of profitability, liquidity, capital adequacy, and asset quality, they are also careful in the extent to which these are attributed to the LOCs (Table 11) (Horus Development Finance, 2014; IaDB, 2016). When LOCs are channelled to well-established FIs, they represent a very small share of client FIs' funding mix. For example, the LOCs provided by the IADB over the period 2005-14 accounted on average for 3.6 percent of FIs' long-term funding (IADB, 2015). For the same reason, the catalytic effects of LOCs in paving the way for more investments are difficult to assess, although the reputational impact of LOCs on FIs can be substantial. The fact of passing the due diligence of an IFI can help leverage the reputation of FIs and improve their access to the private capital markets. For instance, the evaluation by AfDB of the LOCs that it provided to the Banque Ouest Africaine de Développement (BOAD) in 2008 found that the LOCs increased the banking culture of BOAD and its commercial profitability fostered the self-confidence of this regional bank. This resulted in an increased capacity to mobilize additional resources in global financial markets (AfDB, 2016). This reputational effect is larger in medium/small-sized banks that face more constraints in financing themselves (EIB, 2017; IaDB 2017). Another relevant benefit for FIs relates to their increased capacity to comply with environmental and social requirements (E&S), provided that the LOCs requires the FIs to adopt and comply with the IFI's E&S performance standards, and that the IFI actually monitors and verifies FI compliance.

Several measures have leveraged the impact of LOCs on client FIs. These include the use of performance-based contractual covenants that link the disbursement of LOCs to specific performance targets for the FIs (e.g., capital adequacy), and the combination of LOCs with other financial (e.g., equity, subordinated debt) or non-financial (technical assistance) instruments. For LOCs tied to specific target groups, tailored technical assistance (e.g., the development of standardized financial products for energy-efficient investments) was deemed useful to induce the desired changes in client FIs' business models. However, it is important to note that LOCs have thus far provided little incentive for innovation in FIs. This is a relatively new concept in LOCs and has emerged in relation to "green loans" that require the

Table 11 : Expected LOCs Benefits for FIs

Financial benefits	Non-financial benefits
The longer tenor of the funding provided by IFIs helps mitigate maturity mismatches in client FI portfolios. **Diversify source of financing, as FIs receiving LOCs from an IFI are more likely to attract other investors: other IFIs or private investors.** **Improved balance sheet strength and financial performance: capital adequacy ratios, return on assets, return on equity, non-performing loans.**	Capacity building with respect to product development (e.g., SME specific services or standardization of green products, such as energy efficiency credits). Improved FIs' internal procedures with respect to credit assessment, portfolio risk management and monitoring systems. Improvement of environmental and social risk management systems. Improved corporate governance.

Source: Summary from selected evaluation reports.

development of specific environment-related products and processes to be profitable. For example, "KfW is …playing a major international role, together with other development banks, in funding green investment in the rest of Europe, and in emerging and developing countries" (Griffith-Jones, 2016). In the case of SME-related LOCs, evaluations do not identify significant progress concerning the development of lending products customized for SMEs (EIB, 2017; IADB, 2016).

The expected benefits of LOCs for financial systems are overstated and rarely achieve broader market impact beyond addressing short-term liquidity constraints. LOCs objectives include the deepening and strengthening of local financial markets, but there is little evidence of the achievement of these objectives. The benefits of LOCs for local financial systems are higher when the main constraint to finance is a lack of liquidity in the domestic market. The literature review and data analysis on LOCs flows in Africa show that on-lending operations are highly focused on countries with relatively better developed capital markets, notably Egypt, Kenya, Nigeria, South Africa, and Tunisia. This implies that countries with underdeveloped financial markets and services—precisely those that would benefit most from LOCs—are underserved by IFIs[11]. A combination of factors constrain the IFIs' interventions in these markets, including unstable political and economic environments, inability of borrowers to meet IFIs' due diligence standards, the actual and perceived risks of lending to SMEs, and the weak capacity of financial intermediaries to assess the risk of lending to SMEs and of SMEs to prepare bankable projects (EIB, 2017; World Bank, 2014).

LOC impact on financial inclusion are largely undocumented, because of a lack of data on sub-borrowers. LOCs impact on existing oligopolistic structures in local financial systems are more likely to occur when they are provided to small banks. However, the need to mitigate risk and reduce assessment costs create incentives in IFIs to work with the same client FIs through repeated projects. In LOCs operations, there is a tension between expanding access to finance and the provision of financing at risk-weighted pricing through a sustainable business model where financial risk is kept under control. Expanding access to finance would require greater investment in low-income countries with high financial exclusion rates, where risk is high and where the possibility of packing large investments into single projects is very limited. Some evaluations suggest that LOCs impact on financial inclusion would be larger if they were channelled through sound microfinance institutions (ADB, 2013).

In principle, SME-related LOCs are expected to expand financial services to underserved groups, but evaluations cannot verify the attribution of LOCs to SMEs' access to finance because:

- Money is fungible and it is not possible to verify whether a given LOCs has actually served a certain list of beneficiaries.

- Changes in the composition of FIs' loan portfolios are not always documented. When this occurs, findings are not conclusive and attribution or tracing back modifications in FIs portfolio composition to LOCs is difficult[12]. Changes in the relevant portfolio in terms of the number of projects financed and their volume are highly variable. In the case of SME-targeted LOCs, the evaluation carried out by Horus Development Finance (2014) highlighted examples both of FIs that reduced their service to SMEs and FIs that improved their service to the SME market segment. FIs' lending decisions depend upon market conditions. When these deteriorate, FIs are less likely to finance what they might regard as higher-risk borrowers.

- There is little evidence that LOCs facilitate first-time borrowers, which are used as a proxy for improved financial inclusion. The ADB found that among the SMEs that benefitted from its LOCs, very few were first-time borrowers, implying that its SME-related LOCs did not facilitate access to finance for the poor, but mainly financed non-poor groups with small businesses (ADB, 2013).

These findings suggest that the expectations of LOCs development outcomes at the level of SMEs will not materialize automatically unless these expectations are better reflected in contractual covenants, and LOCs are accompanied by complementary measures (e.g., TA for capacity building) that address market constraints beyond merely liquidity shortage.

Benefits for end-beneficiaries are mostly undocumented because there is a lack of a critical mass of information to draw robust conclusions at this level. In most cases, there is no obligation for client FIs to pass the benefits of LOCs on to the end-beneficiaries, such as longer tenure, pricing, advice, etc. Even when LOCs agreements establish minimum tenures of sub-loans, there is insufficient information on how financing conditions for sub-borrowers changed as a result of LOCs.

The fungibility of money makes it impossible to trace back individual sub-loans. When evaluations are based on sub-loan lists provided by client FIs, there are not enough reliable data to attribute improved profitability or higher levels of job creation to LOCs when comparing the before and after socio-economic situation of end-beneficiaries. In fact, FIs do not systematically track the performance of their clients unless they are required to do so in the loan agreement. Even when this requirement is present, the quality of the reporting is too poor and the FIs receive little feedback and guidance from their IFIs on how to prepare acceptable reports. Horus Development Finance (2015) attempted without success to establish a causal link between the sector distribution of the client FI portfolio and job creation, following the assumption that if the FI invests more in labour-intensive sectors then this implies that impact on job creation are, in principle, positive. At the same time, the evaluation assumed that, if the offered sub-loans' tenure were longer than market norms, then business profitability would be more likely to have increased. However, these measures were proxies rather than direct observations, and cannot lead to robust conclusions.

Impact of LOCs on IFIs. LOCs are part of the IFIs' economic model whereby LOCs are supposed to contribute to IFIs' profitability and participate in their financial sustainability. Likewise, LOCs are supposed to help IFI staff to develop a better understanding of banking and private sector financial development (EIB, 2017).

In the case of AfDB, the 2015 evaluation of SMEs found that the financial performance of FI implementing partners in terms of profitability, liquidity, capital adequacy, and asset quality was largely positive. However, the actual contribution of AfDB's assistance towards achieving this result can barely be assessed, especially in the case of well-established FIs. The viability of the sub-projects is also largely positive, but a higher share of non-performing sub-projects is detected with a more pronounced SME orientation. Only a few banks have expanded their SME lending activities as a result of receiving AfDB assistance. There was very limited evidence that FIs had developed new products customized for SMEs. The majority of FIs that received LOCs from AfDB were also supported with TA, but these interventions did not seem to have significantly influenced project results.

- The CSPE of Zambia (2015) recognizes the combination of LOCs with technical assistance as important in enhancing/maximizing development effectiveness. It underscores, however, that the combination requires more time and effort on the part of the staff to identify suitable banks with which it was possible to work and bring together all the various parties necessary to provide the TA.

- The CSPE of South Africa (2017) underscored that most LOCs did not find ways to actually focus on the intended target groups, such as SMEs or niche sectors, nor did LOCs add value to FIs by supporting better measurement of development results or capacity. In 7 of 9 cases, funds were used for major investments and not for targeting SMEs.

Efficiency

LOCs are a cost-effective instrument. This is because LOCs allow IFIs to channel financial assistance into a limited number of operations through financial intermediaries instead of directly delivering resources to end-beneficiaries. LOCs are processed faster than non-financial intermediary operations, and efficiency is particularly high when LOCs go to mid/large-sized FIs, which are lower-risk assets for the IFI and are generally more advanced in terms of their management and governance quality. Volume-wise, the larger the LOCs is, the higher the efficiency gains in cost and time (IADB, 2016). **LOCs were found to be cost effective by AfDB's SMEs evaluation.** Compared with the approval phase, delays in completing disbursement were rare and moderate.

LOC disbursement rates vary considerably but they are generally satisfactory. LOCs absorption rates by FIs are generally high, unless unforeseeable changes in market conditions occur that make LOCs terms uncompetitive with respect to alternative sources of financing (Naudet and Oktar, 2012). Other factors that can reduce the use of LOCs are related to countries' general credit environment, typically characterised by a lack of information on credit risk on potential sub-borrowers. Conditions that can slow down the disbursement of LOCs can also relate to IFIs' internal procedures. These include the use of overly narrow eligibility criteria for sub-loans that unduly restrict the potential pool of borrowers, and the application of ex-ante approvals of sub-loans by the IFIs. For example, for green LOCs, the IADB found that deployment of LOCs by the FIs was easier for LOCs with broader eligibility requirements (IADB, 2016). When the EIB noted that the LOCs provided to African, Caribbean and Pacific countries had significantly low disbursement rates, it modified some of its internal procedures and introduced more flexible allocation procedures, less restrictive commitment fee arrangements, and the increased use of TA for institutional strengthening of the FIs (EIB, 2017).

LOCs are a key contributor to IFIs' profitability, which creates strong incentives for the use of this instrument. LOCs have several financial advantages compared with other operations. These include high and certain returns, low origination and administration costs, and low average credit-risk scores (de-risking of IFIs' private sector operations). LOCs are key contributors to the financial performance of IFIs, which can leverage their good credit status to raise funding to support other projects (e.g., grants for TA) with significant development outcomes (AfDB, 2017).

From the client FI viewpoint, the benefits of receiving LOCs are generally commensurate with the specific requirements of such loans. However, evaluations unanimously report complaints from client FIs concerning LOCs processing times and the reporting requirements associated with LOCs, which are perceived as being excessive. For FIs that receive LOCs from different IFIs, the lack of harmonization in reporting requirements and standards, as well as the lack of harmonization in defining target beneficiaries, is difficult to handle. FIs consider that IFIs' field presence makes dialogue and the exchange of information easier, and has a positive impact in reducing LOCs assessments and approval times (see Annex 4 of this report).

Sustainability

The sustainability criterion is often neglected or only partially addressed in evaluations of LOCs. Sustainability can be defined both from the perspective of FIs and the end-beneficiaries.

- For client FIs, a 'sustainable' LOCs would be evidenced by the FI acknowledging the viability of the asset-class promoted by the LOCs (i.e. sub-borrower type) such that the FI decides to

pursue and grow its portfolio in the future, with or without IFI assistance (preferably without). It refers to the positive impact of the LOCs on strengthening the FI's managerial and financial performance, or where an LOCs tied to specific market segments has helped consolidate the FI's portfolio in that specific sector.

- From the perspective of an end-beneficiary, 'sustainability' could be measured in terms of sustained business profitability and sustained access to appropriate financing. A simple proof of 'sustainability' at the level of end-beneficiaries would be the repayment and re-borrowing of sub-loans, or a record of good debt-service and increasing debt requirements over time (indicating growth in the business). However, information on these data are not available in evaluations.

While the literature identifies positive impact of LOCs on FIs, especially when the LOCs is accompanied by tailored TA, it does not document the long-term impact of such operations on client FIs. Even when an FI has clearly improved its performance in addressing specific market segments, such as SMEs, evaluations are generally cautious in discussing sustainability, notably because banks can rapidly decide to pull back from lending to SMEs. Although it is more likely that an FI with a well-established strategy for targeting the SME sector will continue serving this market segment, FIs, along with other banks, also have to respond to changes in regulatory, economic or political conditions, which could impact their strategic focus on SMEs.

Information on the sustainability of AfDB's LOCs is scant and therefore the sustainability of the results remains unclear. This is due to the deficiencies in monitoring and data collection of the results attained by the operations. The case study of Ghana for the 2015 SME evaluation concluded that, while a sizeable impact was likely to have been generated by investment funds, the sustainability of its innovative business model was far from clear. Likewise, the case study of Zambia considered that without further support from AfDB or other IFIs, the overall sustainability of Investrust's SME operations was unclear. However, evaluations suggest that the sustainability of the impact of LOCs are more likely when the end-beneficiaries are corporations. For instance, the LOCs provided by AFDB to BOAD in 2008 was used to finance SONATEL in Senegal. This enterprise was making sustainable profits as the number of clients increased. It also benefitted from the participation of the government in its capital. Furthermore, AfDB's CSPE of Ghana (2017) reported that stakeholders at CAL Bank, which received an LOC, argued that by lending to larger, more profitable firms, they had been able to create more jobs than if they had supported smaller SMEs.

Environmental and Social Standards

Evaluations report that although IFIs always assess FIs for compliance with their E&S management system, these are not always followed through satisfactorily. IFIs apply environmental and social standard (E&S) policies that require all their operations to be environmentally sustainable and in compliance with established E&S safeguards. In this specific area, LOCs are more challenging than direct investments because IFIs have to rely on FIs to mitigate E&S risks at the sub-project level. Ideally, the IFI needs to require the FIs to apply the prescribed E&S safeguards across its whole portfolio. For example, the application of an exclusion list in an IFI's loans extends to its FI's overall operations, not just new loans advanced under the LOC. Where there are existing portfolio assets in prohibited sectors (tobacco, arms, spirits and drugs) the FI is normally required to submit a plan for accelerating or replacing these loans, and not committing further funds to these businesses. Generally, reporting by FIs on E&S in sub-projects is unsatisfactory and depends to a large extent on the capacity of the FIs to conduct such assessments (EIB, 2017; IaDB, 2016).

As part of the IFI's due diligence on an FI, the IFI needs to screen the FI's existing portfolio to identify high-risk E&S assets and verify compliance before the LOCs is approved. However, evidence shows that client FIs are not inclined to internalize E&S unless they are forced to do so, as they do not consider this to be part of their business. The capacity of FIs to understand and systematically implement a process of environmental and social analysis in their operations is variable, because it is influenced by numerous factors, including the general institutional setting (i.e., the existence and enforcement of environmental laws). In the absence of appropriate regulatory frameworks, some types of investment might be environmentally and socially acceptable in specific countries, even if they would not be compatible with the IFI's own safeguard standards. Furthermore, even when these standards are in place, the quality and consistency of enforcement remains a major issue. For instance, in some Africa-region countries, E&S safeguards are seen as an avenue for rent-extraction, or regulation is patchy or selectively based on the size or sector of a business.

Thus far, there has been insufficient consideration of the sub-project level risk. Because money is fungible, the IFIs cannot protect themselves against the reputational risk of financing projects in non-eligible sectors. In this respect, both the initial E&S risk assessment of client FIs and continuous monitoring become critical. E&S risk classifications can be undertaken on a list of projects selected by the FIs, or on the relevant portfolio. In the former scenario, FIs might be tempted to swap high-risk projects for low-risk projects, just to comply with the IFI's E&S policy. To produce long-lasting impact on FIs' E&S screening practices, the IFIs need to focus on facilitating a cultural change within client FIs to increase their level of understanding and management of E&S risk, rather than focusing on the compliance with E&S standards in sub-project lists. To do this, IFIs need to secure support from FIs' senior management levels and provide better guidance and training to FI staff. This should also ensure that the quality of FIs' E&S reporting, which evaluations deem to be largely unsatisfactory, improves.

The targeting of SMEs may expose IFIs to greater E&S risks. The risk profile of SMEs is highly heterogeneous, ranging from low to high risk, depending upon their sector of activity. In developing countries, even formal SMEs can have some areas of informality, and generally do not have E&S standards in place. For this market segment, the capacity of FIs to assess compliance with E&S standards of its SME portfolio is key to ensuring that the LOCs is not used to finance projects that do not comply with the IFI's E&S policy.

There might be a tension between speeding up LOCs approvals and the need to carry out a thorough E&S assessment of an FI's relevant portfolios. This implies that the IFI's assessment of FI compliance is not always commensurate with risk, and that the quality of pre-investment reviews varies considerably. Consequently, monitoring and mitigation measures are often found to be insufficient even when a potential risk is identified within a client FI. The CSPE of South Africa (AfDB, 2017) indicated that there was an acute lack of environmental and social detail at the sub-project level for LOCs.

Conclusions

Relevance

The evaluations reviewed consider LOCs as a relevant financing instrument for both IFIs and FIs. However, their relevance is more questionable in terms of the end-beneficiaries, including SMEs. LOCs provide long-term financing where private banks and private investors are unwilling to risk their capital in long-term investments. They are financially profitable for IFIs and FIs. However, the relevance of LOCs to the intended end-beneficiaries is more open to debate. Evaluations question whether LOCs are the most appropriate instrument to address the issue of deepening market financing compared with other types of interventions, including leasing, microfinance, guarantees, and equity funds. The use of LOCs is generally justified by the need to address market failures in financial markets, but evaluations show that most LOCs designs are not underpinned by sufficient analytical work that carefully explores the constraints to access to finance for specific market segments in specific country contexts.

The design of LOCs is not always underpinned by sufficient analytical work. First, the selection of the partner FI does not always match well with an LOC's intended objectives. This happens for instance when LOCs targeting the SME market are provided to FIs that have little commitment, or no strategy, to operate in such a market. The selection of client FIs is driven by financial integrity, due diligence, and credit risk considerations, which has led to the prioritizing of top banks and reducing additionality. Risk considerations do not play in favour of serving less mature financial markets and less solid FIs, although these are the market segments that need most support in the form of liquidity and capacity. Second, eligibility criteria for sub-loans are not based on clear and consistent definitions of what constitutes an SME within a specific country context. Definitions of what an SME is also differ from one IFI to another IFI, implying that client FIs receiving funds from several IFIs need to use different parameters to identify their SME client base in each case.

Effectiveness

A common challenge to evaluate the effectiveness of LOCs stems from the lack of reliable information on sub-borrowers, and from the difficulties of convincingly attributing the benefits in FIs and sub-borrowers to LOCs.

For FIs, reported financial and non-financial benefits are well documented. Financial benefits to FIs include diversification of sources of funding, mitigation of liability maturity mismatches, capital adequacy and asset quality, profitability, and liquidity. Non-financial benefits include improvements in internal procedures, operational capacity, and corporate governance. However, the attribution of these benefits to LOCs remains difficult, especially when they are provided to large FIs where the LOCs accounts for only a small percentage of an FI's total long-term liabilities. LOCs also provide reputational impact to FIs because passing the due diligence test of an IFI can help leverage the reputation of the FI and improve its access to private capital markets.

There is evidence that a number of measures can leverage the impact of LOCs on client FIs. These include the use of performance-based contractual covenants that link the disbursement of LOCs to specific performance targets for the FI (e.g., capital adequacy) and the combination of LOCs with other financial (e.g., equity, subordinated debt) or non-financial (technical assistance) instruments.

The use of accompanying measures for LOCs proves to be effective. For LOCs tied to specific target groups, tailored TA for developing standardized

financial products for energy-efficiency investments was deemed useful in inducing the desired change in the client FIs' business models. But there is little documented evidence that LOCs have thus far provided incentives for innovation in FIs.

For the local financial system, the benefits of LOCs are higher when the main constraint to finance is a lack of liquidity and when LOCs make a dent in the existing banking oligopolistic structures. On financial inclusion, an ADB evaluation (ADB, 2013) that specifically addresses this theme suggests that LOCs impact on financial inclusion would be larger if they were channelled through sound microfinance institutions. However, thus far, the impact of LOCs in promoting financial inclusion in terms of extending access to financial services to unbanked people has not been demonstrated. Similarly, LOCs capacity to introduce financial innovation in FIs has not been documented.

For end-beneficiaries, there are no reliable data about the impact of LOCs in terms of improved profitability or job creation. Similarly, there are no data on the impact of green LOCs on energy efficiency and energy consumption. When evaluations are based on assessing the performance of a list of end-beneficiaries provided by FIs, evaluators report that FIs do not systematically collect data from their clients even when this is part of their agreement with the IFI. This is due to a combination of the following factors: (i) FIs do not have experience in collecting data on the impact of their loans; (ii) FIs do not have management information systems in place to perform such tasks; and (iii) IFIs implement lax oversight during LOCs disbursement.

The use of the pipeline approach vs the portfolio approach. When evaluations are based on sub-loan lists provided by client FIs, there are not enough reliable data to assess the socio-economic impact of LOCs on the end-beneficiaries. This is due to poor monitoring because FIs do not systematically track the performance of their clients. Even when this does occur, the quality of the reporting is too poor, and FIs receive little feedback and guidance from the IFIs on how to prepare acceptable reports. This has led several IFIs to adopt a portfolio approach in designing and implementing LOCs. In this case, the evaluations seek to measure the effectiveness of LOCs on the concerned market segments in terms of agreed targets. From the evaluations reviewed, there is no evidence that this new approach has been able to overcome the daunting issues related to measuring the development outcomes and impact of LOCs.

Efficiency

The efficiency of LOCs is satisfactory when measured in terms of the IFIs' profitability, their disbursement rates, and timeliness. LOCs make a positive contribution towards the performance of IFI portfolios by increasing margins and reducing risk, which also creates internal incentives in favour of LOCs. LOCs are more cost-effective than other instruments, because they allow the packaging of a large amount of financial aid into a limited number of operations that are then channelled through existing institutions that do not require the setting-up of separate administrative systems. However, a trade-off exists between LOCs efficiency and their capacity to reach intended beneficiaries in underserved market segments. LOCs disbursement is more rapid when there are broader eligibility criteria, but tightening up criteria and controls can significantly slow down the delivery of LOCs.

Sustainability

The sustainability of LOCs is rarely addressed by the evaluations. This is partly because the concept of sustainability deals with the likelihood of development impact persisting after the closure of the project and withdrawal of the IFI. This requires some forward-looking analysis to be conducted at the same time as the IFI has ceased to earn any revenue from the project and is seeking to redeploy its funding elsewhere. Hence, there is little incentive

to address the issue of sustainability beyond some fairly perfunctory statements recording the status quo at the time of closure.

Environmental and Social Standards

Environmental and social (E&S) standards' considerations. Evaluations report that although IFIs always assess FIs for the compliance of their E&S management systems, the standards are not always followed through satisfactorily. While the vast majority of countries have adopted environmental, social, health and safety standards in line with those of IFIs, the quality and consistency of enforcement of the standards remains a problem. Inadequate monitoring and reporting, as well as the lack of agreements and standards enforcement, give rise to issues with accountability and transparency of LOCs. This also can lead to significant reputational damage to IFIs.

Points for Consideration by IFIs

The reporting obligations on development results. IFIs need to be made more accountable and transparent with respect to reporting on LOCs effectiveness. In turn, IFIs should be more proactive in holding FIs to account for reporting on LOCs development objective obligations. This implies better assessing the capacity of FIs to deploy LOCs in accordance with the IFI's target beneficiaries, rather than continuing to partner with the same large FIs. There is a need, however, to consider the trade-off between increasing the scope and the quality of M&E and the associated costs. A corollary to this is that achieving the right incentives between IFIs and FIs is paramount.

Ex-ante scrutiny of the business case for LOCs approvals. First, IFIs should underpin LOCs rationale and design through analytical work to make more realistic assumptions about how LOCs will contribute to improving access to finance for underserved market segments. IFIs' funding additionality to the market needs to be ascertained, implying that LOCs should primarily go to FIs that cannot easily obtain such funding. Second, IFIs should tighten up LOCs covenants to identify eligibility criteria that can be consistently implemented by partner FIs and are aligned to the LOCs objectives. Finally, the selection of FIs should be based on a clear commitment to serve a certain market segment.

The need for effective M&E systems. It is necessary to address LOCs transparency and accountability problems. Reporting requirements on sub-loan and sub-borrower performance should be defined ex-ante and followed through closely during the disbursement of the sub-loans. More effective checks are needed to verify that funds are used as originally agreed. Evidence shows that eligibility criteria alone will not give the IFIs assurance on the desired deployment of the credit line. There is also a need to provide capacity-building to the FIs to ensure the monitoring and reporting systems exist to produce information on development results at the sub-borrower level. But the implementation of a more proactive supervision is likely to reduce the cost-effectiveness (efficiency) of LOCs from an IFI perspective. IFIs could consider using new information and technology tools using mobile phone to collect information on outputs, outcomes, and impact directly from end-beneficiaries.

Provide resources for other instruments to address the binding constraints of the demand-side of access to finance, in parallel with LOCs. LOCs alone are not sufficient to create an efficient and effective financial intermediation system to support private sector development. First, they require complementary measures provided to the FIs. TA could be used to help FIs to enter new market segments, such as green lending, to assess the risk of lending to SMEs and fulfil their reporting obligations. For instance, TA accompanying green LOCs could develop standardized financial products for supporting energy-saving investments. Second, in parallel with LOCs, it is imperative for IFIs to promote and support reforms of the regulatory environment of financial systems and of the financial information system, for instance, in the setting-up of effective credit bureaus.

The capacity of IFIs. Staff competence requires strengthening expertise in: (i) banking and the private sector financial needs and how to address them; and (ii) ex-ante assessment including compliance with E&S standards within FIs; and (iii) monitoring and evaluation. As part of IFIs' due diligence of FIs, IFIs' investment officers should carefully screen FIs' existing portfolios to identify areas of the highest value addition and where to intervene. To this end, IFIs need to carry out economic and sector work on the financial sector to develop a good understanding of the needs-including those of the underserved

segments of the markets-and how to address them. For AfDB, this will require increased collaboration between the investment officers of the Financial Sector Department and the country economists in analysing the local financial market.

Harmonizing the IFIs' approaches towards LOCs. As one FI might partner with more than one IFI, the harmonization of procedures is needed to reduce the transaction costs for beneficiary FIs. Because IFIs' monitoring requirements can add a substantial administrative burden to FIs, IFIs should work with a shared definition of what constitutes an SME and apply the same indicators for monitoring and evaluating LOCs outcomes at the sub-borrower level. There is a need to strongly support initiatives to harmonize SME definitions among stakeholders to facilitate collecting and comparing data (Dalberg, 2011).

The pipeline vs the portfolio approach. Documentation of good practice in providing LOCs has yet to be prepared to guide IFI investment officers in their daily work. A portfolio approach is appropriate to assess whether a LOCs has had any impact on an FI business model. This approach is based on assessing changes in the composition of the FI portfolio before and after the LOC. The attribution problem can be overcome by benchmarking data on the trends of the market segment of the portfolio of an FI that has received a LOCs with that of a comparable FI that did not receive a LOC. However, for measuring outcomes of LOCs for end-beneficiaries, the evaluations reviewed by this synthesis failed to show any evidence that the portfolio approach was superior to the pipeline approach. Consequently, a further study to determine when to use which approach is recommended.

Environmental and social standards' considerations. IFIs should ensure that the client FIs have appropriate and effective environmental and social (E&S) management systems in place and the capacity for E&S monitoring at the sub-borrower level.

Communication of the LOCs lending policy. IFIs are advised to communicate their LOCs lending policy as widely as possible, to help foster competition between FIs and provide information to SMEs to make them aware of IFIs' funding. This could help to produce better results in terms of complying with loan covenants and yielding development results at the end-beneficiary level.

Dealing with fragile situations. The analysis of the portfolio of AfDB over the period 1969-2017 shows that 11 countries out of 54 were never provided with LOCs and that 17 countries did use LOCs after 2000. The majority of those countries are of small size and they deal with the challenges of fragile situations. The objective of universal access to finance implies that IFIs should find ways to extend their financing instruments to SMEs in fragile situations, including by supporting microfinance bank branches Horus Development Finance, 2014; AfDB, 2015).

Annexes

Annex 1: Recent IDEV Evaluations Related to LOCs

Nr.	Title	Publication
1.	Nigeria: Evaluation of AfDB's Country Strategy and Program 2004–2016.	2018
2.	Ghana: Evaluation of AfDB's Country Strategy and Program 2002–2015.	2017
2.	South Africa: Evaluation of AfDB's Country Strategy and Program 2004–2015.	2017
3.	Toward private sector led growth, lessons of experience. Evaluation synthesis	2016
4.	AfDB (2016). Evaluation de la performance du projet de ligne de crédit accordée par la BAD à la BOAD en 2008 – Projet financé au Sénégal.	2016
5.	Evaluation of AfDB group assistance to SMEs (2006-2013. A Synthesis with the following case studies: Country case studies of Ghana, Kenya, Morocco, Tanzania, Togo, and Zambia.	2015
6.	Fostering Inclusive Finance in Africa: An Evaluation of AfDB's Microfinance Policy, Strategy and Operations, 2000–2012.	2014
7.	Independent evaluation of AfDB's Additionality and Development Outcomes Assessment (ADOA) Framework for private sector operations.	2014
8.	Independent Evaluation of Non-Sovereign Operations, 2006-2011.	2013
9.	Unlocking the Potential of Africa's Sub-Regions: Review of Bank Group Assistance to Sub-Regional Development Banks.	2010

Annex 2: Evaluation Methodology Note

The evaluation started with the formulation of the evaluation questions reported in the reading grid below:

Reading grid

Evaluation criteria	Guiding questions
Relevance & design	▌To what extent was the additionality of LOCs ascertained to avoid crowding out alternative sources of financing? ▌Were the LOCs aligned with the development objectives of the IFIs, the financial intermediaries and the final beneficiaries? ▌Was the design of the operations appropriate to the needs of final beneficiaries and LOCs objectives? (e.g. in terms of loan characteristics, selection of the intermediary institution, eligibility criteria for final beneficiaries)? ▌Did the IFIs set up an M&E system to effectively document the outputs and outcomes of the LOCs on FIs and end-beneficiaries? ▌Were the indicators appropriate to quantify the impact of LOCs on FIs an on the end-beneficiaries? ▌Were institutional, adverse selection and moral hazard risks adequately assessed?
Effectiveness	▌Was there any evidence of the impact and did the evaluations differentiate between the attribution and contribution towards the results? ▌Have LOCs improved FIs' governance and to what extent were LOCs beneficial to IFIs? ▌Were the LOCs provided used for the intended results on the targeted end-beneficiaries? ▌Have the LOCs contributed to strengthening both local financial sectors and private sector investments? ▌To what extent were the planned outcomes attained, were there any unanticipated results? ▌What are the factors of success/failure?
Efficiency	▌Did the implementation arrangements allow for cost-effective delivery in terms of respect of the implementation schedule and the related costs? ▌What was the cancellation level and its explanation? ▌From the point of view of the IFIs, did the development value of the LOCs justify the costs?
Sustainability	▌Is there evidence of an enduring impact of the LOCs for both intermediaries and end-beneficiaries in addressing constraints to access to credit? ▌Did the LOCs contribute towards ensuring the revolving objective of the IFI portfolio?
Management and organizational issues	▌Were there appropriate mechanisms and instruments in place to ensure an adequate coordination and information flow between the IFI and its client FIs? ▌Have the monitoring, reporting and supervision arrangements in place enabled the IFI to oversee the delivery of the sub-loans? ▌Were risks appropriately monitored? ▌If risks were realized, how effective were the planned mitigation measures? ▌Were the LOCs complemented by other services, such as TA or policy dialogue to reform countries' business and investment climate? ▌Which added-value did these additional services bring to the LOCs? ▌In the case of co-financed LOCs, how was the coordination between development partners?

The evaluation then conducted a literature review from which relevant evaluation reports were identified from a web search by combining the following words, both in English and French.

- Lines of credit
- Intermediated loans
- Intermediated lending
- SME
- Non-sovereign
- Green loans
- Private sector
- Microfinance
- Inclusive Finance
- Blended financing

It identified the evaluation reports on LOCs from the evaluation departments of the following IFIs:

List of IFIs Scanned for the Evaluation Synthesis

Multilateral	Bilateral
African Development Bank Asian Development Bank Caribbean Development Bank EBRD EIB IFAD IFC Inter-America Development Bank Islamic Development Bank World Bank	Agence France de Développement (France) Proparco (France) FMO (Netherlands) DEG (Germany) BIO (Belgium) European Development Finance Institutions KfW (Germany)

A total number of 29 reports were identified, but only 12 were selected for the evaluation synthesis (Annex 4). Of these, only five have an exclusive focus on LOCs. Most of the evaluations that include LOCs cover wider topics. For the 17 non-retained evaluations, it was not possible to disentangle the impact and performance of the LOCs from other instruments, but for some specific examples.

The reports selected vary greatly in terms of scope of the analysis and structure, but have at least four common themes:

They are either structured along the DAC evaluation criteria, or they allow to link the evaluation findings to the DAC evaluation criteria;

They aggregate findings from different projects and are based on a combination of evaluation methods, including desk and literature reviews, portfolio analysis, case studies, and interviews with key practitioners;

They are detailed enough to isolate LOC-specific lessons; and

Their geographical scope covers low-income and middle-income countries.

Evaluation findings were complemented by information collected through a broader literature review concerning IFIs' policies, strategies, and procedural reports, which provided additional insights into LOCs objectives and business models in terms of design, management and organizational issues.

Data on approved LOCs operations by AfDB were collected from the Private Sector Department's database. These data were compared with those extracted from the Statistical Department's database, which is a repository of official AfDB statistics. The evaluation team worked with both departments to ensure the quality of information to be analysed. The team benefitted from the database officer of the Secretary General in charge of the list of approvals by the Board of Directors of AfDB. There was a limited comparison between the largest providers of LOCs in Africa between 2010 and 2017: AfDB, IFC, and EIB.

To develop a better understanding of the ongoing discussions on LOCs, the evaluation team conducted interviews with the task managers, managers and other subject-matter experts in AfDB (departments of private sector, risks, ADOA and finance); with LOCs experts of AFD and PROPARCO; CGAP; and Frankfurt School experts working with AfDB's financial sector department.

Annex 3: Instruments Used in AfDB's Financial and Private Sector Departments

	Amount approved (UA)				Percentage		
	LOC	Equity	Guarantees	Total	LOC	Equity	Guarantees
2000	187	2	262	**452**	**41.5**	0.5	58.0
2001	264	-	-	**264**	**100.0**	0.0	0.0
2002	335	-	-	**335**	**100.0**	0.0	0.0
2003	300	-	-	**300**	**100.0**	0.0	0.0
2004	213	3	2	**218**	**97.8**	1.5	1.0
2005	212	35	7	**254**	**83.4**	13.8	3.0
2006	157	-	9	**166**	**94.7**	0.0	5.0
2007	88	185	-	**273**	**32.1**	67.9	0.0
2008	298	146	25	**468**	**63.6**	31.1	5.0
2009	235	142	12	**389**	**60.4**	36.6	3.0
2010	348	190	-	**538**	**64.7**	35.3	0.0
2011	729	53	-	**782**	**93.2**	6.8	0.0
2012	318	134	-	**452**	**70.4**	29.6	0.0
2013	193	100	432	**724**	**26.6**	13.8	60.0
2014	412	133	173	**718**	**57.4**	18.5	24.0
2015	575	64	697	**1,337**	**43.1**	4.8	52.0
2016	662	205	268	**1,136**	**58.3**	18.1	24.0

Annex 4: List of Selected Evaluation Reports and Other References

Selected Evaluations with their Key Information

Horus Development Finance, 2014. Evaluation of the Effectiveness of EIFI Support to SME Development through Financial Institutions in Africa	
Years covered	2006-2012
Geographical coverage	Sub-Saharan Africa
Portfolio size	About USD285.6 million (LOCs only)
Evaluation theme/objective	SME finance through intermediary financial organisations. Gather evaluative evidence on whether and how intermediated assistance contribute to increased supply of credit to SMEs.
Evaluation approach	Literature review on SME finance. No portfolio review but a study sample of four medium-sized and two large commercial banks, operating in West Africa (Ghana), East Africa (Kenya, Uganda, Tanzania), and Southern Africa (Zambia).
Key findings	▮ FIs under review all improved their financial strength. They reduced their maturity and currency mismatches, improved their capital adequacy and were successful in domestic deposit mobilization. However, it is hard to establish the contribution to SME business lines made to their profitability, as none of them has been able to measure this. ▮ Most of the supported banks did not have a dedicated strategy for the SME market, and most did not set up or strengthen dedicated structures. ▮ Specific SME banking capacity was not strengthened significantly in response to EIFI support. FIs that were studied typically chose to keep serving a relatively small number of select SME clients, and not to develop methods aimed at expanding credit provision to large numbers of SME customers. ▮ What financial intermediaries the EIFI members choose to work with is an important determining factor of effectiveness. The financial intermediaries that had already invested in their SME business line and had built specific SME capacity have been more successful in further expanding their SME banking capacity and financing when they received funding. Working with small banks, which tend to have a higher strategic interest in serving SMEs, may also be relatively more effective for improving SME access to finance.
Key recommendations	▮ EIFIs should seek to choose financial intermediaries that have already developed a strategy for their SME business and have committed dedicated investments to this business line. Nonetheless, working with large banks should not be ruled out as they may be able to develop innovative products and approaches for reaching large numbers of SMEs when the environment allows. ▮ Financial institutions that have not yet invested significantly in the development of their SME business should be offered support to do so, specifically in the areas of strategy, marketing, cost and risk management, and in managing MIS development projects. ▮ EIFIs would have to request baseline data and then to monitor progress on client financial institutions' SME financing, both in qualitative (e.g., innovations in products and service delivery relevant for SME clients) and quantitative terms (e.g., number of SME clients/loans). ▮ Baseline and monitoring will allow EIFIs to more actively manage their investments with respect to results in terms of improved SME finance. Loans may be disbursed in tranches, with disbursements of later tranches made conditional on specific SME financing or banking milestones being achieved. ▮ The fact that most of FIs under review were unable to adequately identify their SME clients in their IMS and to determine the contribution their SME business lines made to their profitability further underlines the desirability of focused support for MIS development projects. ▮ Harmonization—along the lines of the IFI harmonization initiative-will help the development of shared methods (e.g., baseline studies) and the communication of results achieved.

World Bank, 2014. The Big Business of Small Enterprises Evaluation of the World Bank Group Experience with Targeted Support to Small and Medium-Size Enterprises,	
Years covered	2006-2012
Geographical coverage	Worldwide, low-income and middle-income countries
Portfolio size	USD18 billion (entire portfolio)
Evaluation theme/objective	SME targeted assistance
Evaluation approach	Complete independent evaluation. Desk/literature review (the Logic of Targeted SME Support), portfolio review, country case studies (6 field missions and 14 desk-based)
Key findings (in relation to LOCs)	▌IFC's relevance is greatest where the financial sector is weakest in serving SMEs. IFC's relevance is greater when it operates at or near the frontier, especially in low-income and fragile and conflict-affected countries or regions where SMEs are not served; in countries where the financial sector has not yet developed to serve SMEs; with intermediaries that lack a firmly established SME practice; and in extending financial services to the underserved. ▌Many clients value IFC's support. However, these projects often lack key features that would enhance their relevance to the targeted firms, such as an appropriate SME definition; a clear connection of the intervention to correcting a market, policy, or institutional failure; or language in the project's legal documents that requires benefits to be directed to SMEs. ▌Projects that on-lend through financial intermediaries have the highest average development outcome, in part because they are located in relatively higher-income countries than other product lines. ▌In general, IFC's targeted SME investments lack sufficient monitoring and baseline information to enable reliable measurement of development impact.
Key recommendations (in relation to LOCs)	▌IFC, MIGA and the World Bank should harmonize their SME approaches and make clear the objectives and analytic justification for targeted SME support, how it relates to systemic reform, where it is appropriate, what main forms it will take, and how it will be monitored and evaluated. ▌The M&E framework should be designed to capture the impact of project interventions in these dimensions-at the beneficiary, client and broader market level. ▌World Bank Group management should refine its SME approaches to shift benefits from better-served firms and markets to frontier states, frontier regions, and underserved segments.

EIB, 2017. Evaluation of EIB Intermediated Lending through the Investment Facility in ACP	
Years covered	2010-2015
Geographical coverage	Sub-Saharan Africa, Pacific, Caribbean
Portfolio size	EUR 1,240 million
Evaluation theme/objective	Lines of credit for SMEs also called intermediated lending
Evaluation approach	Complete independent evaluation. Include an analysis of upstream policy documents, desk research on past evaluations of intermediated lending targeting SMEs and an analysis of other IFIs portfolio. Portfolio analysis and individual evaluations of a sample of 15 EIB contracts signed with 11 financial intermediaries located in Nigeria, Kenya, Uganda and Haiti.
Key findings	▌The use of the EU definition for what constitutes an SME does not allow distinguishing between enterprises that actually qualify as small, medium and large in the ACP context, as most of the clients of the local banks with which the EIB works could be included in this category. ▌Insufficient long-term, local currency liquidity is only one of many barriers constraining access to finance. The evaluation finds that there are other, equally important barriers, some of which are within the remit of the EIB: the actual and perceived risk of lending to SMEs; the limited knowledge of financial intermediaries to assess the credit risk of SMEs; and the weak capacity of SMEs to prepare bankable projects. ▌The vast majority of allocations approved were to finance investments within the so-called "missing middle". However, the majority of the funding volumes were approved for financing a small number of large projects. The evaluation questions whether such a significant share of lending for larger allocations and enterprises is in line with the spirit of the IF objectives for intermediated lending, which aim to support SMEs and initiatives. ▌LOCs have been a useful instrument for strengthening financial intermediaries. Longer-term local currency loans allowed financial intermediaries to mitigate their maturity and currency mismatches, and capex loans supported intermediaries in their expansion and consolidation strategies. ▌Monitoring and reporting are found to be insufficient to track and demonstrate policy results, largely because the implementation of LOCs was mainly driven by eligibility and not by strategic objectives. ▌The evaluation finds that allocation lists are mutually interchangeable; financial intermediaries were able to swiftly replace allocation requests with new ones when the EIB objected to a proposed allocation, or the proposed allocation would require additional scrutiny by EIB services. This suggests that intermediaries have a portfolio of projects from which they draw a sample to submit as allocation requests.
Key recommendations	▌To maximise impact in terms of access to finance and financial sector development, the EIB should continue to explore and, when feasible, use instruments that address not only liquidity constraints but also barriers relating to the risk of lending to SMEs and to weaknesses in the capacity of financial intermediaries and SMEs. When relevant, it should also continue to explore the possibilities for coordination with partner institutions that address legal and regulatory barriers. ▌AfDB should request the Investment Facility Committee to confirm the types of final beneficiaries and objectives it wishes to prioritise through LOCs and should integrate Investment Facility objectives, particularly those relating to increasing access to finance, throughout the project cycle-from the selection of financial intermediaries, to project design, the drafting of contracts, and design of monitoring tools ▌The EIB should adapt tools and processes to improve monitoring and reporting of IF policy objectives. In particular, it should explore how progress towards achieving the expectations set at appraisal stage could be monitored. It should produce a study on the pros and cons of using an allocation versus a portfolio approach for monitoring LOCs in ACP.

AFD, 2012. Méta-évaluation des projets « lignes de crédit »	
Years covered	1996-2009
Geographical coverage	Tunisia, South Africa and Vietnam
Portfolio size	EUR 402 million
Evaluation theme/objective	LOCs
Evaluation approach	Case studies, 14 lines of credit delivered to Tunisia, South Africa and Vietnam
Key findings (in relation to LOCs)	▮ The relevance of LOCs is recognised regardless of the point of view held. The objectives and the partners have been well chosen, whether with regard to the strategies of AFD or the priorities of the countries involved in the intervention. ▮ From the point of view of efficiency, the financial conditions offered were often competitive and the procedures relatively flexible, which in most cases allowed for satisfactory completion times. ▮ The achievement of the objectives is rarely verifiable from the existing reporting/monitoring. However, the evaluators' analysis of a sub-sample of projects concluded that their effectiveness was satisfactory. ▮ The impact of funded projects is not measurable. More relevant is the question of the additionality of AFD financing in terms of development results. The assessment is mixed based on this criterion. ▮ The sustainability of the results of the funded projects is also difficult to assess, the question of obtaining lasting impact in the policies and strategies of the FIs receives mixed responses.
Key recommendations (in relation to LOCs)	▮ Reduce the gap between intentions and practice. Manageable eligibility conditions and more modest aspirations in terms of monitoring the project results are prerequisites for reducing the gap between the commitments made at the start of funding and the practical arrangements that are put in place during implementation. ▮ Consider additionality as the main objective of funding. The objectives of LOCs should not only be limited to the objectives of the funded projects. As such, greater emphasis should be given to institutional objectives of LOCs (adapting the credit policy of the FI, reinforcing the capacity of end-beneficiaries, leveraging the impact on the credit market, etc.), the means to influence these objectives (innovation, use comparative advantage, mixed loans/grants, TA), and instruments to verify the achievement of these objectives. ▮ Focus on learning and progressivity in FI partnerships. In most cases, LOCs are intended to drive a lasting partnership with an FI.

AFD, 2014. Evaluation of LOCs from AFD through BOAD	
Years covered	2000-2010
Geographical coverage	Western Africa
Portfolio size	EUR 95 million
Evaluation theme/objective	LOCs to regional development banks
Evaluation approach	Case studies, 3 LOCs delivered to the West Africa Development Bank (BOAD).
Key findings	▌The relevance of intermediation and the development objectives was high. ▌The efficiency of setting up these 3 LOCs was uneven over the stages of the process. Their planning was conducted in close collaboration with AFD within a satisfactory time and their disbursement by AFD was rapid. However, the findings were more nuanced regarding project realization. ▌Regarding the strengthening of BOAD's structure, the quality of the technical discussion between AFD and BOAD was satisfactory, especially for training of LOCs and project selection. However, the close coordination ceases once the project is up and running, with AFD leaving BOAD to be responsible for implementation. This apparent lack of interest leads to AFD losing contact with the achievements and therefore the lessons that it could draw from them.
Key recommendations	It is necessary to better define the involvement of AFD in the training and monitoring of projects financed by BOAD. AFD should not interfere in the management and implementation of projects. However, it must exercise a consultative role upstream of BOAD's training process during the presentation by BOAD of its requests for LOCs projects. AFD should have a greater interest in the results achieved by the projects financed by these 3 LOCs.

AfDB, 2013. Independent Evaluation of Non-Sovereign Operations.	
Years covered	2006-2011
Geographical coverage	Africa
Portfolio size	UA 3.9 billion
Evaluation theme/objective	Private sector operations (LOCs, direct lending, equity, guarantee) along the following dimensions: strategy alignment, portfolio performance, risk management and institutional efficiency.
Evaluation approach	Review of the policy documents, complete portfolio review, interviews, questionnaires and site visits. Benchmarking with peer organisations.
Key findings (in relation to LOCs)	▌Compared with its peers, AfDB has used a relatively narrow range of instruments to support private sector development; predominantly senior loans, lines of credit and equity investments. ▌AfDB's reach to micro and small enterprises through these credit lines is not always evident. ▌AfDB has inadequate monitoring procedures to enable it to gather credible results data during supervision, so limiting its ability to judge outturn development effectiveness. This is due to a lack of client knowledge or capacity to collect and provide relevant data to AfDB, but it also stems from a lack of internal focus on these areas during supervision.
Key recommendations (in relation to LOCs)	▌Review the strategy, policies and procedures for financial sector investments, particularly intermediation through lines of credit. ▌Develop specific guidelines in supporting SMEs to ensure that financial intermediaries are held accountable for the deployment of AfDB's funds and that these funds have the best chance of reaching their intended beneficiaries (e.g., SMEs). Address the apparent low level of client reporting on development results. ▌Include environmental and social requirements, and ensure that financial institutions comply. ▌Explicitly take into account the projected impact from increased exposure to LICs, fragile states, and other high risk-rated priority groups.

AfDB, 2010. Unlocking the Potential of Africa's Sub-Regions Review of Bank Group Assistance to Sub-Regional Development Banks	
Years covered	1998-2008
Geographical coverage	Africa
Portfolio size	UA 352 million
Evaluation theme/objective	Assistance provided to regional development banks (LOCs, equity participation, and technical assistance) to: Assess the strategic alignment of the assistance against the relevant policies and strategies of AfDB, sub-regional banks, and member countries. Examine the effectiveness of AfDB's interventions against the defined objectives at appraisal. Identify lessons to improve the performance of future AfDB interventions via sub-regional financial intermediaries and enhance their development effectiveness.
Evaluation approach	Desk review of policy and operational documents; field work for interviews and to directly collect evidence on evaluation criteria applied to the three sub-regional banks covered by this review: PTA Bank, EADB and DBSA and 9 LOCs.
Key findings	▪ The quality and commitment of the management team, as well as the governance structure and practices of the sub-regional IFIs, directly impact the effectiveness of AfDB's assistance. ▪ Sub-regional IFI's size matters given the fact that Africa's development finance needs are enormous. ▪ Providing a remedy for the failure of the 'market for long-term funding' on its own is not enough; start-ups usually need advice and guiding on management and governance. ▪ The only way to ascertain the E&S compliance of sub-projects is through strong supervision and follow-up; reliance on the borrower to do so has proved to be unsuccessful. ▪ Restriction of ADB's Board presence to project approvals does not help in averting sub-regional IFIs' management crises. ▪ Wholesale lending operations are a strong option for finance intermediation via sub-regional IFIs to support SMEs and promote intra-regional infrastructure with the introduction of more innovative instruments.
Key recommendations	▪ AfDB should strive to finalize its 'Partnership Strategy' with the sub-regional IFIs and use it to guide all future operations. ▪ The new 'partnership strategy' should consider wholesale operations via sub-regional IFIs as an option for targeting national IFIs and SMEs. ▪ The sub-regional IFIs should seek to enlarge their balance sheet and strive to establish stronger partnerships with their shareholders. The sub-regional IFIs are relevant, but their impact is limited because of their relatively small size. The sub-regional IFIs should also seek to play a greater role in supporting regional integration by adopting the plans, policies, and strategies of their respective RECs. ▪ The board representative of ADB should come from a higher managerial level of AfDB and should use its presence to influence both policy and strategy of the sub-regional IFIs. ▪ ADB should leverage all the resources and initiatives available to help the sub-regional IFIs improve and fill any gaps that might exist in their operational performance.

ADB, 2013. ADB Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth	
Years covered	2000-12
Geographical coverage	Asia
Portfolio size	USD10.7 billion
Evaluation theme/objective	Thematic evaluation assessing how private sector operations are contributing to inclusive and environmentally sustainable growth as part of efforts to promote private sector investments and growth. The study primarily seeks to identify lessons from relevant experience with a view to informing the selection, design, and monitoring of future PSO.
Evaluation approach	Review of corporate strategies and portfolio allocations, document review of the development focus and design features of all 173 Private Sector Operations Department transactions, review of evaluation reports, project visits, surveys, and other relevant information for the more than 70 projects that are operational and have sufficient data points to assess their actual contributions to any of these objectives.
Key findings (in relation to LOCs)	▌Many finance sector transactions did not contribute significantly to growth, poverty reduction or inclusion despite a large share of SME-related operations. ▌SME-focused PSO are not necessarily supportive of inclusive growth. To design relevant transactions, the method in which SMEs contribute to innovation, competition, entrepreneurship, and (self-)employment including, among others, of the poor, women, and rural populations, needs to be clearly established; as well as factors identified that impede their potential for larger contributions. ▌Lack of funding has rarely been the key binding constraint to private investment, but lack of a conducive investment climate and inadequate policy and regulatory frameworks have.
Key recommendations (in relation to LOCs)	▌Country partnership strategies and project documents need to make explicit the causal pathways, transmission channels, and underlying assumptions about how projects will contribute to inclusive growth, be it directly or indirectly. For any project seeking to improve inclusion, targeting and transmission mechanisms need to be in place and demonstrated. ▌ADB tends to be one of several financiers and at best a minority shareholder. Unless ADB can also provide advisory services, its window for influencing approaches to financial institution lending is small and usually limited to specific lending or investment allocations and ESMS specifications. ▌Other significant nonfinancial impediments need to be addressed in tandem. ▌ADB needs to strengthen the monitoring of PSO development outcomes by: (i) improving the inclusion of relevant outcome statements and indicators in project design and monitoring frameworks; and (ii) systematically collecting required monitoring reports from private sponsors and fund managers. For example, while DMFs for SME-related PSO appropriately include increased SME lending among the envisaged project outputs, enhanced capacity of supported financial institutions for SME lending-rather than improved performance of financed SMEs—usually is the stated project outcome. Improvement in access to goods and services for the poor, women, and rural populations have to be identified and quantified in pertinent projects.

IaDB, 2016. Evaluation of IDB Group's Work Through Financial Intermediaries	
Years covered	2005-2014
Geographical coverage	Latin America and Caribbean
Portfolio size	USD17 billion
Evaluation theme/objective	Lending of the Inter-American Development Bank Group through financial Intermediaries.
Evaluation approach	Comprehensive evaluation covering all IaDB windows delivered through FIs. Summary evaluation of 5 thematic evaluation addressing: SME Finance, Trade Finance, Housing Finance, Leasing and Factoring, and Green Lending. It is also based on the following background reports: Environmental and Social Safeguards, Benchmarking of Development Finance Institutions, OVE Survey of IaDB Staff, OVE Survey of FI Clients, IaDB External Feedback Survey for FI clients, Country Profiles
Key findings (in relation to LOCs)	▌Only one-fifth of IADB country strategies during the evaluation period included the financial sector as a priority, even where IaDB had significant FI operations. ▌The lack of diagnosis of access to finance issues at the country level impeded the strategic selection of FI operations. Almost half of operations originated opportunistically out of client requests. Given the absence of overarching strategic goals for FI operations or a formal process to allocate FI operations across windows, different windows approached the same clients, sometimes competing with each other. ▌IaDB group structured most FI operations by attempting to track the use of its proceeds, despite the fungibility of funding within FIs. For most lending, all IaDB set certain eligibility criteria and required FIs to submit a list of projects that would fulfil those criteria. FI clients told evaluators that they selected projects that they thought would meet IaBD criteria from among their broader client base. ▌FI operations were processed faster than non-FI operations, contributing significantly to the overall efficiency of the IaDB. The number of days from the initial assessment or proposal to approval was consistently lower for FI operations than for non-FI operations. Despite this, FI clients are still not very satisfied with IaDB's processing times. ▌Despite improvements over time in IaDB project evaluation architecture, the core issue of how to measure the results of FI operations was not effectively addressed. The idea of tracking specific sub loans being funded by IaDB loans is conceptually flawed, given the fungibility of resources in FIs. ▌Incentives within the IaDB were skewed toward short-term and financial goals. When asked to prioritize the perceived incentives during the selection and design of FI operations, officers ranked them as follows: first, risk mitigation; second, an immediate FI need for IaDB funding; and third, approval volumes, and in some windows disbursements. In fact, some officers mentioned incentives to build volumes through large FI operations rather than several small ones. ▌The evaluation found that FI operations – particularly those with large FIs – were key contributors to IaDB profitability.
Key recommendations (in relation to LOCs)	▌Develop and implement a meaningful IaDB-wide strategic approach for working through FIs. ▌Better integrate FI work across IaDB into country strategies. Issues of financial development and access to finance are country-specific, and AfDB's approach should be tailored to country situations, while also taking into account the demand-driven nature of IaDB support. ▌Strengthen M&E and IaDB accountability for results by creating and applying adequate incentives and instruments. ▌Review and strengthen the way environmental and social safeguards are applied to FI operations.

IaDB, 2016. Evaluation of IDB Group's Work Through Financial Intermediaries -SME Finance	
Years covered	2005-2014
Geographical coverage	Latin America and Caribbean
Portfolio size	USD7.85 billion
Evaluation theme/objective	This evaluation covers FI operations for SME finance managed by all IaDB group windows.
Evaluation approach	Policy review, portfolio analysis, interviews, surveys.
Key findings (in relation to LOCs)	▮ IaDB sees FI operations as a cost-effective mechanism to reach SMEs. Lending directly to SMEs is prohibitively costly for IaDB. Therefore, IDBG supports and works with the region's FIs so they can on-lend to SMEs. ▮ A key objective of the FI operations reviewed as part of this evaluation was to expand access to finance for SMEs, deliver expected positive outcomes in key economic development variables such as productivity and employment, and strengthen client FIs, and particularly their capacity to sustainably serve SMEs. However, FI lending operations are unable to tackle many problems that constrain access to finance, such as weak legal and regulatory frameworks, poor financial infrastructure, or low creditworthiness of potential borrowers. The fact that liquidity was not a major constraint to FI lending during the evaluation period calls into question the relevance of IaDB direct loans as an instrument of support. ▮ IaDB usually targeted SMEs using its own definitions, which were not aligned with those of FIs, making it difficult to measure the growth of the relevant portfolio (loans to SMEs) and its performance. Only about one-sixth of the FI operations considered increasing the FI´s SME portfolio as an objective, and only half of them set a specific target for it. ▮ For about one-quarter of FI operations, the independent evaluation department was able to independently estimate the increase in the relevant portfolio, finding that in 75 percent of cases MSME portfolios grew at least as much as the funding provided by IaDB. However, the extent to which this increase is attributable to IaDB is unclear. ▮ There is limited information on the effects of IaDB financing on beneficiaries, especially regarding interest rates for on lending. ▮ There is little information about the effect of improved access to finance on SME performance, such as increases in jobs, sales, and productivity. Although these were often the ultimate objectives of SME FI operations, IaDB did not track SMEs' performance on revenues, jobs, and exports.
Key recommendations (in relation to LOCs)	▮ To enhance the relevance of its SME FI operations, IaDB needs to work with country partners to understand the main barriers to access to finance for SMEs in each country, and to pursue FI lending operations only where they are the appropriate tool. ▮ If IaDB is to enhance the development impact of its SME financing, it will need to overhaul the way it structures its loans and monitors outputs and outcomes. Requiring lists of specific SME loans is an ineffective way to monitor development results. Given the fungibility of money, growth in the FI's relevant (i.e., SME) portfolio is the more appropriate indicator to track. ▮ To be able to capture information about the SME targeted portfolio, IaDB would need to adapt its SME definition to that of the FI. ▮ IaDB could usefully ramp up its contributions to strengthening SME capacities, so that FIs are more likely to provide them with financing.

IaDB, 2016. Evaluation of IDB Group's Work Through Financial Intermediaries -Green lending	
Years covered	2005-2014
Geographical coverage	Latin America and Caribbean
Portfolio size	N/A
Evaluation theme/objective	This evaluation reviewed the general portfolio of green lending operations and looked in detail at 3 specific projects to understand: (i) the role of credit lines as an instrument for climate change mitigation and adaptation; and (ii) IaDB's impact in the three cases.
Evaluation approach	Portfolio analysis and case studies. The cases were chosen so as to cover different instruments (loans vs. guarantees), different market sizes and different sustainability and energy policies and incentives.
Key findings (in relation to LOCs)	▮ The green lines reviewed did not contain a clear definition of objectives at either the project or the program level. The conceptual link between the intervention and any expansion of the green portfolio was weak in all three cases, and it is unlikely that the FIs' portfolios changed as a consequence of the IaDB intervention. ▮ The FIs increased their engagement and green portfolio after the IaDB operation. However, the increased engagement seems to have been a cause, rather than a consequence, of the IaDB operation. ▮ Funding per se was not a constraint to FIs' investments in the green loan market; the greatest potential was to be found in interventions that corrected information asymmetries or that promoted financial innovation. In all cases, FIs succeeded when they identified a well-defined niche in the energy sector, and they further developed a successful strategy to finance environmental projects.
Key recommendations (in relation to LOCs)	▮ If IaDB is to use credit lines through the private sector to increase the number of green operations, it should consider redefining its intervention strategy. Specifically, since funding is typically not the main barrier to the expansion of green lending, the independent evaluation department suggests moving from a model centred on the loan-and the conditions attached to it-to a model that is centred on the FI and places the emphasis on knowledge. Such a model would be more consistent with the market failures identified. ▮ To implement this intervention strategy, management could move in the direction of establishing partnerships with FIs that are interested in pursuing green lending. In that partnership, lending should be used to establish and maintain a relationship with the client and make it possible for the IDB to finance TA, while technical assistance is key to bridging informational asymmetries.

AfDB, 2015. Evaluation of Bank Group Assistance to Small and Medium Entreprises	
Years covered	2006-2013
Geographical coverage	Africa
Portfolio size	About USD1.9 billion
Evaluation theme/objective	SME-targeted assistance. The evaluation assessed the relevance, additionality, effectiveness, sustainability, and efficiency of SME assistance operations, as well as AfDB's approach to SME development.
Evaluation approach	Independent evaluation. Literature review, policy review, portfolio review, case studies (Ghana, Kenya, Morocco, Tanzania, Togo, and Zambia).
Key findings (in relation to LOCs)	▪ The themes addressed by AfDB are highly relevant for SME development. However, when compared with other IFIs, AfDB is more focused on improving conditions for SME finance, while less attention is paid to other areas of interventions (investment climate reform, financial market infrastructure, market access, etc.). About 80 percent of SME assistance was provided through credit lines, including apex lending operations with regional development finance institutions. ▪ One persistent gap in AfDB's product mix is the limited use of local-currency lending, which limits its ability to effectively reach SME beneficiaries ▪ The relevance of SME assistance operations was often undermined by weaknesses in design. In some cases, there was a limited appreciation of client's financial needs, which resulted in project cancellations. Financing agreements often did not appropriately specify eligibility criteria for sub-loans. This provided ample room for the risk-averse banks, a substantial subset among the recipients of AfDB's SME assistance, to utilize loan proceeds for safer corporate lending. As a result, a significant share of AfDB's assistance was nominally targeted at SMEs, but in practice can be better described as generic private-sector development assistance. ▪ Only a few financial intermediaries expanded their SME portfolio and even fewer introduced new financial products for SMEs. ▪ The effects of AfDB's SME assistance are difficult to gauge, partly due to the lack of information. The M&E of SME assistance operations is challenging, requiring the design of appropriate measuring tools and the collection of a significant mass of data. The matter is further complicated by the two-tiered structure of most SME operations, which in principle requires information from both immediate beneficiaries (banks, equity funds, etc.) and ultimate beneficiaries (the SMEs). ▪ No rating is possible for sustainability. Little can be said about sustainability due to the limited number of completed projects and the paucity of development results sustained. ▪ Provision of long-term resources enabled financial intermediaries to match the demand for term credit (medium- to long-term lending). However, AfDB rarely played a catalytic role. Most intermediaries were recipients of or were concurrently receiving substantial support from other IFIs/IFIs. The majority of banks receiving credit lines from AfDB were also supported with technical assistance, but these interventions do not seem to have appreciably influenced project results.
Key recommendations (in relation to LOCs)	▪ An official definition of SME should be adopted by AfDB so that the target groups are clearly defined. In the case of operations with financial intermediaries, AfDB may consider complementing the size-based definition for all AfDB's operations with one based on loan size for each specific intermediary, which is likely to be more easily handled by FIs. ▪ Expand the utilization of local currency financing. ▪ Improve the design of investment operations. The design of future operations should involve a more accurate assessment of FIs' financial needs, with the primary objective of drastically reducing cancellations. This should be accompanied by a more realistic assessment of FIs' propensities and abilities to effectively serve SME clients, with the setting of more realistic targets. ▪ Strengthen eligibility conditions to ensure that SMEs are effectively reached. ▪ Diversify the range of client FIs and countries of operations. AfDB should actively seek to work with a broader range of FIs across Africa ▪ AfDB needs to collect credible information on both financial intermediaries and ultimate beneficiaries. Loan agreements should require FIs to provide information on their lending or investment activities. At a minimum, FIs should have to provide: (i) the number and basic features of the sub-loans; (ii) detailed data on the composition of their portfolio, with a separate indication of the number and value of operations with SMEs (based on a uniform definition of SMEs); and (iii) data on non-performing operations, again with a separate indication of the relevant parameters for SMEs. Whenever feasible, FIs should also be required to collect information on client SMEs for at least some basic variables (turnover, employment, exports).

Non-selected Evaluations

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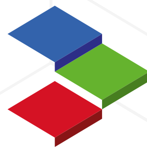
Endnotes

1. These constitute the final beneficiaries of LOCs, which use the on-lent money to invest in their projects.
2. Other intermediated financial instruments include guarantees, senior or subordinated loans, equity investments and trade finance facilities.
3. This refers to the experience of the Asian Development Bank, the Inter-American Development Bank and the African Development Bank.
4. Since the mid-1980s, many African countries have implemented financial sector reforms. To a large extent, these reforms aimed at restructuring and privatizing state-controlled banks (Eugene Bempong Nyantakyi and Mouhamadou Sy, 2015).
5. There is an accelerated timeline and lighter information requirements for approval.
6. The most recent period is 9 years.
7. Countries and international financial institutions committed to step up their financial support to fund the 2030 agenda for sustainable development (Griffith-Jones, 2016).
8. This can include both other types of financial instruments, such as guarantees or leasing, or policy dialogue at the government level to address regulatory bottlenecks for SME lending (e.g., credit bureaus, property rights, collateral legislations, foreclosure legislation).
9. IFC's SME Loan Size Proxy: A Reliable Predictor of Underlying Small and Medium Enterprises in the IFC's Financial Markets Portfolio. Available at IFC web site: https://www.ifc.org/wps/wcm/connect/635f64804efbe2b18ef5cf3eac88a2f8/IFC_Factsheet_SME_Loan+Size+Proxy_Brief.pdf%20?MOD=AJPERES
10. Even if LOCs are priced at the prevailing market rate, LOCs conditions, especially their long-tenor, make them more beneficial than other sources of financing.
11. The evaluation of the CSP for Nigeria (2018) underscored that LoC recipients are major banks concentrated in Lagos and mostly financing sub-borrowers located in the area, with depressed communities actually not receiving any focus.
12. Another critical issue is that SME classification differs among IFIs and among FIs.



IDEV

Independent Development Evaluation
African Development Bank

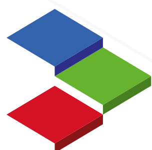
An IDEV **Evaluation Synthesis**

About this Evaluation

The Independent Development Evaluation (IDEV) conducted an evaluation synthesis of Lines of Credit (LOCs) with an aim to interrogate the design, implementation and effectiveness of LOCs in order to improve future investments in LOCs. The main objectives of the evaluation were to identify good practices from the experience of the AfDB and peer institutions in the achievement of LOCs' development objectives; and to draw strategic and operational lessons that could inform the design, implementation and use of future LOCs.

The evaluation team assessed 12 selected evaluations in terms of the extent to which LOCs are a relevant, cost-effective, and sustainable instrument for increasing access to finance and promoting inclusive growth. They also interviewed investment officers, managers of LOCs and subject matter experts both at the AfDB and at other related institutions. Focus group interviews were conducted with AfDB's task managers and senior managers working on finance matters, and a workshop was organized to discuss emerging findings with AfDB staff from relevant departments.

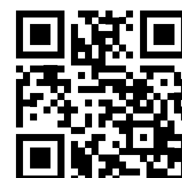
Overall, the evaluation synthesis revealed that LOCs represent 10% of the Bank's total approved amount and they are relevant for International Financial Institutions (IFIs) and client Financial Intermediaries (FIs). There are however a number of challenges that need to be addressed including insufficient analytical work to guide the design of LOCs; lack of reliable information from which to deduce development results; inadequate literature on sustainability of LOCs; and inadequate enforcement of environmental and social standards. To partly address these challenges, the synthesis underscored the need for IFIs to be more accountable and transparent in their reporting on LOCs' effectiveness; and to be more proactive in holding FIs to account for reporting on LOCs' development objective obligations.



IDEV

Independent Development Evaluation
African Development Bank

African Development Bank Group
Avenue Joseph Anoma, 01 BP 1387, Abidjan 01, Côte d'Ivoire
Phone: +225 20 26 20 41
E-mail: idevhelpdesk@afdb.org



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