



Fourth Independent Evaluation Report to the IIC Board of Executive Directors

The Inter-American Investment Corporation's evaluation system was created in June 1999 to "assess progress and performance in fulfilling the IIC's mission." The evaluation system is based on a two-pronged approach: a self-evaluation done by IIC and an independent evaluation carried out by the Office of Evaluation and Oversight (OVE) of the Inter-American Development Bank (IDB). The IIC prepares Expanded Annual Supervision Reports (XASRs) on matured projects (according to best practices for multilateral organizations), and OVE reviews each report to verify the reliability of the analysis, impartiality and consistency in ratings, and completeness of the identified lessons learned. Once this review is completed, OVE then prepares a report for the Board of Executive Directors of the IIC.

Following is a summary of OVE's most recent report (for 2005/2006); it is the fourth such report on the IIC's evaluation system. The report covered twenty-nine projects (twelve corporate and seventeen financial intermediary projects) that met maturity criteria in 2005. As in previous years, the report assessed outcomes and outcome drivers of the IIC's investment operations during the life of projects. It also assessed the implementation status of past recommendations aimed at improving the IIC's evaluation process.

The report concluded that the IIC is making good progress in implementing OVE's past recommendations with respect to improving its evaluation process, namely: i) compliance with the Evaluation Cooperation Group of Multilateral Development Banks (ECG-MDB) standards and procedures; ii) implementation of lessons learned identified in XASRs; and iii) compliance with specific 2005 OVE Recommendations.

OVE concluded, after reviewing the twenty-nine XASRs, that 65 percent of operations achieved high development outcomes. This is an improvement over 2004, when only 44 percent of reviewed projects had high development outcomes. Sixty-two percent of the projects evaluated achieved satisfactory financial results—a percentage similar to that of 2004. Fifty-nine percent of operations achieved "win-win outcomes," meaning that they delivered both high development and high investment outcomes.

Development outcomes and investment outcomes are measured as follows:

- Development outcome indicators measure a project's overall impact on the development of the host country. The rating is based on four underlying indicators: project business performance; economic impacts; environmental, social, health, and safety impacts; and contribution to private sector development (see Box 1).
- Investment outcome: measures the financial benefit to the IIC of a specific project.

Box 1: Measuring Development Outcomes

The development outcomes of the IIC's projects are based on four performance dimensions:

Project Business Performance (64 percent success rate): Real sector projects generated a satisfactory financial rate of return. Financial sector projects contributed positively to increased lending to SMEs.

Economic Impacts (59 percent success rate): Projects generated an economic rate of return (ERR) of at least 10 percent. This indicator also takes into account employment generation, foreign-exchange generation, and value added for corporate projects.

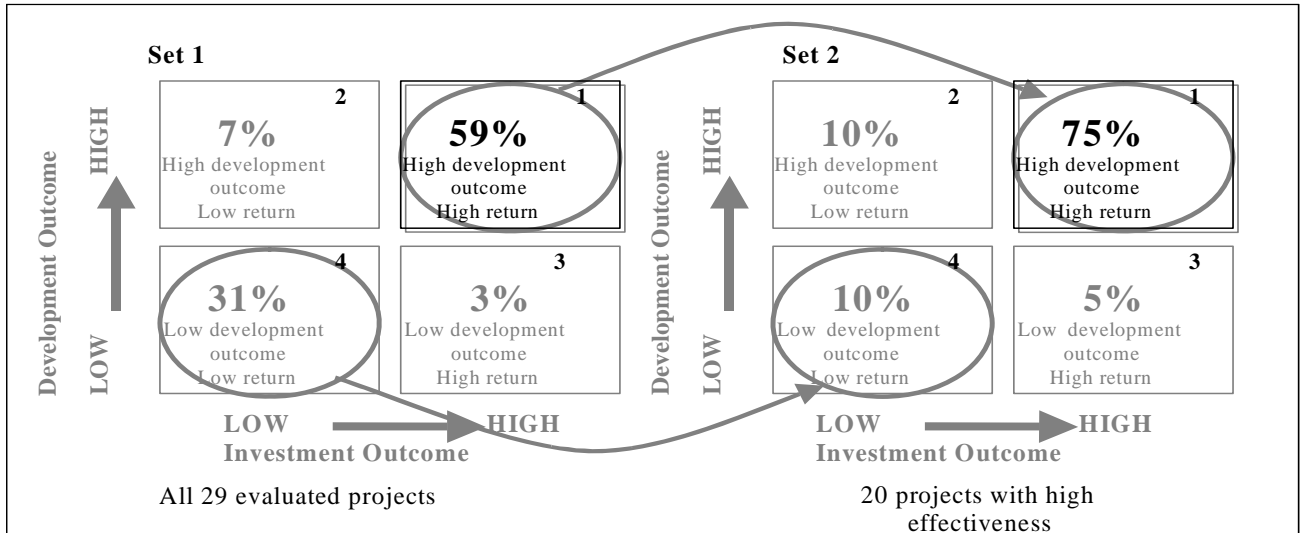
Environmental Effects (67 percent success rate): Met or exceeded the IIC's environmental, social, health, and safety requirements at approval.

Private Sector Development (81 percent success rate): This indicator measures a project's contribution to private sector development beyond the impact on the company, such as demonstration effects in creating a sustainable enterprise capable of attracting finance, increasing competition, establishing linkages, encouraging important legislative changes, strengthening capital markets, and introducing improved technology.

Drivers for High Development and Investment Outcomes: The IIC's Work Quality

The IIC's goal is to undertake investments that are both developmentally successful and profitable. As was indicated in previous reports, the quality of the IIC's work has a direct impact on development and investment outcomes. Work quality is measured in three areas: i) screening, appraisal, and structuring of projects; ii) supervision and administration; and iii) role and contribution (or additionality) of the IIC (i.e. the extent to which the IIC's presence affects the project and its results). According to the report, high work quality ratings were achieved in 69 percent of the projects reviewed. This demonstrates an improvement over the 2004 report in which only 38 percent of the projects achieved high work-quality ratings. Figure 1 (included in OVE's report) illustrates that out of the twenty projects where the quality of the IIC's work was high, 75 percent achieved positive development and investment outcomes. The conclusion then is that as the quality of the IIC's work increases, better development and investment outcomes occur.

Figure 1:



Following are two examples of projects analyzed in 2005, one with a highly successful development outcome and one with an unsuccessful development outcome.

Example 1: Highly Successful Development Outcomes

The project was a five-year loan to expand a recently privatized grain warehousing company.

Project Business Performance: *Excellent.* Management successfully restructured the company, introducing new projects and increasing production. It acquired skills that are unique in the market. The company greatly exceeded its revenue target and production levels. The company became a leader in its industry.

Economic Impacts: *Excellent.* The highly innovative loan structure made it possible to reach approximately 5,900 small farmers.

Environmental and Social Impacts: *Satisfactory.* The project helped the company to comply with local and IIC environmental requirements.

Private Sector Development: *Excellent.* The program had a high demonstration effect. It has been replicated by the government.

Example 2: Unsuccessful Development Outcomes

The project was a five-year loan to a bank for onlending to small and medium-size companies.

Project Business Performance: *Unsuccessful.* The bank incurred trading losses and a deterioration of its loan portfolio. The IIC suspended disbursement of the remaining portion of the loan due to noncompliance with the contract. The bank was intervened after it was unable to raise US\$251 million to cover defaulted loans. Subsequently the bank was liquidated.

Economic Impacts: *Partly Unsatisfactory.* The bank financed only two subprojects of US\$3 million each as compared with the expected ten to twenty projects. **Environmental Effects:** *Satisfactory.* The bank sent employees to an IIC training course, and the two subloans were in compliance with the IIC's environmental and labor requirements.

Private Sector Development: *Unsatisfactory.* The loan was not fully utilized.

Following are the conclusions set forth in OVE's fourth report:

1. With respect to compliance with ECG standards and procedures, this year's evaluation exercise made significant progress. In addition, good progress was made in improving data collection and assessments of developmental outcomes. Appraisal stage problems were only identified in 31 percent of the projects (compared with 69 percent in the 2004 Report). Similarly, supervision was weak in only 21 percent of the projects (compared with 44 percent in the 2004 report).
2. Development outcomes were better for the projects analyzed in 2005. For instance, 65 percent of the XASRs evidenced high development outcomes.
3. OVE found a recurrent pattern with respect to the previous report. The higher the quality of the IIC's work (including front-end risk assessment, project design, risk mitigation, supervision, and "additionality"), the better the development outcomes and investment outcomes.
4. In 2005, corporate projects largely outperformed financial intermediary projects in the area of development, profitability, and work quality. The evidence suggests that tracking of developmental indicators under corporate projects has been more complete and accurate than for financial intermediary projects. Only 17 percent of corporate projects did not meet projected financial expectations, while 53 percent of financial intermediary projects did not do so. In addition, the IIC's work quality was rated highly in 83 percent of the corporate projects, while only 59 percent of financial intermediary projects achieved high work-quality ratings. Given the importance of IIC work quality to achieving successful outcomes and in light of the fact that lending to financial intermediaries is expected to increase, the IIC needs to put greater emphasis on this aspect.
5. Review of the previous four annual evaluation reports indicates that IIC work quality has improved over time. The ratings have increased on the average from Partly Unsatisfactory to Satisfactory.

Following are the recommendations contained in the fourth OVE report:

Recommendation 1: Continue to make progress toward standardizing the measurement and analysis of development outcomes and project additionality so that the IIC can clearly demonstrate its developmental results and apply the lessons learned to the design and execution of future operations and product lines.

Recommendation 2: Continue implementing the recommendations extracted from the evaluation of financial intermediary lines in order to bring the developmental performance of financial intermediaries in line with those of corporate transactions and thus ensure full compliance with the IIC's corporate mandates of developmental impact and additionality.

Recommendation 3: Continue transforming the business model to ensure that the IIC becomes not only a provider of funding, but also a reliable supplier of value-added services for its clients. In so doing, the IIC should explore options for leveraging the comparative advantages afforded by its access to a network of international strategic partners, as well as to technical cooperation resources from the rest of the IDB Group. The IIC is already working in this direction by enhancing its interactions with clients with respect to value-adding processes in areas such as corporate governance and environmental practices. In the future, the IIC plans to keep leveraging technical cooperation resources from different sources, but those efforts need to be deepened over time until the perception of the IIC in the marketplace achieves a level of competitive differentiation that is closely linked to the availability and quality of its value-added services.