Evaluation Report

Evaluation of FMO

For publication

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Contents

List of acronyms

AfDB	African Development Bank
AFW	Agriculture, Food and Water
ADB	Asian Development Bank
CCR	Client Credit Review
CDC	CDC Group
CG	Corporate Governance
CIP	Clearance in Principle
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
DFIs	Development Finance Institutions
ECA	Europe and Central Asia
EDFI	The Association of European Development Finance Institutions
ESG	Environmental, Social and Governance
ESO	Environmental and Social Officer
E&S	Environmental & Social
ESAP	Environmental & Social Action Plan
EQs	Evaluation questions
FI	Financial Institution
FDI	Foreign Direct Investment
FMO	Nederlandse Financieringsmaatschappij voor Ontwikkelingslanden
FMO-IM	Nederlandse Financieringsmaatschappij voor Ontwikkelingslanden Investment Management
FP	Financial Proposal
GF	Government Funds
GHG	Greenhouse Gas
ICM	Independent Complaints Mechanism
IFC	International Finance Corporation
IO	Investment Officer
ILO	The International Labour Organisation
IMF	The International Monetary Fund
IMS	Infrastructure, Manufacturing and Services
IOM	The International Organisation for Migration
IRR	Internal rate of return
JIM	Joint Impact Model

LAC	Latin America and the Caribbean
LDC	Least Developed Country
LIC	Lower Income Countries
LMIC	Lower Middle-Income Countries
MDB	Multilateral Development Bank
MENA	Middle East and North Africa
MFA	Multifactor authentication
MoFA	The Ministry of Foreign Affairs
MSME	Micro, Small & Medium Enterprises
MFI	Microfinance Institution
NDA	Non-Disclosure Agreement
NPL	Non-performing Loans
NBFI	Non-bank Financial Institutions
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PA	Portfolio Analyst
PDM	Private Direct Mobilisation
PE	Private Equity
PIM	Private Indirect Mobilisation
PSD	Private Sector Development
RBC	Responsible Business Conduct
SDG	Sustainable Development Goals
SHIFT	Strategic Horizon for Impact and Footprint Transition
SMEs	Small and Medium-Sized Enterprises
SPV	Special Purpose Vehicle
SSA	Sub-Saharan Africa
TA	Technical Assistance
ToC	Theory of Change
ToR	Terms of reference
UMIC	Upper Middle-Income Countries

Executive Summary

This evaluation assessed FMO's achievement of its strategic objectives of development impact, additionality and mobilisation of capital, as well as its management of environmental and social issues, from 2014 to 2018.

Introduction to the evaluation

This evaluation was commissioned in November 2019 by the Ministry of Foreign Affairs (MoFA) to assess Nederlandse Financieringsmaatschappij voor Ontwikkelingslanden's (FMO) achievement of its key principles as documented in the Agreement between the State and FMO, and to provide a perspective on FMO's future strategic direction. It focuses on the evolution of FMO's portfolio, impact, additionality, mobilisation of capital, environmental and social (E&S) performance and future priorities. The evaluation assessed FMO's portfolio, policies and processes related to these areas and reviewed in detail FMO documents for 30 sampled investments. Four country case studies were conducted to assess how these policies and principles are operationalised in practice, and FMO's E&S policies and processes were benchmarked against peer organisations.

The findings address historical accountability and future strategic options and are intended to be useful for: (i) staff involved in the oversight of FMO's work at MoFA; (ii) FMO staff; and (iii) those conducting a review of MoFA's work on development finance. We hope they are also of interest to development finance institutions (DFIs), the development finance community and to the Dutch public and civil society.

Portfolio review

FMO's loan portfolio grew rapidly from 2013–2018, particularly with Energy projects and Financial Institutions. Agribusiness, Food and Water (AFW) loans also grew significantly, but still only accounted for 12% of lending exposure in 2018. Regionally, the largest market for loans was Latin America and the Caribbean, but Africa and Europe & Central Asia (ECA) accounted for three-quarters of increased lending over the period. FMO's increased focus on Africa was even more marked in the equity portfolio, which accounted for more than half of the 160% expansion. Equity investment in Asia also grew sharply.

Across the portfolio, loan spreads remained stable between 3% and 6%, with non-performing loans (NPLs) also relatively constant as a share of the expanding portfolio. For new commitments made between 2013 and 2018, spreads declined after 2014, particularly for Financial Institutions and Energy sector loans. For equity investments exited over the period, Africa was the worst-performing region and Asia the best. Equity investments in the Energy sector performed worst of the exited investments, and those invested in diversified sectors and Financial Institutions performed best. For equity investments made between 2013 and 2016 which have not yet been exited, Africa and Asia account for almost 85% of equity capital committed over the evaluation period and therefore drive portfolio performance. African equity investments are currently the worst performing on a regional basis, with those in Asia showing the strongest performance.

FMO's strategic priorities over the period were to focus geographically on Africa, Asia and the European Neighbourhood and, at the sector level, on Energy, Financial Institutions (FI) and AFW. For instruments, the aim was to gradually expand the equity portfolio. In all these areas, the portfolio has evolved as planned.

Additionality

Additionality can be financial or non-financial. FMO has been set up and received government support to 'only provide financial services which the market does not provide, or does not provide on an adequate scale or on reasonable/workable terms' as documented in the Agreement between the State and FMO. There are two elements to this within an individual investment. First, FMO's investment should not have been available elsewhere in a form that would have achieved the same result, i.e. there is no alternative finance, or there is, but it is not on 'workable terms and conditions'. A second form of additionality relates to the output of this investment. In many cases, DFIs aim to mobilise additional investment. This is additional if the mobilised investment would not have happened without the DFIs' input. For DFIs, non-financial (or 'value') additionality includes inputs that improve commercial prospects, governance or environmental & social issues. This is generally specific to a deal but can also take a wider approach as in FMO's sector initiatives.

The second form of financial additionality relating to mobilisation is examined with respect to mobilisation, with non-financial additionality considered in the context of development impact and E&S. The main findings on the financial additionality of FMO investments are as follows:

- **The ability to provide longer tenors is the main source of FMO additionality.** FMO also appears to have the capacity to provide longer tenors than are available in the commercial market. This is scarce in all of FMO's markets, particularly lower-income countries, and may be a more acute issue in some sectors, notably agriculture. An important source of long-term funding is the DFI community. While the development importance of agriculture is well understood, and some DFIs prioritise the sector as a result, others have withdrawn or heavily scaled back their engagement due to large losses in the past. This suggests that providing long-term finance in AFW sectors, particularly in lower income countries (LIC) is likely to be strongly additional. More generally, FMO also appears to be able to provide longer tenors than other DFIs in many instances.
- **The provision of flexible and countercyclical financing in different currencies to suit investees' needs is additional.** Other DFIs have some of these capacities, but few have all of them. FMO is able to tailor financing more than all commercial investors and most DFIs, and has also shown flexibility in adjusting financing terms when necessary, most recently with respect to Covid-19.
- **Where alternative finance was available but on less favourable terms, it is important to be clear about why the FMO terms are needed.** This will indicate whether the investment meets FMO's definition of additionality: providing a 'financial product that is not readily available from commercial banks/investors on workable terms and conditions, at the time of approval'. All borrowers prefer cheaper financing, but this is not a development rationale. In most cases reviewed, there was such a rationale, but not in all as discussed in the findings section. Where a rationale was lacking, providing finance on more favourable terms than what is available risks distorting domestic financial sector development.
- **While financial additionality can be significant for Financial Institution (FI) investments, it is less obvious than other sectors and needs to be further justified and demonstrated.** While Financial Institutions have access to a range of sources of finance, they require different forms of financing within an overall capital structure, and finance from FMO can be additional in the form it takes. While FI investments can be less obviously additional than projects in other sectors (AFW, for example) this does not mean they are not additional. In many cases, FMO investment can be justified on the basis of the types of activities it enables FIs to conduct (e.g. long-term financing from FMO supporting long-term green lending by a financial institution) or the borrowers it supports (e.g. women entrepreneurs), but this requires more demonstration than in other sectors where a general scarcity of capital is evident.
- **FMO may provide finance that is not available commercially in line with its additionality principle, but, when part of a DFI consortium, it is important to also show why FMO is needed**. If, for example, the consortium could have successfully made the investment without FMO, the FMO investment may

be additional to what was available in the commercial market, but unnecessary as the investment would have happened anyway. At the very least this represents an opportunity cost as the FMO resources could have been deployed elsewhere generating additional net impacts, as the impacts resulting from the DFI consortium would have happened without FMO. There are various ways FMO investment could be essential in this context. Often, for example, this is because a certain scale is needed that requires all DFIs to participate. While generally demonstrable, this was not always clear in the reviewed investments.

- **While the use of government funds in a blended structure has high potential for additionality, it comes with significant risks.** The risk, particularly in an environment of competition between DFIs, is a 'race to the bottom' with DFIs offering financing on increasingly concessional terms, supporting projects that either do not need concessional funding, or those that will never be commercially viable. This is recognised by FMO. The strong commercial culture at FMO, clear policies to minimise concessionality and greater experience than most DFIs with blended finance deployment and design makes FMO better placed than most to mitigate these risks.

Financial additionality recommendations:

- **Expand the range of financial products** that FMO can provide to build upon FMO's flexibility. Expanding equity portfolio relative to loans, local currency at range of tenors, risk-sharing facilities and FX hedging products would be valuable.
- **Link financing structure to impacts** in *ex ante* and *ex post* framework to systematically identify the value-add of different financing products and terms.
- **Develop specific frameworks to assess Financial Institution additionality** and use to allocate resources within the sector to maximise additionality. FMO accepts that non-financial additionality is more important for FI investments and has a framework to assess this. We suggest this is developed into a holistic financial sector additionality tool that combines financial and non-financial elements systematically.
- **Ensure rationale for joining DFI consortia is clearly articulated** and linked to DFI exit strategy as part of the transition to commercial viability, even if this transition is a gradual process, where DFI involvement will remain essential for a long period.

Mobilisation

Mobilisation generally refers to the attraction of commercially-oriented finance to a particular investment, usually, but not always, from the private sector. Related terms are 'leveraging' and 'catalysing'. Mobilising investment has increased in strategic importance for FMO in recent years. The logic is simple: the sustainable development goals funding gap is such that a huge increase in private investment is needed.

- **It is important to recognise trade-offs between additionality and mobilisation**. Investment in high-risk environments are likely to be additional, but also the most difficult into which to mobilise private capital.
- **While not always a priority in every FMO investment, we find evidence of successful mobilisation**. In more challenging environments, mobilisation is more likely to involve other DFIs than private investors, reflecting the trade-off described above.
- **In some cases reviewed, FMO did not claim mobilisation which may have been significant despite not being 'provable'**. These more subtle effects may be a very significant form of mobilisation.
- **An increasingly important way of addressing the trade-off described above is with blended finance**, which can be used to improve the risk-return characteristics of transactions, help the transaction to

survive its difficult pioneer state and, over time, help make the investee attractive for commercial financiers.

- **The risk is that concessional finance does not enable a commercial transition, but instead supports non-viable enterprises, wasting scarce financial resources, or that it supports commercially viable enterprises, distorting market development**. FMO has significant experience that can help protect against these risks, both individually and through the DFI Working Group on Concessional Blended Finance. However, a more systematic approach is needed.
- **Mobilising capital from institutional investors needs bigger tickets**. Pension and insurance funds are very large institutions and would only invest at scales above FMO's current operations in most cases. At the same time, the direction of travel in terms of additionality and impact (see below) is toward smaller projects. This is particularly true of AFW investments, which tend to be relatively small, but also for Energy, where distributed energy and mini-grid projects are likely to become more common.
- **FMO-Investment Management (FMO-IM) is a clear example of crowding in** (i.e. financial additionality), as these investors are typically unfamiliar with these markets and are only prepared to invest because of the comfort provided by FMO and its experience with these types of investments. They are only likely to be interested in a sub-set of the investments FMO would want to make, e.g. not in the highest risk categories or loans in local currency. FMO-IM's pooled vehicles means this will be a relatively large sub-set, particularly if FMO balances smaller investments with larger transactions and 'upstream' proprietary deal sourcing.
- **Mobilising domestic investment would likely be assisted by a local presence in partner countries through local offices or formal relationships with local partners.** The more embedded FMO is in the local financial sector, the more likely it is that it will be able to identify and positively influence domestic investors. This would also support other strategic objectives, as discussed further below.

Mobilisation recommendations:

- **Develop disaggregated mobilisation strategy linked to strategic objectives**, where capital from different types of development actors, over differing time frames is targeted systematically.
- **Initiate research to better understand FMO's indirect mobilisation effects, for example through demonstration effects,** and develop long-term strategy to build upon this, tailored to different country contexts.
- **Expand FMO-IM suite of funds** to link investors with different risk appetites, ticket sizes and investment modalities with identified investment gaps and the sustainable development goals (SDGs) (whilst ensuring not to distort the market of private, commercial service providers).
- **Develop strategies and local partnerships,** including considering the option of establishing local offices where feasible and desirable, aimed at raising mobilisation of local investment without distorting local markets.

Development impact

FMO had two broad approaches to measuring impact over the period of this evaluation. The first is based on an impact model developed by Steward Redqueen, and the second uses sector-specific indicators to monitor FMO's development impact over time. The Impact Model provides *ex ante* estimates of impact, while the sector-specific indicators measure impact *ex post*. The model-generated figures suggest that FMO is creating significant employment through its investments, though this is not validated by *ex post* measures. The GHG (Greenhouse Gas) avoided figures are robust measures of positive environmental impacts, as these are largely the result of renewable energy generating capacity that directly displaces future fossil-fuel generated energy. The impact figures refer to the activities of the enterprises supported by FMO and are unlikely to be fully attributable to FMO in most cases. Understanding the share of these figures that FMO could claim would require detailed contribution analysis type studies. Given that FMO is found to be financially additional in most cases reviewed, we can therefore conclude that significant development impacts are being achieved, as suggested by the Impact Model estimates. While this is proven in the case of GHG emissions, *ex post* measurements of other impacts do not enable us to isolate the impact of FMO relative to other causal factors in the case of sector-specific indicators.

- **FMO's approach to *ex post* impact monitoring evolved significantly in the period under review, and has subsequently improved further**. As is usual among DFIs and other impact investors, links between reported impacts and FMO's activities remain weak. DFIs generally measure and report outputs such as employment by investee companies, revenues generated and taxes paid. While these are useful measures in most cases, they do not capture the influence that the DFI has had over these variables, relative to, for example, general economic condition or changes to tax policy.
- **The introduction of 'green' and 'reducing inequalities' labels had a strong effect on investment decisions, which is likely to have increased impact**. The need to demonstrate that a deal deserved a label and to defend this in the face of challenge caused a major change in incentives at FMO. The fact that an investment obtains a label or does not, means that the incentive was to fill the quota with qualifying investments rather than seek to maximise how green or inclusive they were.
- **FMO's model produces a partial view of impact, particularly for AFW investments where impacts appear underestimated**. The new Joint Impact Model (JIM) is likely to correct current issues and add further value from being open source.
- **The balance between achieving positive impact and reducing negative impacts is difficult to get right.** In some investments, it is easy to see positive impacts generated with little downside. In other cases, FMO may help an investee improve its performance, reducing negative effects rather than creating positive ones. This is discussed further below with respect to E&S risk.
- **Concessional funds in blended-finance structures have the potential to increase impact, but need to be used carefully**. Blended finance enables projects to happen that otherwise would not. Many have high impacts, but as one interviewee put it, if they fail, the impact is a one-off that is neither scaled nor replicated. Distinguishing between investments that will never be commercially viable and those that could be with the support of concessional finance at a key stage, is an extremely difficult task, but not impossible.

Development impact recommendations:

- **Ensure impact measurement frameworks accurately capture the full range of impacts** and use them to direct *ex ante* project selection. Indicators should be sector-specific, as few as possible, consistently maintained over the long term, and derived from a structured theory of change (ToC) development process.
- **Develop a 'green' and 'inclusive label' approach** to incentivise maximisation in both areas, i.e. a scoring system to capture and promote the degree of 'greenness' or 'inclusiveness'.
- **Integrate the Joint Impact Model into the decision-making framework as far as possible.** The current model has not been used to inform decision making due to its limitations, particularly the fact that its accuracy is greatest at the portfolio level. While this problem will remain with the JIM, it should be reduced due to improvements in the model. More generally, a powerful and accurate model that can capture both direct and indirect impacts should have some usefulness in decision-making as well as reporting.

Environmental and social risk and non-financial additionality

Non-financial additionality, particularly E&S (but also governance[1]), is an area where FMO believes it brings significant value. As mentioned with respect to financial additionality, FMO is often more expensive than other DFIs, but it believes clients may still choose FMO because of the additional value that it brings in areas such as E&S. Findings from the case studies support this view.

FMO brings value in areas such as gender and the environment and developing robust E&S management systems. It also appears to be more advanced on these issues than some other European DFIs, particularly on human rights where it is closer to Nordic institutions, for example.

An important aspect of FMO's approach is that it takes an incremental approach that prioritises direction of travel. Even where there are major E&S challenges, FMO is more likely than some other DFIs to work with the client to develop a plan to overcome these. Urgent issues need to be addressed immediately of course, but others can be addressed over time. FMO also sees E&S issues as central to the long-term success of the companies in which it invests, as distinct from a compliance-based approach.

While other DFIs are catching up with FMO in terms of resources, it retains the largest E&S department of the comparable DFIs and is widely seen as a leading DFI on these issues. Annex A contains the results of a benchmarking study of FMO against the International Finance Corporation (IFC), CDC Group, Deutsche Investitions- und Entwicklungsgesellschaft (DEG), Proparco and the African Development Bank (AfDB) (with the full benchmarking provided in Annex B). We find that FMO is aligned with IFC Performance Standards in virtually all areas and exceeds them in many. FMO is viewed very positively by its peers on E&S issues and remains a leader in the field.

Criticisms of FMO from the Dutch NGO community are similar to those made of other DFIs. FMO, like other DFIs, would benefit from more transparency and a less defensive attitude to criticism, as well as a greater willingness to engage with stakeholders in the countries in which it invests, including before investments are made. As elsewhere, a greater local presence or deeper local partnerships in partner countries would be valuable.

- **FMO remains a leading DFI on E&S** issues but needs to continue to actively engage with other DFIs and investments to push the boundaries in areas such as human rights.
- **FMO's sector initiatives bring particular value.** While improving E&S performance should support investees commercial prospects over the long term, in the short term, they can come at a cost. To avoid putting those that invest most in E&S at a competitive disadvantage, raising the bar on E&S across the sector is a clear win-win to the extent that standards are implemented across the sector.
- **Supporting E&S improvements through Technical Assistance (TA) funds is necessary in some cases.** Not all E&S improvements can be addressed through sector-wide initiatives. Having the ability to draw on TA funds is seen by other DFIs as a valuable resource available to FMO.
- **FMO's incremental approach to E&S has value but needs to be better communicated.** If FMO were to divest from fossil fuels as argued by some NGOs, it would have to disinvest from all banks in markets which are dependent on fossil fuels. This would prevent it positively influencing these banks, which would be likely to find alternative finance. This is not straightforward, but FMO's approach is reasonable if (i) its engagement leads to as much positive change as can be achieved, and (ii) this is communicated to stakeholders in both partner countries and the Netherlands in a transparent way.
- **Engaging with a wider set of stakeholders rather than relying on clients for information is crucial to identifying and managing E&S risks.** Before, during and after investments are made, FMO could engage more proactively with a wider set of stakeholders than is currently the case. Local knowledge is

[1] Corporate Governance was not part of the desk review part of the evaluation, but did emerge in the case studies in some instances as discussed.

essential in identifying E&S risks that may affect different stakeholders (and which the client may be unaware of) and managing these risks effectively. There is no substitute for an engaged local presence or effective local partnerships.

- **A more open, self-reflective approach to E&S**, including discussing where things went wrong, is an important way of building understanding of the trade-offs that FMO has to manage.
- **FMO's Independent Complaints Mechanism is a valuable innovation that is unusual among bilateral DFIs, but could have more visibility among local stakeholders and more could be done to ensure that initial recommendations are followed up on and documented.**
- **FMO recognises that it needs to have better visibility of E&S issues at the portfolio level.** This is in place on a deal-by-deal basis, but if E&S is to have a similar steering effect as the 'green' and 'inclusive' labels, a portfolio-level view is needed to support this. The evaluation team understands that the process is underway within FMO to develop a sustainability information system to support Environmental, Social and Governance (ESG) visibility at the portfolio level.

E&S and non-financial additionality recommendations:

- **Adopt an open and self-reflective approach to E&S issues**, which engages with a wider range of stakeholders, particularly in partner countries, examines the trade-offs facing FMO, and communicates more clearly the value of its incremental approach to E&S.
- **Develop the sector initiative approach systematically,** based upon an assessment of sectors where raising E&S standards has high potential impacts but may come at a short-term cost for investee firms. Consider prioritising sectors where FMO is likely to invest less in the future but where it has significant E&S experience (e.g. large-scale energy).
- **Develop FMO's E&S capacity in key partner countries** to engage proactively with stakeholders (including pre-investment), and identify and mitigate E&S risks more effectively.
- **Publicise widely, and require investees to publicise widely, the existence of the Independent Complaints Mechanism in the local language** of the countries of operation.
- **Continue to lead on E&S issues with the DFI community** and take the lead on Dutch priority issues, such as human rights. Engage with Dutch and partner country stakeholders on a regular basis to help set priorities in this regard.

Strategic positioning of FMO

FMO seeks to be additional (financially and non-financially), to mobilise investment and to achieve the maximum impact it can. It also needs to maintain a stable balance sheet. In addition to the A Portfolio, FMO manages government funds that can be invested on concessional terms[2], and has growing experience with blended-finance structures. This can allow FMO to do things that the balance sheet constraints preclude, but comes with significant risks as described in various parts of this report.

At the same time, FMO is operating in a changing development finance landscape where DFIs have more resources and increasing access to concessional funds, leading to a convergence of DFIs around good quality deals, particularly in Africa. As well as channelling concessional funds to projects where they are not needed, this is driving down pricing to levels that may distort the development of key markets.

Given this environment, how should FMO position itself so as to achieve the greatest impact, while also pursuing its other objectives of additionality and the mobilisation of investment?

[2] By concessional terms, we refer to the provision of finance at rates below that available in the market, or with other features such as grace periods that are not commercially available, or by providing risk mitigation instruments on a non-commercial basis. As well as financing, concessional support may be provided on a non-financial basis through technical assistance and other grant-equivalent mechanisms.

- **FMO sector staff expect a greater focus on more nascent areas where commercial finance is scarce and long-term development potential high.** Often, although not always, this means smaller, higher-risk ventures, and also those with a more direct development impact/SDGs association.
- **For products, the presumption is more on equity compared to loans**, as this enhances the ability of FMO to have a positive influence particularly on ESG grounds.
- **If implemented at scale, these changes would be likely to increase the riskiness of the investments that FMO manages.**
- **Both risk effects and this trade-off could be addressed by balancing the portfolio** with more, large, commercially attractive investments, or by offsetting the increased risk by other means.
- **For example, increased use of concessional funds** (i.e. greater blending of government funds with the A portfolio) **could enable FMO to absorb more risk if carefully managed.**
- More broadly, **blended finance has the potential to create more synergies between FMO's objectives** of additionality, impact, mobilisation and returns, but requires a more systematic approach.
- **FMO would be well placed to lead an international initiative to develop a framework to operationalise the Blended Finance principles** of the DFI Working Group in this area.

Future strategy recommendations:

- **Undertake ToC process to refresh strategy** in terms of sector prioritisation (FMO-level ToC) and within target sectors (sector-level ToC).
- **Link outcomes of process to options for either maintaining the same level of risk through diversification or increasing the overall level of risk.**
- **Expand use of blended-finance products in line with preferred options** to support mobilisation in more challenging environments.
- **FMO to lead process to develop a robust, blended-finance framework** to operationalise principles of the DFI Working Group on Concessional Blended Finance. To ensure that the risks associated with blended finance are mitigated, a systematic framework is needed for all DFIs that: (i) accurately measures the degree of concessionality (including non-financial); (ii) designs structures to systematically minimise concessionality; and (iii) incorporates dynamic elements to taper the degree of concessionality over time as part of a transition to commercial viability.
- **Ensure FMO's structures are compatible with strategy.** FMO is constrained in its operations by international and national regulatory frameworks, for example, on the amount of regulatory capital it must set aside for its operations. As these frameworks change – e.g. as Basel IV takes effect – FMO will need to ensure its structures continue to enable it to pursue its objectives.
- **Ensure E&S capacity expands as needed to address any increased activities in challenging environments.**

1. Background to FMO

Section 1 provides background information about FMO and its governance structures, a summary of how FMO's strategy evolved during the evaluation period and an outline of FMO's approach to development impact from 2013–2018. It also provides an overview of the current context for development finance institutions, an introduction to the evaluation and an outline of the structure of the report.

1.1 Background to FMO

FMO invests with the aim of enhancing local prosperity in emerging markets 'Empowering entrepreneurs to build a better future'. The Agreement between the FMO and the State of the Netherlands, in 1998, states that FMO shall contribute to the advancement of productive enterprises in developing countries by: (i) taking equity interests; (ii) advancing loans and furnishing guarantees; (iii) providing subsidies for technical assistance and training, and for investment promotion activities which may be conducive to the advancement of productive enterprises in developing countries; (iv) executing programmes and/or projects commissioned by third parties.[3]

FMO is structured as a corporation, with the State of the Netherlands holding 51% of its shares and private shareholders holding 49%.[4] The State oversees FMO through two Ministries: the Ministry of Finance acts as shareholder, while the MoFA monitors the role FMO fulfils as partner for development cooperation. FMO is directly supervised by the Dutch Central Bank.[5]

FMO invests and bears its own risk and expense (the FMO-A portfolio). It also manages government funds on behalf of the Dutch state, referred to as Government Funds (GF). GF have been established in order to support private sector activities with high potential development impacts, but where risks are too high for FMO to invest using its own balance sheet.[6] FMO also works actively with Dutch businesses to support their investments and operations in FMO's focus regions under the auspices of its NL-Business subsidiary.[7]

From 2007, the Ministry of Finance expects a financial return for each of its State holdings, and targets are set every three years at portfolio level. These targets are intended to be a tool to support discussion between entities and do not incur punitive measures if not met. In general, the minimum financial return equals a government bond yield plus a margin. For FMO, this means its financial return lies between 4.0 to 4.5%.[8] FMO has a triple-A status, which allows it to borrow internationally on favourable terms.[9]

1.2 Evolution of FMO strategy 2013–2018

Before the period under evaluation, FMO had made a number of significant changes to its strategy. In 2009, it reorganised the front office from a regional to a sectoral structure and increased its focus on low-income countries.[10] In 2011, Agribusiness, Food and Water became a focus sector,[11] but only became a separate department from 2015.

[3] FMO, *FMO Strategy 2025*, 2017, p. 2—3.
[4] Carnegie Consult, *FMO-A Evaluation: 2014 Final Report*, p. 14.
[5] Carnegie Consult, *FMO-A Evaluation: 2014 Final Report*, p. 14.
[6] FMO, *FMO Development Impact Report 2013–14*, p. 5.
[7] https://www.fmo.nl/nl-business-funds.
[8] Evaluation Agreement State-FMO; p. 2.
[9] Evaluation Agreement State-FMO; p. 1.
[10] FMO, *A review of FMO's 2009–2012 strategy, Moving Frontiers*, 2012.
[11] FMO, *A review of FMO's 2009–2012 strategy, Moving Frontiers*, 2012.

In 2013, the Dutch government allocated additional funds to FMO. FMO started to implement the Strategic Horizon for Impact and Footprint Transition (SHIFT), a roadmap to achieving FMO's strategic goal of doubling impact and halving footprint by 2020. This roadmap had two aims: (i) to better steer the business towards meeting the strategic goal by 2020; and (ii) to increase FMO's accountability and transparency in reporting on the goal.[12] This document outlines a ToC of how FMO's investments lead to impact and a set of FMO-wide and sector-specific indicators, mapped against the outcomes identified in the ToC. Each sector was expected to have defined targets for at least two outcome indicators by the end of 2014.

In 2017, FMO published its 'Strategy 2025',[13] which included an increased focus in sectors where FMO could deepen its expertise and client relationships, resulting in a move away from infrastructure, manufacturing and services (IMS) to focus on three sectors: Financial Institutions, Energy and Agribusiness, Food and Water. The strategy also increased FMO's geographical focus on Africa, Asia and countries in the circle around Europe with only selective growth in Latin America and an intention to stop activities in the Balkans and China. Prior to this, FMO invested in four regions: Latin America, Africa, Asia and Europe & Central Asia, with investments in over 80 countries.

'Strategy 2025' outlined that all products would be maintained, but with an increase in ambitions in equity, gradually shifting to more direct investments. There would also be an increased focus on mobilising public funds for blending and strengthening FMO's fund management proposition for public sector funds. The strategy also aimed to raise the quality of ESG risk assessments and mitigation, including a human rights lens, whilst increasing impact.

1.3 Evolution of FMO's approach to development impact 2013–2018

FMO had two broad approaches to measuring direct and indirect impacts over the period of this evaluation. The first is based on an impact model developed by Steward Redqueen, and the second uses sector-specific indicators to monitor FMO's direct impact over time. The Impact Model provides *ex ante* estimates of indirect impact, while the sector indicators measure direct impacts *ex post*.

Both need to be seen in the light of the changes to FMO's strategy described above. As described, FMO's aim to 'double impact and halve footprint' was developed during the evaluation period. Progress towards this aim was measured using the FMO Impact Model. The Model covers all FMO transactions and includes two economic and two environmental indicators: (i) jobs supported; (ii) value added; (iii) GHG emissions; (iv) GHG avoidance. These are measured at a direct and indirect level. Direct effects are the sum of impacts at FMO end-beneficiary level, while indirect effects are the sum of backward, induced and forward effects in the wider economy.

While the model produces estimates on GHG, avoided emissions reported by FMO are calculated and reported separately; this largely relates to renewable energy projects, where additional capacity is assumed to displace future fossil fuel generation one-to-one and therefore counted as avoided emissions. For green private equity (PE) funds and financial institutions investing in renewable energy, the GHG avoidance is estimated by FMO using an internationally recognised tool developed by the International Finance Corporation.

Over the period of analysis, FMO required impact reporting on an increasing number of indicators at the sector level, using feedback from 'impact champions' in each sector to give advice on how FMO could improve the reporting in its impact cards. It incorporated these responses into its impact card manuals in 2015 and 2016. Guidance and instructions have been changed both actively and reactively in line with developments since then.

There has also been an increasing focus in the period on measuring impact on women. Definitions were changed in 2018 and all types of impact card are required to report against 'direct employment for

[12] FMO, *Towards a Better World: The Road to Doubling Impact and Halving Footprint by 2020*, 2013.
[13] FMO, *FMO Strategy 2025*, 2017.

women'. There has been an increasing focus on impact on women in other areas and measuring women's micro small and medium sized enterprise (MSME) loans in the AFW sector is one of the examples of this. However, collecting women-specific data has been a recent development for FMO and we were unable to analyse FMO portfolio-wide data on women for the period under review due to a lack of data.

While not in place during the period of this review, impact cards are now used. There are several types, depending on the investment: bank impact cards for financial institutions; impact cards for non-bank financial institutions (NBFI); corporate impact cards for corporates; project finance impact cards for financing of long-term infrastructure, industrial projects and public services where debt and equity used to finance the project are repaid from cash flow generated by the project. Impact cards capture a broad set of indicators dependent on the type of investment. These indicators include, but are not limited to direct employment, direct employment for women, and number of people reached. Sector-specific indicators include the number of people served via power generation for Energy projects or the number of smallholders supported for agriculture investments.

FMO has also recently developed a new impact model jointly with a number of DFIs. The Joint Impact Model will be an open-source resource that will help DFIs and other development agencies deploy a common approach to the assessment of the economy-wide impacts of their activities on employment, economic output and the environment.

1.4 Current Context for Development Finance Institutions

DFIs exist to achieve development impact through private sector development. They do this through investing to support the creation or expansion of private firms, or the infrastructure upon which they rely. These firms provide the goods and services people need, support livelihoods and generate jobs. The nature of private sector development (PSD) and infrastructure provision also profoundly influences the environmental consequences of growth.

The landscape facing DFIs has changed in recent decades. A key strategic choice facing them is the balance between direct and indirect activities. Direct activities are DFI investments which create development impacts through jobs, the provision of goods and services, or generation of positive environmental results. Indirect effects come through DFIs' mobilisation of private capital, through being co-investors in deals or through the creation of positive examples i.e. 'demonstration effects' leading to increased investment in the future. A number of DFIs have shifted strategically towards a greater focus on direct development impacts. There has also been a greater emphasis on ensuring financial additionality among DFIs.

At the same time, the non-DFI capital that can potentially be invested in development-oriented projects has expanded. The pool of impact investors who are also looking for good returns is growing rapidly, and this is likely to continue. As well as greater impact investment, we have seen a general increase in capital flows to developing countries, with annual direct investment increasing from around $100 billion in 2005 to four times this figure 10 years later (International Monetary Fund (IMF) 2019).

Given, i) the greater focus on generating direct impacts among some DFIs, ii) increased private and impact investment in developing countries, and iii) DFIs' heightened need to demonstrate additionality, a number of DFIs have also shifted towards lower-income, higher-risk countries which are less likely to attract private inflows, where greater, direct impacts may be achievable and additionality is clearer.

Many DFIs have also seen their resources expand, with European DFI capital growing by an average of 10% per annum in recent years, while other official development assistance (ODA) flows have remained stable. We therefore see increasing amounts of DFI finance seeking to achieve direct impacts in low-income, high-risk countries, particularly in sub-Saharan Africa. There is an important trade-off to consider here. The countries where DFIs are expanding their operations are also those where it is most difficult to mobilise private investment. The ability to achieve indirect impacts through leverage is thus constrained as the risks involved in these markets may be too high for commercial investors relative to alternatives. One response has been to increase the use of blended finance to boost risk-adjusted returns.

As part of this evaluation, we have been asked to examine the relationship between financial returns, development impacts, additionality and the mobilisation of investment. In our view, this is inextricably linked to this evolving DFI landscape.

1.5 Introduction to the Evaluation

This evaluation has been commissioned by the MoFA. It meets the contractual requirement in the Agreement between the State and FMO (which states how FMO is governed) to conduct an evaluation of the agreement every five years.[14]

The evaluation was conducted by Itad between November 2019 and August 2020. It was guided throughout by evaluation focal points at the MoFA and at FMO. FMO provided documentation, data, guidance and coordination with FMO colleagues during the evaluation process. A formal Evaluation Reference Group provided strategic and technical oversight to the evaluation.

1.6 Structure of the Report

This evaluation report is structured as follows:

- Section 1: Introduction, including background information on FMO, an introduction to the evaluation, and an outline of the report structure;
- Section 2: Evaluation objectives and scope includes the evaluation objectives, intended use and scope of the evaluation;
- Section 3: Methodology, which outlines the evaluation design, evaluation questions, methods used in the evaluation and sampling approach, considerations of ethics and limitations including adaptations to the methods to account for Covid-19 restrictions;
- Section 4: Findings, which opens with a detailed review of the portfolio analysis, then is structured according to the key themes of the study outlined in the evaluation questions, namely additionality, mobilisation, development impact, environmental and social processes and practices and the strategic positioning of FMO;
- Section 5: Conclusions, drawing summative conclusions on the implications of the findings for the MoFA and FMO; and
- Section 6: Recommendations, which outlines the recommendations resulting from the conclusions.

In addition, the annexes to this report include:

- Annex A: E&S Benchmarking analysis
- Annex B: Benchmarking against IFC Performance Standards for E&S
- Annex C: Review of FMO's Independent Complaints Mechanism
- Annex D: List of FMO stakeholders interviewed for Process Review
- Annex E: Full evaluation matrix
- Annex F: Terms of Reference
- Annexes G – J: Four Case Study reports, which have been removed from this public version of the report to protect the anonymity of sampled firms.

[14] Terms of Reference, p. 1.

2. Evaluation Objectives and Scope

Section 2 outlines the objectives of the evaluation, including the primary audience for the evaluation and how it will be used. It also includes information on the scope of the evaluation.

2.1 Evaluation Objectives

The aim of this evaluation is 'to establish how FMO balances development impact, financial returns and additionality, and to what extent these three factors interact'.[15] The MoFA has commissioned this evaluation of the Agreement between FMO and the State for two purposes:

(i) **Accountability**: to examine whether FMO's **activities** are in line with the Agreement and FMO's **strategy**, and whether MoFA meets the **obligations** defined in the Agreement.

(ii) **Learning**: to examine whether improvements can be made to the Agreement, the role of FMO and MoFA, or FMO's activities that will **increase development impact**, **additionality** or the **catalysis** of funds while maintaining solid **financial returns**.[16]

The primary audience for the evaluation is staff at MoFA who are responsible for policy related to FMO's work and staff at FMO. For this audience, the evaluation provides a good opportunity to generate and document evidence on FMO's achievements between 2013 and 2018 and to find out what FMO could do differently to maximise achievement of its strategic objectives. Furthermore, MoFA are conducting a broader strategic review of all their work related to development finance and this evaluation report will be provide input for the strategic review.

Given public interest in FMO's operations and impact, it is likely that this report will be published and made available to the general public. The evaluation team are willing to support the dissemination of the findings and recommendations to a key group of stakeholders, for instance, at a roundtable event.

2.2 Evaluation Scope

The evaluation covers the period of 2013 to 2018 and focuses on questions regarding portfolio characteristics, effectiveness, relevance, impact, additionality, catalysis and FMO's role as a Fund Manager. For more information on the evaluation questions, please refer to section 3.2.

The focus of the evaluation is on FMO-A as separate evaluations are being conducted into the government funds that FMO manages; however, this evaluation does assess how government funds affect the way that FMO deploys funding from its own balance sheet.[17]

Given increased public interest in the environmental and social (E&S) practices at FMO, the evaluation team agreed with MoFA and FMO to increase the focus on E&S policies, processes and practices within the evaluation, compared with what was initially envisaged in the Terms of Reference. This has resulted in an agreed extension to the scope of the evaluation to include benchmarking of FMO's policies and procedures against the IFC Performance Standards and against a sample of FMO's peers. It also led to an increased focus on E&S in practice within the case studies. Technical assistance and capacity development for improved E&S was included in the assessment of E&S within the case studies. A review of corporate governance was outside the increased scope for the evaluation and therefore not included in the review of E&S policies, process and practices or in the benchmarking.

[15] Terms of Reference, p. 4; included in Annex E.

[16] Terms of Reference, p. 4.

[17] Terms of Reference, p. 2.

3. Data and Methodology

This section first describes the overall design of the evaluation and its constituent modules, followed by an introduction to the evaluation questions in the second sub-section. The third sub-section outlines the methods used to collect, collate and analyse data in each component of the evaluation in order to generate findings against the evaluation questions. The fourth sub-section outlines the approach used to sample investments for the desk review and case studies. The fifth sub-section focuses on considerations of ethics within the evaluation. The final sub-section outlines the limitations to the evaluation, including adaptations made to the evaluation methods to account for Covid-19 restrictions.

3.1 Evaluation Design

Our evaluation approach is based on a modular design to translate evaluation questions into criteria, indicators and information sources at three levels: (i) portfolio and processes; (ii) desk review of sampled investments; and (iii) case studies. We do not attempt to answer every evaluation question in each module (some questions speak only to process, for instance). However, a strength of this approach is that it enables us to consider key evaluation questions from different perspectives. We have triangulated and validated multiple data sources and evaluation modules across the evaluation framework during the synthesis stage.

Module A: Portfolio and Process Review has two components: (i) the portfolio analysis, which focuses on the quantitative data related to the financial returns and development impact of FMO's investments; and (ii) the process review, which focuses on how FMO's governance structures and organisational systems affect FMO's effectiveness.

Module B: Desk Review collects evidence against Evaluation Question 2 (e-g) and Evaluation Question 3 (a-d) that relate to how principles, systems and processes are operationalised. For the full list of evaluation questions and sub-questions, please refer to Annex D: Evaluation Matrix. Module B is a desk review of a sample of investments (30 in total), building on the portfolio analysis in module A and drawing on quantitative and qualitative data to provide further insights into FMO's investment portfolio.

Module C comprises case studies in four countries: South Asia Case Study Country 1, South Asia Case Study Country 2, East Africa Case Study Country and West Africa Case Study Country, focusing on a cluster of four investments in each country.[18] The case studies build on Modules A and B in examining how the observed processes and analyses for sampled investments are translated into practice at the client level, including on E&S issues.

An additional module of benchmarking E&S policies and processes has been added to the evaluation design since the agreed inception report.[19]

3.2 Evaluation Questions

The evaluation team made minor changes to the evaluation questions during the inception phase for this evaluation. The agreed evaluation questions, following submission of the inception report, are as follows:

1. How has FMO's portfolio developed?
2. To what extent has FMO contributed to the advancement of productive enterprises in developing countries and to inclusive development?

[18] With the exception of East Africa Case Study Country, in which it was only possible to include three investments.

[19] Itad, 'Additional work to extend the focus on E&S in the evaluation of FMO', April 2020.

3. To what extent would other commercial or private investors be available for FMO-investments?
4. To what extent do FMO's investments catalyse additional (private) resources?
5. How does the management of State funds influence FMO's own portfolio FMO-A?
6. In the light of Evaluation Questions (EQs) one to five, how should FMO position itself in the evolving development finance landscape to maximise synergies between the goals of additionality, mobilisation and impact?

EQs one to five also include sub-evaluation questions (and some of these have further, more detailed questions). A detailed evaluation matrix in Annex D presents in which evaluation modules each of the evaluation sub-questions are addressed, using which criteria, indicators and data sources.

The evaluation team grouped the EQs and sub-questions according to the key principles within the Agreement between the state and FMO and other significant themes within the EQs. This enabled the team to synthesise evidence across different EQs and generate findings, conclusions and recommendations according to MoFA and FMO's strategic objectives and priorities for FMO-A. We have used these themes to structure the report sections on findings, conclusions and recommendations. The mapping of the EQs to themes is outlined in Table 1.

Table 1: **Mapping EQs to key themes in the evaluation**

Key theme	Relevant evaluation question
Portfolio Analysis	EQ1. How has FMO's portfolio developed? EQ1A. How has FMO-A's portfolio developed between 2013–2018 in terms of size and sector of businesses, countries and regions, client type, product type and financing of technical assistance? EQ1B. What is the composition of the financial return in terms of size of investment, countries and regions, product type and distribution over the investments? EQ1C. What is the relation between development impact and financial return, and how does this vary by context? How does this vary when definition of impact is broadened and time horizons are lengthened?
Mobilisation	EQ4. To what extent do FMO's investments catalyse additional (private) resources? EQ4A. What kind of blended-finance structures does FMO engage in and how has this developed? EQ4B. To what extent do FMO's investments catalyse additional (private) resources? i. To what degree does FMO attract co-financing on project level? ii. Which type of investments work best in catalysing resources from third party financiers (other DFI's and private financiers)? iii. What are the consequences of catalysing on the additionality and risk-profile of FMO clients?
Additionality	EQ3. To what extent would other commercial or private investors be available for FMO-investments? EQ3A. Are investments in line with the policy principle of additionality and how has FMO operationalised this? i. What are FMO's incentives to be additional and innovative? ii. How does FMO determine minimum levels of additionality? iii. Which type of investments had high/low levels of financial additionality (in terms of sectors, currency, product type, client type, countries and regions, etc.)? What is the relationship between high/low levels of additionality, risk and financial return? EQ3C. Does FMO benchmark its additionality versus other DFIs, and does it seek to be an innovator in the field of additionality within this group?

Development Impact	EQ2. To what extent has FMO contributed to the advancement of productive enterprises in developing countries and to inclusive development?
	EQ2A. What have been the direct and indirect effects on sustainable development?
	EQ2B. Does FMO maximize development impact per invested euro, given the required financial return? How does FMO operationalize this?
	EQ2C. Is FMO's development impact management fit for purpose?
	EQ2D. How does FMO ensure that benefits accrue to underserved sections of a society?
	EQ2E.What is the quality of FMO's indicators and impact data, how did the quality develop during the evaluation period, and how can they be used to measure effectiveness and impact?
E&S and Non-financial Additionality	EQ3D. What is FMO's non-financial additionality and its value-added to FMO clients compared to other DFI's and market parties?
Strategic Positioning of FMO	EQ3B. How does FMO ensure its additionality in a rapidly changing market environment with more private players entering the market?
	EQ2F. What has been the role of the Dutch State in ensuring that FMO maintains a good balance between risk, development results and financial targets?
	EQ2G. How does FMO's banking license contribute to its mandate? Is FMO's current set-up the correct form to execute its mandate?
	EQ5. How do the State funds influence FMO's own portfolio FMO-A?
	EQ6. How should FMO position itself in the evolving development finance landscape to maximise synergies between the goals of additionality, mobilisation and impact?

As referenced in section 2 on scope, a focus on E&S was introduced to the evaluation following agreement of the evaluation matrix and therefore is not featured explicitly in the evaluation questions but included in the key themes in Table 1.

3.3 Data and methodology for portfolio analyses

3.3.1 Data provided by FMO

The desk review selection, case selection and portfolio analyses were informed by working with a number of data sets provided by FMO. Three groups of datasets were provided.

The first datasets cover investment returns (loans spreads, non-performing loans and equity internal-rate-of return (IRR) calculations for the period in question, broken down by geography and sector. Loan data provides information on spreads and NPLs in each of the years. The analysis of equity returns is more complicated. When an equity investment is made, FMO begins to calculate an IRR, which is then updated as the investment proceeds. It is not until the equity investment is exited, therefore, that the full picture can be seen in terms of the IRR. To give a balanced view of the equity portfolio over the period, we have looked through two different lenses. First, we examine equity investments that were exited in each year from 2013 to 2018. These investments were all made before the period of the evaluation; however, and so do not reflect decisions made during this time. To account for this, we also looked at the most recent IRRs (December 2019 to avoid being distorted by Covid-19 effects) for equity investments made by FMO from 2013 to 2016. We exclude the final two years of the evaluation period, as IRRs during the early years of an equity investment do not give a true reflection of performance. The IRRs (for investments made between 2013–16) as of the end of 2019 will also be different from realised IRRs when these investments are exited, but they do provide an indication of what this will be, particularly when viewed comparatively across sectors and regions.

The second group of data was comprised of the sector-specific indicators discussed above from 2014. Two datasets were received. The first contained a wider set of indicators than the second, but FMO requested that the second set of indicators be used for the evaluation as the data were of higher quality. While some of these indicators were broken down by gender, this was skewed towards the later years of the period and too limited to use in the analysis.

The third group of data was drawn from the FMO impact model for 2016−2018 when this data became available. This is comprised of jobs and GHG avoided indicators. These were combined with data for returns and mobilised capital for the same period to analyse the relationship between FMO's objectives in each of these areas, i.e. returns, impact, and mobilising capital. Because of the issues with estimating post-2016 equity returns described above, this analysis is only performed for the loan portfolio. We use impact data from the model for this analysis as, unlike the sector-specific data, it applies to all investments in the FMO portfolio. For each loan where matching data was available, this combined dataset contains: country, sector, the total commitment made by FMO, the amounts mobilised by FMO, estimated jobs created by the investment, estimated GHG emissions avoided due to the investment and the weighted average spread of loans to the investee.

3.3.2 Data manipulation and approach to the quadrant analysis

Jobs supported data: For loan investments for which FMO provided data on the estimated number of jobs supported, the evaluation team calculated a 'jobs multiplier' by dividing the estimated jobs by the total commitment in millions of Euro. The 'jobs multiplier' provided the estimated number of jobs supported per million Euros invested by FMO in a specific company.

GHG emissions avoided data: For loan investments for which FMO provided data on GHG emissions avoided, the evaluation team calculated a 'GHG multiplier' which was calculated by dividing the GHG avoidance by the total commitment in millions of Euro. The 'GHG multiplier' provided the GHG avoided per million Euros invested by FMO in a specific company.

Percent mobilised: For each investment, the evaluation team calculated the percent mobilised by dividing the mobilised amount by the total commitment made by FMO.

Standardisation of data: For the loan data, the evaluation team created a combined impact index. To do this, the means and standard deviations were separately calculated for positive values of jobs multiplier, GHG multiplier and percent mobilised. The values of the individual investments were then converted to standardised values. These standardised values were then averaged to create an impact index value. Missing values were not included in the averages. The weighted average spread values of loans were also standardised using the same procedure.

Using the standardised values, each investment was ranked according to the created variables. For example, each loan investment had percentile values for its rank in the impact index for loans, percent mobilised and weighted average spread against other loans in FMO's portfolio. This allowed the evaluation team to identify loans that performed better or worse on impact, mobilisation and return.

The combined dataset was analysed across temporal, sectoral and regional dimensions. These analyses included summary statistics, dispersion of return analyses and individual investments plotted against the average values of the created impact indices and standardised return values. These plots allowed the evaluation team to conduct a quadrant analysis whereby it identified investments that were high impact/high return, high impact/low return, low impact/high return and low impact/low return. These classifications of 'high' and 'low' were relative to the averages of the entire loan portfolio.

Finally, the above analyses were conducted with and without the percent mobilised standardised values included. The evaluation team conducted a sensitivity analysis using the quadrant work outlined above to ascertain the investments which changed quadrants once the mobilisation data was excluded.

3.4 Sampling approach

The Portfolio Analysis, Process Review and E&S benchmarking were conducted at the organisational level and therefore did not require a sample to be drawn. The Desk Review was conducted based on a sample of 30 deals, and the case studies focused on a sample of up to 16 investments, which were a sub-set of the Desk Review sample.

As the first step in the sampling process, the case study countries were determined as South Asia Case Study Country 1, South Asia Case Study Country 2, East Africa Case Study Country and West Africa Case Study Country. These were sampled to meet the following criteria: inclusion of at least one fragile and conflict affected state;[20] diversity of sectors in each country; each country must be significant in the FMO portfolio, in terms of commitment value and number of commitments; and each country must include both loans and equity. Given FMO's increased focus on Africa and Asia, we aimed to sample two countries in Africa and two in Asia.

Second, a longlist of possible investments was drawn from the full portfolio based on multiple criteria, developed to support the selection of a sample that is representative of the FMO portfolio. The longlist is composed of all of the investments in each of the four case study countries, plus all of the investments in South Asia Desk Review Country as the longlist was drawn whilst South Asia Desk Review Country was being considered as an alternative to South Asia Case Study Country 1 for a case study. The criteria for adding additional projects to the longlist were: investment product, geography and sector. They were designed to ensure that the proportion of variables under each of these criteria was broadly representative of the proportion across the portfolio.

30 investments were sampled from the longlist based on the following criteria:

- Criterion 1: Must include five deals per case study country (to allow for sampling of three or four of these for case studies).

- Criterion 2: Broadly equal split with respect to:
  i. Development Impact with mobilisation rating (based on the evaluation team's portfolio analysis; approximately a third each of high/average/low);
  ii. E&S Additionality (approximately equal proportions of: tagged as having E&S additionality / not tagged as having E&S additionality);
  iii. Returns rating (based on the evaluation team's portfolio analysis; approximately a third each of high/average/low);
- Criterion 3: Broadly similar proportion of the following criteria as the proportion that can be found across the portfolio:
  i. Equity/debt (22% equity to 78% loans);
  ii. Sectors for the debt portfolio (15% Agribusiness, Food and Water; 22% Energy; 37% Financial Institutions; and 4% infrastructure[21]);
  iii. Regions (25% Africa; 6% East Asia & Pacific; 21% Europe & Central Asia; 4% Global; 25% Latin America and the Caribbean; 5% Middle East & North Africa; and 12% South Asia[22]);
  iv. Inclusion of both national and regional investments (not targeted at a specific proportion).

Following the drawing of the sample, the sampled investments and sampling approach was shared with MoFA and FMO for feedback and approval. The rationale for each sampled investment was also provided.

[20] http://pubdocs.worldbank.org/en/179011582771134576/FCS-FY20.pdf.

[21] Equity investments are tagged as a sector; therefore, these proportions total 100% once the 22% equity investments are added.

[22] Approximately 0.8% are not assigned a region in the data set; approximately 0.5% are tagged as Asia; however, this is not included in the criteria as it is too small to relate to a minimum of one investment in our sample of 30.

There were some changes made to the sample based on feasibility and appropriateness of including the investments in the evaluation; for example, two investments were removed from the sample because the sampled entity no longer exists. This resulted in six investments being removed and replaced with alternative deals from the FMO portfolio that met the same criteria.

All possible investments in case study countries were included in the case studies (in order to ensure three to four investments in each country) with the exception of South Asia Case Study Country 1 in which four deals were sampled from a list of five. In South Asia Case Study Country 1, there were two Financial Institution deals and only one was required. The evaluation team reviewed the financial proposal of each and selected South Asia Case Study Country 1/FI 1 as the deal appeared to have more lines of enquiry that were relevant to the evaluation questions.

Table 2 contains details of the sampled investments for the desk review and the country case studies.

Table 2: **Summary of 30 sampled investments for the desk review from which the case study samples were drawn – all investments are anonymised; one row represents one client**

Region	Sector	Debt/Equity	E&S rating	CG rating	Investment referred to as	Overall referred to as
South Asia	Agribusiness, Food & Water	Commercial loans	B+	2	AFW 1	South Asia Case Study Country 1/AFW 1
East Africa	Agribusiness, Food & Water	Commercial loans	B	3	AFW 2	East Africa Case Study Country/AFW 2
West Africa	Agribusiness, Food & Water	Commercial loans	B+	2	AFW 3	West Africa Case Study Country/AFW 3
South Asia	Agribusiness, Food & Water	Commercial loans	B	3	AFW 4	South Asia Desk Review Country/AFW 4
Latin America and the Caribbean	Agribusiness, Food & Water	Loans	A	2	AFW 5	Latin America and the Caribbean Desk Review 1/AFW 5
Latin America and the Caribbean	Agribusiness, Food & Water	Loans	-	-	AFW 6	Latin America and the Caribbean Desk Review 2/AFW 6
South Asia	Energy	Commercial loans	A	-	Energy 1	South Asia Case Study Country 1/Energy 1
South Asia	Energy	Commercial loans	B+	-	Energy 2	South Asia Case Study Country 2/Energy 2
South Asia	Energy	Commercial loans	B+	n/a	Energy 3	South Asia Case Study Country 2/Energy 3
South Asia	Energy	Commercial loans	B+	n/a	Energy 4	South Asia Case Study Country 2/Energy 4
East Africa	Energy	Commercial loans	B+	-	Energy 5	East Africa Case Study Country/Energy 5
East Africa	Energy	Commercial loans	B+	Null	Energy 6	East Africa Case Study Country/Energy 6
East Africa	Energy	Commercial loans	B+	n/a	Energy 7	East Africa Case Study Country/Energy 7
Latin America and the Caribbean	Energy	Loans	-	-	Energy 8	Latin America and the Caribbean Desk Review 3/Energy 8
South Asia	Financial Institutions	Commercial loans	A	2	FI 1	South Asia Case Study Country 1/FI 1
South Asia	Financial Institutions	Commercial loans	A	2	FI 2	South Asia Case Study Country 1/FI 2
South Asia	Financial Institutions	Commercial loans	C	2	FI 3	South Asia Case Study Country 1/FI 3
West Africa	Financial Institutions	Commercial loans	A	3	FI 4	West Africa Case Study Country/FI 4
West Africa	Financial Institutions	Commercial loans	A	2	FI 5	West Africa Case Study Country/FI 5

Central Asia	Financial Institutions	Loans	B	2	FI 6	Central Asia Desk Review Country/FI 6
Latin America and the Caribbean	Financial Institutions	Loans	A	3	FI 7	Latin America and the Caribbean Desk Review 4/FI 7
Latin America and the Caribbean	Financial Institutions	Loans	B	2	FI 8	Latin America and the Caribbean Desk Review 5/FI 8
South Asia	Infrastructure, Manufacturing & Services	Loans	A	-	IMS 1	South Asia Desk Review Country/IMS 1
South Asia	Private Equity	Equity	B+	2	PE 1	South Asia Case Study Country 1/PE 1
South Asia	Private Equity	Equity	B	n/a	PE 2	South Asia Case Study Country 2/PE 2
East Africa	Private Equity	Equity	B	-	PE 3	East Africa Case Study Country/PE 3
West Africa	Private Equity	Equity	A	3	PE 4	West Africa Case Study Country/PE 4
West Africa	Private Equity	Equity	A	-	PE 5	West Africa Case Study Country/PE 5
Africa	Private Equity	Equity	-	-	PE 6	Africa Desk Review/PE 6
Global	Private Equity	Equity	A	2	PE 7	Global Desk Review/PE 7

3.5 Data collection methods for desk review, case studies and E&S analysis

While the following findings sections were informed by the portfolio analysis, the main sources of information were (i) policy documents provided by FMO, (ii) interviews with FMO staff, (iii) deal-specific documents for the sample of 30 transactions (desk review), and (iv) case studies in four countries, with three to four investments analysed in each country. For each investment, the main FMO investment officers and E&S officers, investee management and co-investors were interviewed. Dutch embassy staff were also interviewed to give a national perspective in each country, with Dutch NGOs providing their views on FMO. The E&S study (Annex A) was based on publicly available documents from FMO, CDC, DEG, Proparco and AfDB, and interviews with E&S specialists from these benchmarked institutions.

3.6 Ethics

The evaluation team adheres to nine Itad Ethical Principles.[23] The evaluation team had no affiliations or conflict of interest with the MoFA or FMO, and the independent role of the Evaluation Reference Group further affirmed the independence of the evaluation. In addition to this, the evaluation team appointed an independent peer reviewer who undertook quality assurance of drafts of the inception and final evaluation reports. Interviews were conducted in person with FMO staff as part of the process review and remotely for the case studies and E&S benchmarking. In advance of interviews, information was shared with respondents outlining the background to the evaluation, independence of the evaluation team, how information would be collected and recorded, the team's commitment to keeping their responses confidential, the voluntary nature of their participation, their right to withdraw at any time and details of who to contact if they had any concerns or required more information. At the start of the interview, respondents were given the opportunity to ask questions on the information shared in advance and explicitly asked whether they would like to proceed with the interview on the basis of the information provided. There were no respondents under the age of 18 for this evaluation; therefore, no protocol was developed for the inclusion of children.

FMO shared all confidential data and documentation by providing the evaluation team with limited access to a SharePoint folder, specifically set up to share this information. Each evaluation team member individually signed a Non-Disclosure Agreement (NDA) with FMO. The evaluation team stored all confidential data and documentation on Microsoft Teams. Teams utilises the SharePoint Online environment to store data and therefore is compliant with the robust encryption levels implemented by Microsoft. As an additional layer of security, Itad employs multifactor authentication (MFA) protocols for internal and external users of Teams. MFA requires any users signing into Teams to provide two methods of authentication (a password and a security code), thus ensuring much greater protection against password breaches. Evaluation team members only had access to the information that they required for their role on the evaluation; for instance, those evaluators who were collaborating on the West Africa Case Study Country did not have access to the South Asia Case Study Country 1 investment documentation.

3.7 Limitations

The evaluation began prior to the Covid-19 pandemic and therefore some adjustments to the methods were made to ensure a robust evaluation that could be delivered safely. The portfolio analysis, process and desk reviews and the E&S benchmarking were all largely desk-based, with the exception of interviews with FMO staff for the process review which were conducted before travel restrictions were introduced in The Netherlands. However, we re-designed the case studies due to Covid-19 travel restrictions. In summary, we still conducted the vast majority of the interviews that we had initially planned for these case studies; however, these were all conducted remotely using online platforms. We also recognised that some stakeholders may not be able to participate in interviews, for instance government representatives,

[23] Itad Ethical Principles: independence and impartiality of the researchers; avoiding harm; child protection; treatment of participants; voluntary participation; informed consent; ensuring confidentiality; data security; and sharing of findings.

given the increased pressure on the government's ability to respond to this pandemic at this time. By working remotely, we were less able to understand the context and better able to ensure the safety of those stakeholders who may be more vulnerable to reprisal from speaking with us, such as factory workers raising concerns about management. We decided that it was not appropriate to interview these groups and instead relied on other data sources, such as worker survey data where it already existed.

We put in place a number of measures to ensure that data was collected to a high quality and consistently across the remote case studies. These included a series of checks and balances that are additional to a typical country visit. They included:

- **An introduction workshop on remote 'country visits' between the core team and national consultants** to ensure shared understanding of the evaluation, of specific deals and of the interview guides. This was essential given the core team's deep understanding of MoFA and FMO gathered during Modules A and B.
- **Regular de-briefs between those involved in the interviews** (core team and national consultants). This was an important feedback step to ensure the consistency and quality of the interviews, as well as to further orientate national counterparts on MoFA and FMO expectations.
- **A review of interview notes and feedback to ensure qualitative data was being documented accurately and comprehensively**. The notes were a key part of the evidence base for this part of the evaluation, and it was important to ensure consistency within and between country studies.
- **A remote case study as a pilot,** involving a wider group of the core consultants to establish a shared understanding and standardised approach that was rolled out across the remaining three countries.

The analysis of data within the reviews of the portfolio and processes were not affected by Covid-19 as the data was collected and reported prior to the outbreak. However, this means that the results of these analyses do not reflect the current climate within which FMO is operating.

4. Findings

4.1 Portfolio Analysis

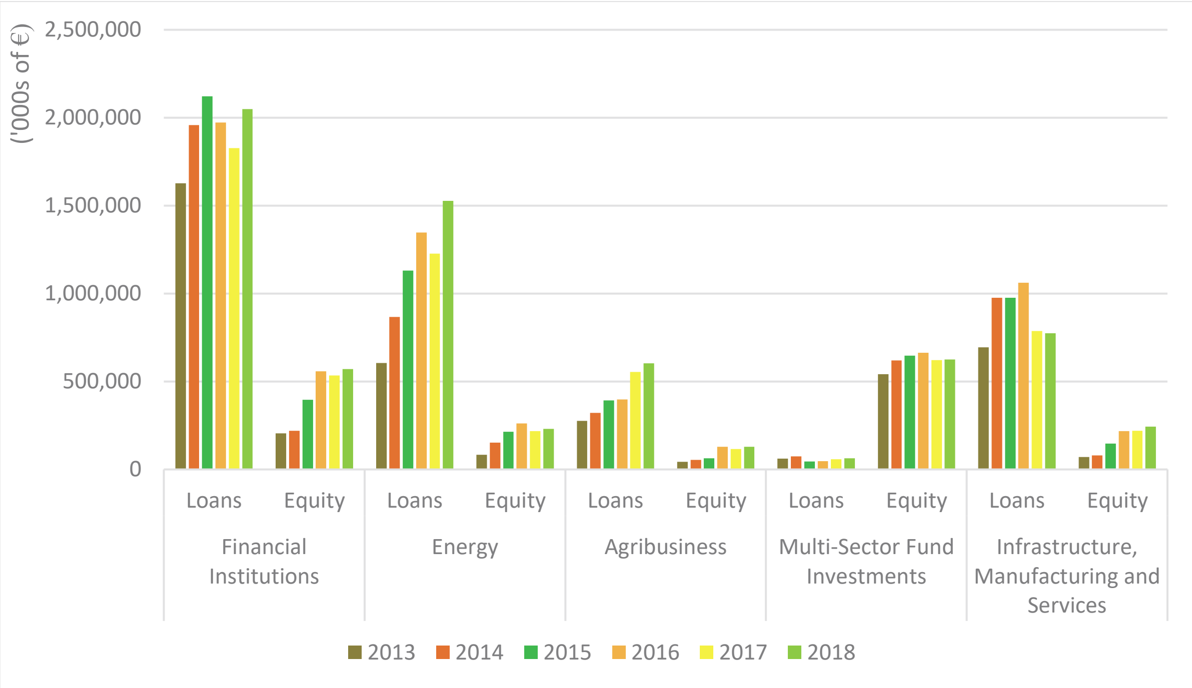
4.1.1 Initial Portfolio overview from publicly available data

Relying upon annual reports published for 2014–2018, the evaluation team undertook an initial analysis of the ways in which FMO[24] invests across different sectors, in different regions, using different instruments and with varying levels of risk. This served the dual purpose of familiarising the team with FMO's portfolio and providing FMO the opportunity to correct any misunderstandings at an early stage.

As described in the strategy overview above, FMO changed its sector strategy in 2017, at which point the IMS sector was discontinued, with investments allocated to the most appropriate of the three focus sectors: AFW, Energy, and FI. Of these, AFW is the most recent sector, becoming a focus sector in 2011, but not established as a separate department until 2015. It was only from 2015 that AFW began to grow significantly and had targets to achieve. Regionally, greater strategic focus was given to Africa, Asia and countries in the European 'neighbourhood', and a gradual increase in the weight of equity in the portfolio was also agreed.

As shown in Figure 1, the portfolio grew rapidly from 2013 to 2018, particularly with Energy projects and FI. Almost 77% of the growth of FMO's loan exposure was from these two sectors. IMS are the next largest investment sectors for FMO loan investments, but exposure was relatively stable over the period. AFW loans grew significantly, but still only accounted for 12% of the total gross lending exposure in 2018. The two largest sectors for equity investments were multi-sector funds and FI. Growth in the equity portfolio was dominated by increased investments in FI, but the equity portfolio increased across every sector, albeit from low levels, in line with the evolving FMO strategy.

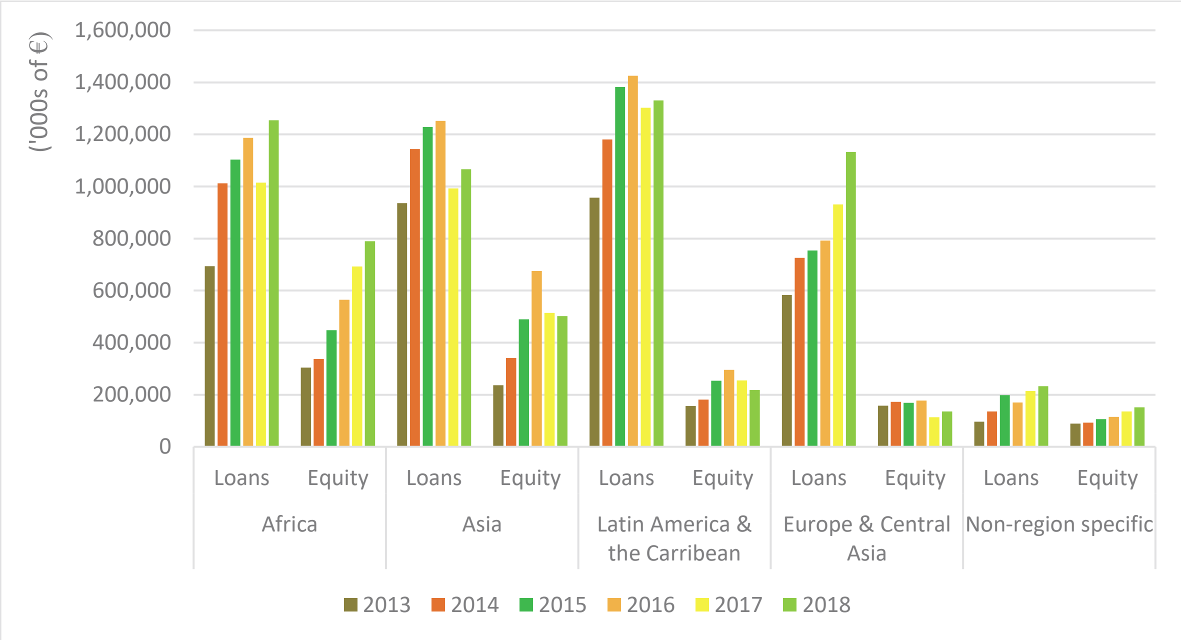
Figure 1: Sectoral breakdown of FMO investments, 2013–2018



[24] Data in this section is drawn directly from annual reports and includes the government funds that FMO manages on behalf of government. Also note that loan data is based on gross exposure. If annual data conflicted between two reports, the most recent data was accepted as accurate.

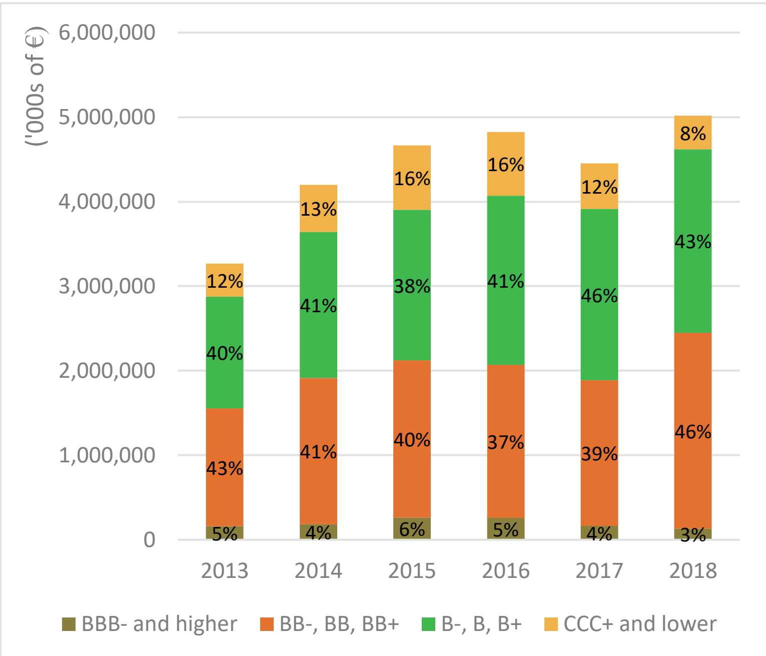
Regionally, the largest market for loans from 2013–2018 was Latin America and the Caribbean. Taken together; however, Africa and Europe & Central Asia accounted for 73% of increased lending over the period. In 2018, FMO's gross exposure to Africa was just €76 million less than its exposure to Latin America and the Caribbean. This compares to a gap of €242 million in 2013.

Figure 2: Regional breakdown of FMO investments, 2013–2018



FMO's increased focus on Africa was even more marked in equity, which increased by almost 160% during the period. More than half of the growth in the equity portfolio was the result of greater investment in Africa. FMO also increased its equity investment in Asia sharply over this period, more than doubling this compared to 2013. These regional changes are in line with the strategic priorities described above.

Figure 3: FMO gross lending exposure by internal rating, 2013–2018



From a risk standpoint, the loan portfolio became slightly riskier from 2013–2018, with lending to investment grade (BBB- or higher) falling somewhat. FMO also invested less in projects or companies with the highest credit risk (CCC+ and lower). Lending in the BB- to B+ range expanded as a share of the portfolio.

The evaluation portfolio analysis of FMO below is based on information received from the finance department, the investment department and the impact department.

4.1.2 Portfolio returns 2013–2018

This section provides summary statistics on returns over the evaluation period for the loan and equity portfolios. The former is based on actual annual payments received (i.e. margins), and therefore may differ slightly from spreads agreed at the time of investment. The latter are presented in two ways: (i) realised IRRs for equity investments exited in each year of the period, but for investments made before 2013; (ii) the most recent IRRs for live equity investments made between 2013 and 2016.

Figure 4: Weighted average all-in loan margin by sector, 2013–2018

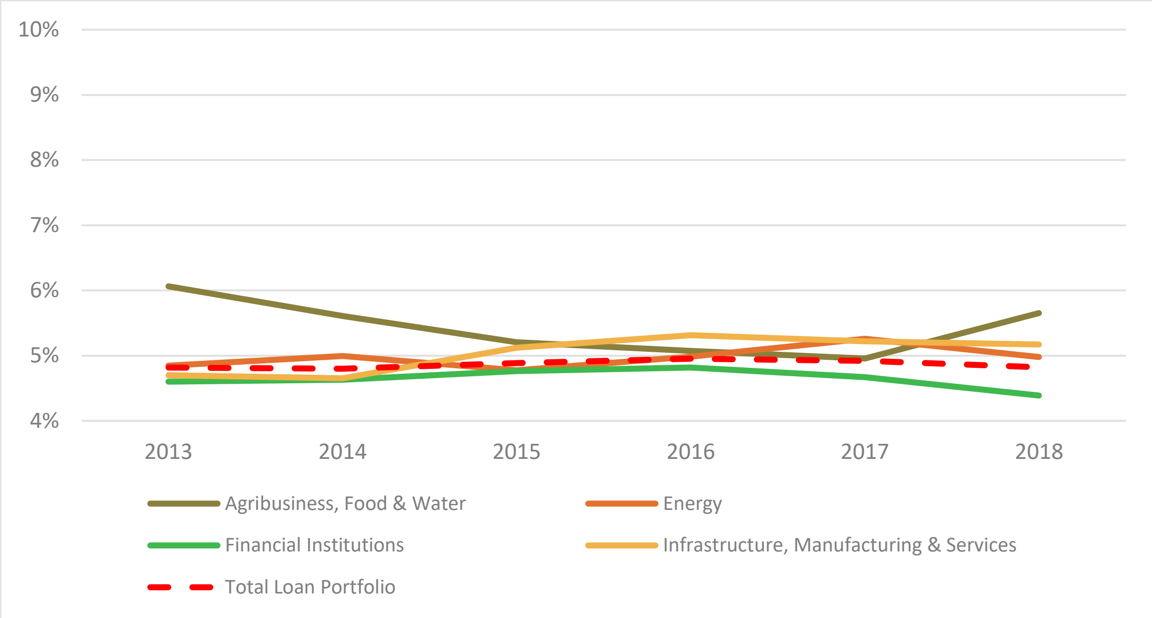
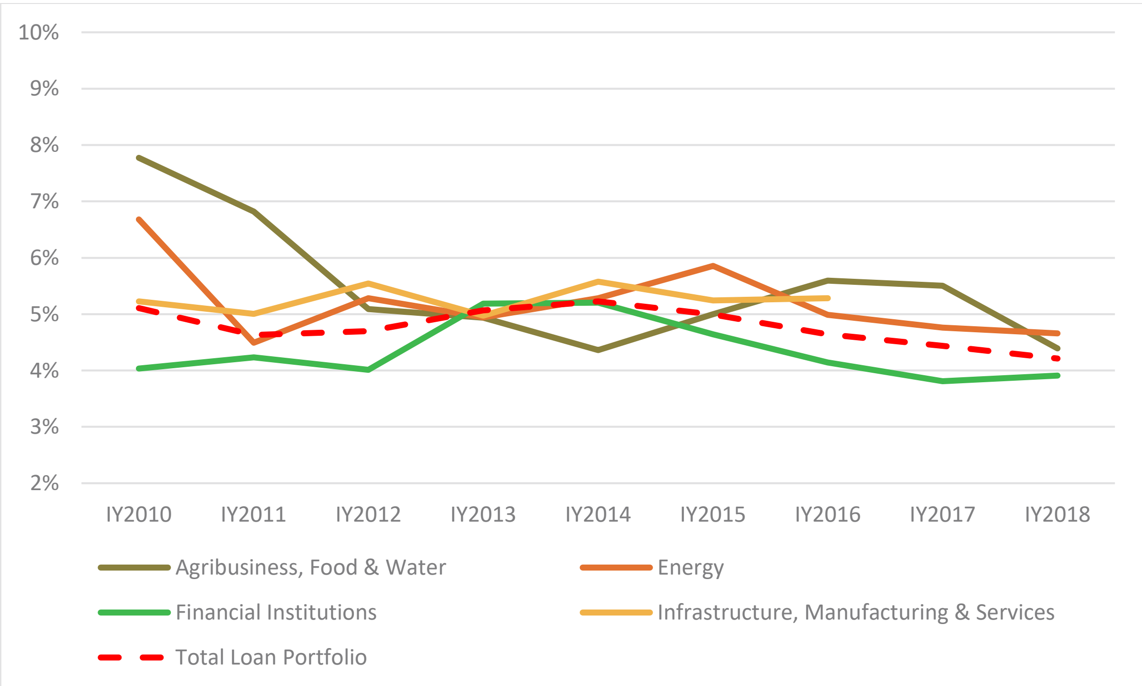


Figure 4 shows changes in loan margins across the portfolio from 2013–18. As we can see, performance has been steady over the study period. Although there was some volatility in AFW and FI loans, margins have stayed within a tight 4%–6% band. In order to capture annual changes, Figure 4 shows annual margins for all loans in the portfolio regardless of when the loan was made. To capture how margins may be changing over time, Figure 5 looks at margins in the year each loan was made going back to 2010 to add context to the evaluation period.

Figure 5: Weighted average all-in loan margin by year of investment 2010–2018



As we can see, overall margins on new investments were decreasing for most of the evaluation period after reaching a high point in 2014. This is largely a result of lower margins in FI loans and, after 2015, Energy sector loans.

Figure 6: Weighted average all-in loan margin by region, 2013–2018

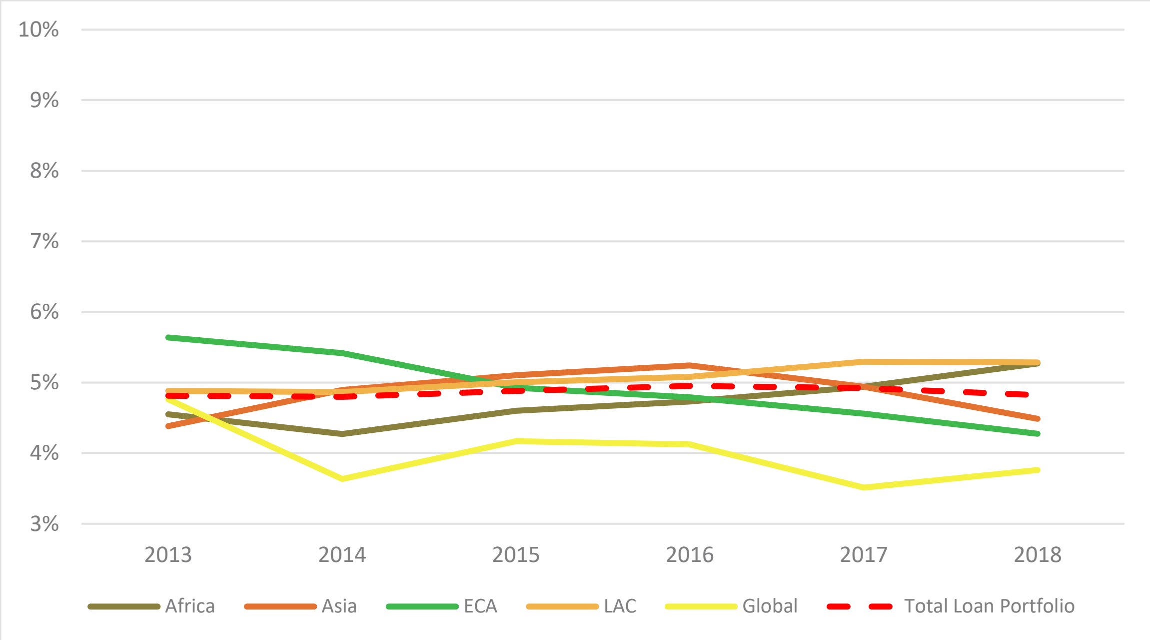
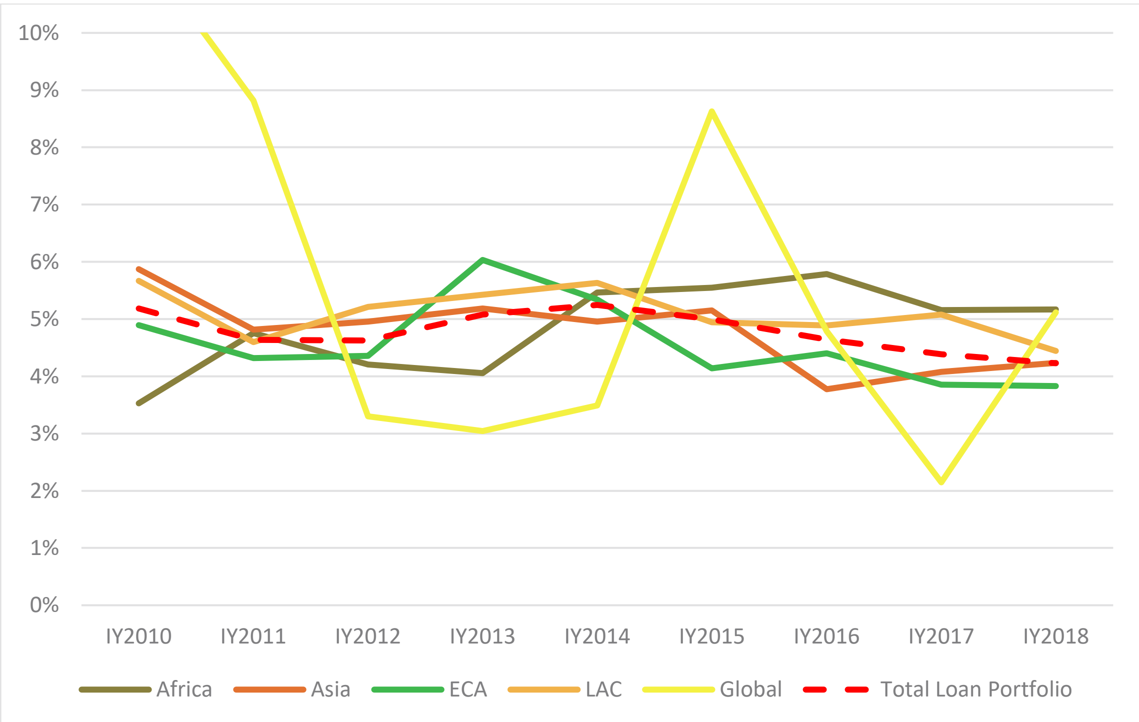


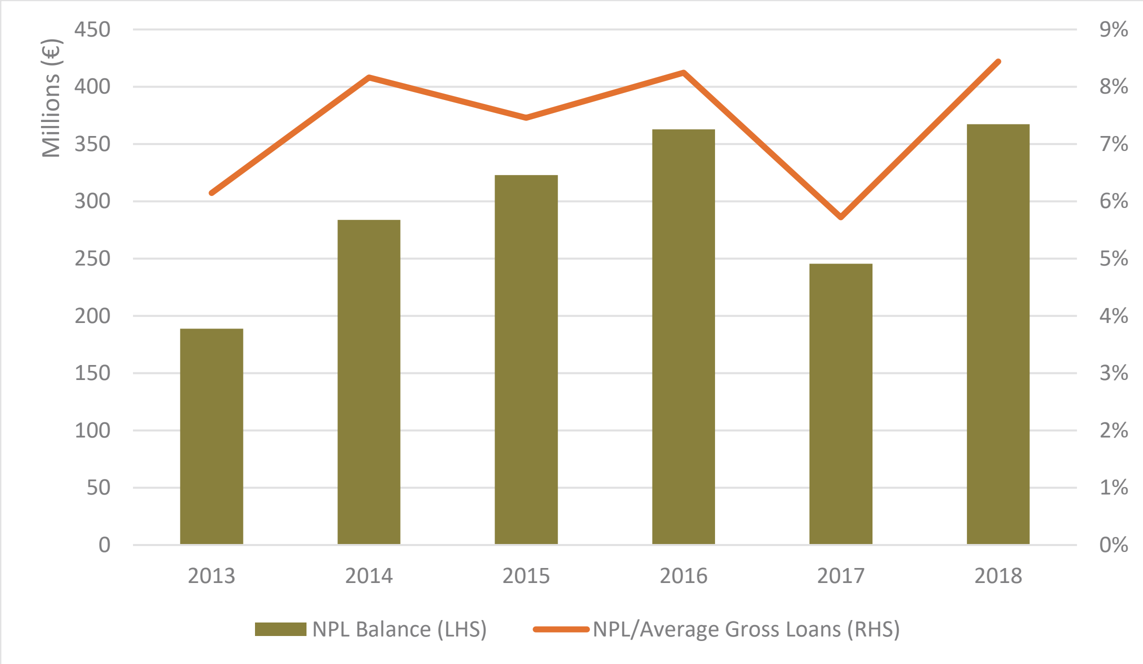
Figure 6 presents the same overall portfolio data as Figure 4 on a regional basis. Here, loans labelled as 'Global' have underperformed the rest of the portfolio, while those in Latin America and the Caribbean (LAC) have been consistently higher than the total loan portfolio.

Figure 7: Weighted average all-in loan margin by year of investment 2010–2018



Looked at by year of investment, as in Figure 7, it should be noted that total loan portfolio percentages are different from sectoral breakdown as Figure 7 includes loans for which a sector may not be labelled. In terms of regional differences, we see that global loans have the most volatile margins, but are not influential on overall loan portfolio due to them accounting for a small share (3.3% of 2010-2018 investments) of the total portfolio. The post-2014 decline is largely due to decreases in Europe and Central Asia (19.3%), LAC (28.8%), and Asia (24.4%), while African (24.2%) margins remained higher than the rest of the portfolio despite falling between 2016 and 17.

Figure 8: Non-performing loans, 2013–2018



Reflecting the expansion in the loan portfolio, the bars and left-hand scale in Figure 8 show growth in the value of NPLs over the period. The line and right-hand scale, however, show that, as a proportion of total loans, NPLs have remained largely within the 6–8% band.

If we break the NPL data down by sector and location in terms of weight in the portfolio, we find that Asia accounts for most of the NPLs in the FMO loan portfolio relative to its size, while historically, the African and LAC portfolios have performed best in terms of NPLs. On a sector basis, IMS loans have been the worst performing sector by far. Relative to their weight in the portfolio, FI's share of NPLs is far lower than would be expected, while NPLs for AFW and Energy are in line with their size.

Using data from the last two years of the evaluation period (2016–18), Table 3 compares volume weighted spreads by region and income group for the period. As we can see, on a regional basis, spreads are highest in Africa, followed by Latin America and the Caribbean, Asia, Europe & Central Asia, and Middle East and North Africa, with global investments having the lowest weighted average spreads.

Table 3: **Regional spreads by income group 2016–18**

Region	Volume Weighted Spreads
Africa	**4.80**
Low Income	4.74
Middle Income	5.02
Upper Income	4.20
Asia	**4.59**
Low Income	5.13
Middle Income	4.25
Europe & Central Asia	**3.94**
Low Income	6.96
Middle Income	4.17
Upper Income	3.55
Global	**3.13**
Middle Income	3.13
Latin America & Caribbean	**4.78**
Middle Income	4.43
Upper Income	4.94
Middle East & North Africa	**3.76**
Middle Income	4.21
Upper Income	3.51

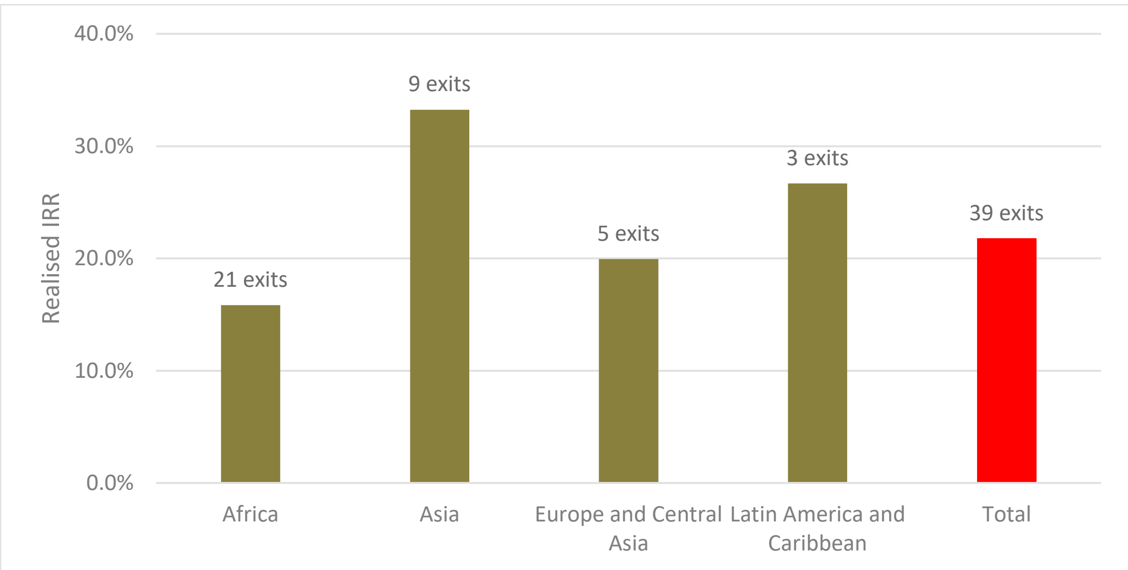
If we look at income groups as a whole (i.e. for all regions combined) the difference between spreads offered in Lower Middle-Income Countries (LMIC) and Upper Middle-Income Countries (UMIC) is negligible, but spreads in LLIC) are considerably higher than LMIC spreads.

Comparing income groups and region, the divergence between LIC and LMIC spreads is larger in Asia and ECA. It is noteworthy that LICs have a lower spread in Africa than LMIC countries, suggesting a greater use of concessional funds in African LICs, and/or spread compression due to competition in these markets.

If we look by sector, FI has the lowest and most stable spreads, reflecting the lower average risk of these investments. Energy and AFW investments have the same average spread over the period, but the latter are more volatile, while Energy loans show consistently declining spreads.

Turning to the equity portfolio, Figure 9 gives details on realised IRRs for investments exited over the evaluation period on a regional basis, provided by FMO as a weighted average based on size of investment.

Figure 9: Equity investment realised IRRs and exits by region, 2013–2018



As we can see, Asia and LAC equity investments delivered higher than average IRRs, while Africa and ECA were below average. Of the regions, Africa had the largest influence on the total IRR return as it had the most exits, pulling down the overall IRR.

Figure 10: Equity investment realised IRRs and exits by sector, 2013–2018

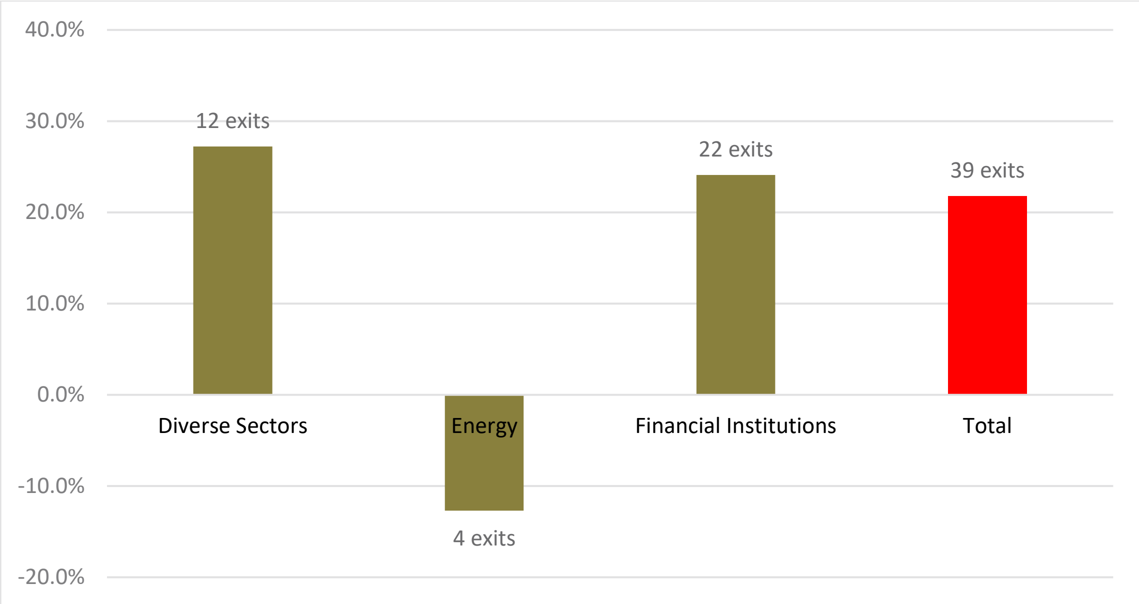


Figure 10 gives the same information by sector. Total IRR is supported by above average returns from diverse sector and FI equity investments. It is important to note that Energy sector investments that were exited during this period only accounted for 7.3% of paid-in capital for the total exited investments, which explains the limited impact on overall performance from this sector.

Figure 11: **2013–2016 Live equity investment IRRs by region (labelled by number of investments made during the period)**

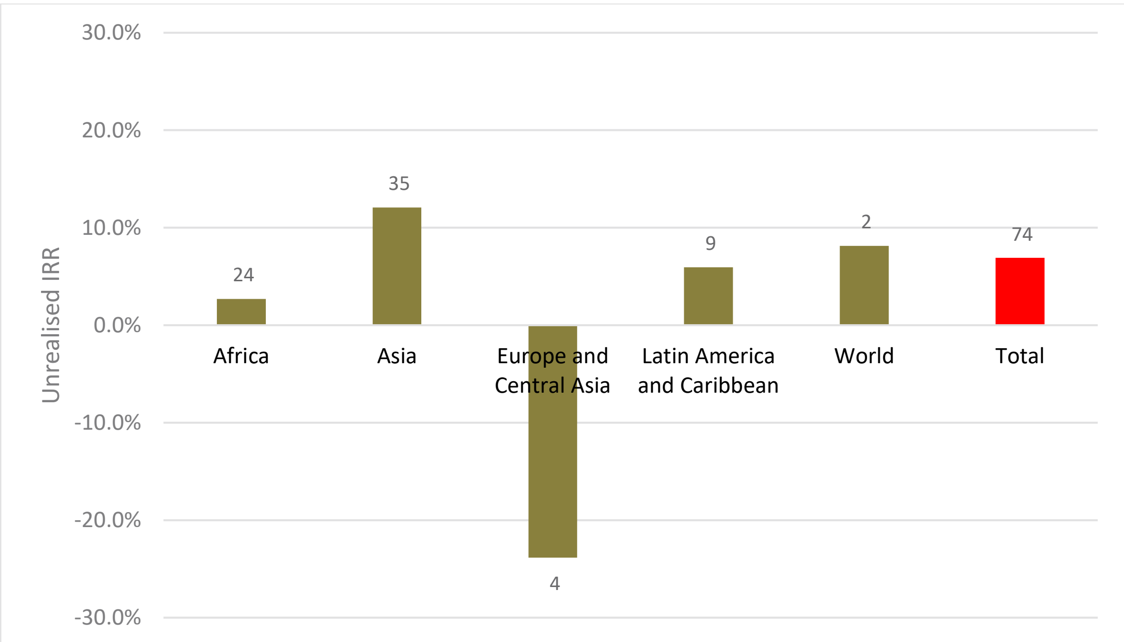
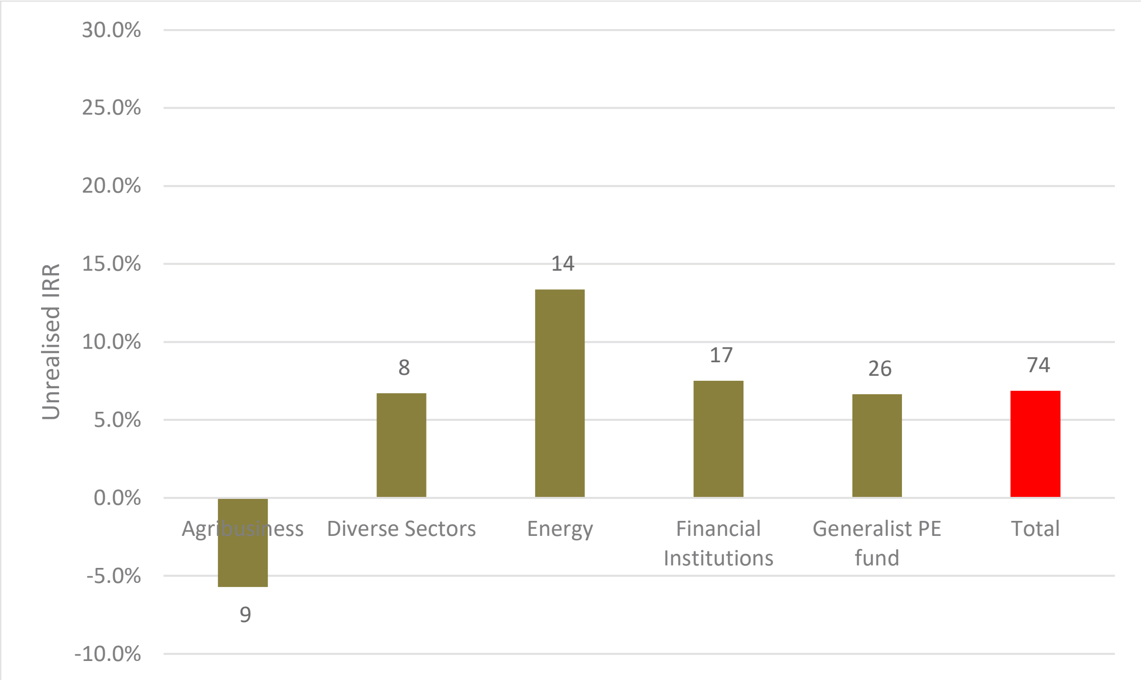


Figure 11 looks at IRRs as of December 2019 for equity investments made between 2013 and 2016. While ECA investments are by far the worst performing, they represent less than 2% of paid-in capital and so have little effect on the overall figure. The large majority of investment in terms of capital is accounted for by Africa (43.7%) and Asia (40.5%), with the relatively high returns in the latter pulling up overall IRRs.

Figure 12: 2013–2016 Live equity investment IRRs by sector (labelled by number of investments made during the period)



As we can see, AFW investments are the worst performing but, as they account for less than 10% of paid-in capital, this has limited overall effect. The most important drivers of overall performance are returns on FI (37.7% of capital) and Generalist PE funds (32.3%). Unlike exited investments where the Energy sector performed badly, current IRRs on live Energy sector equity investments are considerably higher than in other sectors. This has less effect than the two largest sectors, however, as these account for 16.35% of paid-in capital, which is considerably higher than was the case for exited investments, but still much less than FI or generalist fund investments.

4.1.3 Sector-specific impact data 2014–2018

FMO has collected sector-specific impact data since 2014. The list of the main indicators that FMO collects across all sectors and by sector is listed in Table 4.

Table 4: **Impact indicators collected across all sectors and by sector**

Across all sectors
Direct employment
Direct employment for women
Green investment (‘Green label’: Y/N); if green label applied, Percentage Green investment (%)
Reducing inequalities investment (‘Reducing inequalities’ label: Y/N)
Annual avoided GHG emission compared to most likely alternative (tCO2eq/yr.)
GHG emission (tCO2eq) [measured in specific circumstances]
Corporate tax (in reporting currency)
Total non-current assets of client (in reporting currency) [except for some agribusiness clients and some off-grid clients]
Total revenues of client (in reporting currency)
Total profit after tax of client (in reporting currency)
For Private Equity funds in any sector: each portfolio company is a small and medium sized enterprise (SME) at date of investment by Fund Manager (Y/N)

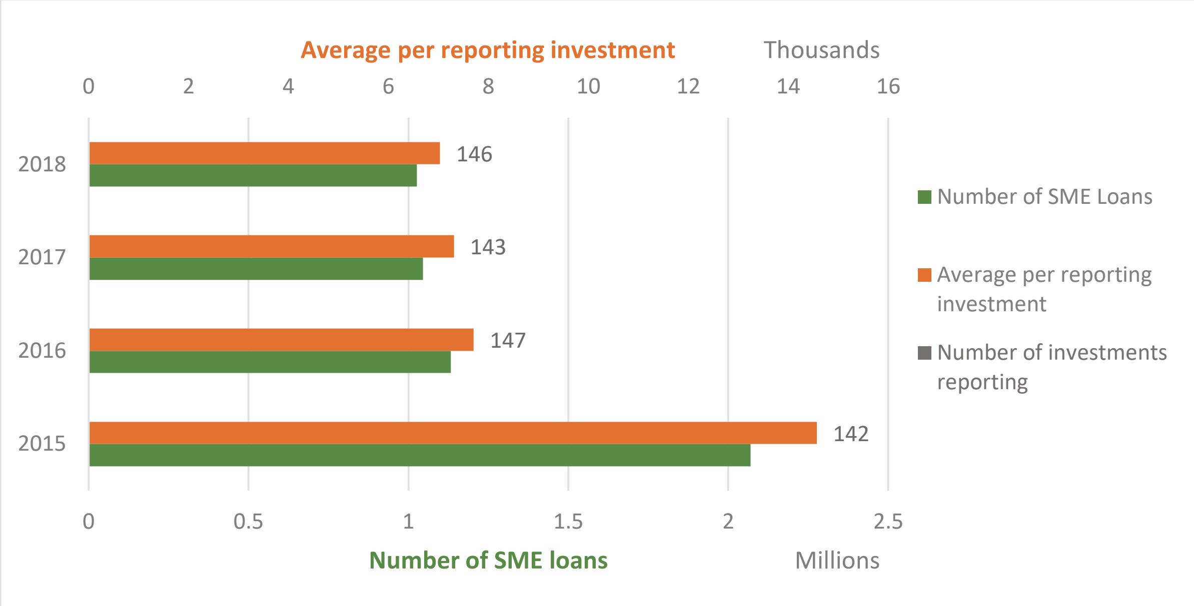
Agribusiness, Food & Water	Financial Institutions[25]	Energy
Smallholder farmers supported (#)	Total gross loan portfolio (in reporting currency)	(Gross) Total installed electricity capacity (MW)
Area of forest under management (hectares)	Volume of gross micro finance loan portfolio (in reporting currency)	Power production (GWh)
	Volume of gross SME finance loan portfolio (in reporting currency)	Equivalent people served via power generation (#)
	Total gross MSME finance loan portfolio (in reporting currency)	
	Number of micro loans provided by the FI (in #)	
	Number of SME loans provided by the FI (in #)	
	SME Use of funds clause	
	Loan portfolio sector breakdown (only for FMO new commitments)	

The following summary graphs of sector-specific impact data are based upon the streamlined dataset provided, which FMO believes to be compatible with the quality that can be achieved today based on the current systems and processes. As described previously, there is some breakdown by gender on these indicators, but these only become available towards the end of the period and are not provided by a sufficient proportion of investees to be informative, with some being specific requirements for governments funds. Data collection through Impact Cards was initiated in 2014; therefore, there is a limited number of reporting investees for this year, which is why we excluded these from the analysis. We include data up until 2018, inclusive, given the period under evaluation is 2014 to 2018. We therefore focus here on general trends, from 2015 to 2018, in the following main indicators collected:

- Financial Institution investments: number of SME loans and number of microloans.
- Energy investments: number of people served via power generation.
- AFW investments: number of smallholders supported.
- All sectors: direct employment.
- Government funds: number of people reached.

[25] This does not apply to banks with which FMO only has a trade finance facility.

Figure 13: Financial Institution impact monitoring (1): SME loans 2015–2018



SME loans are defined by FMO as those between USD 10,000–1,000,000. As shown in figure 13, a little under 150 FIs reported on this indicator in each of the years. Other than 2015, the average reported per institution is relatively constant between 7,000 and 8,000 SME loans provided.[26]

Figure 14: Financial Institution impact monitoring (2): Microloans 2015–2018

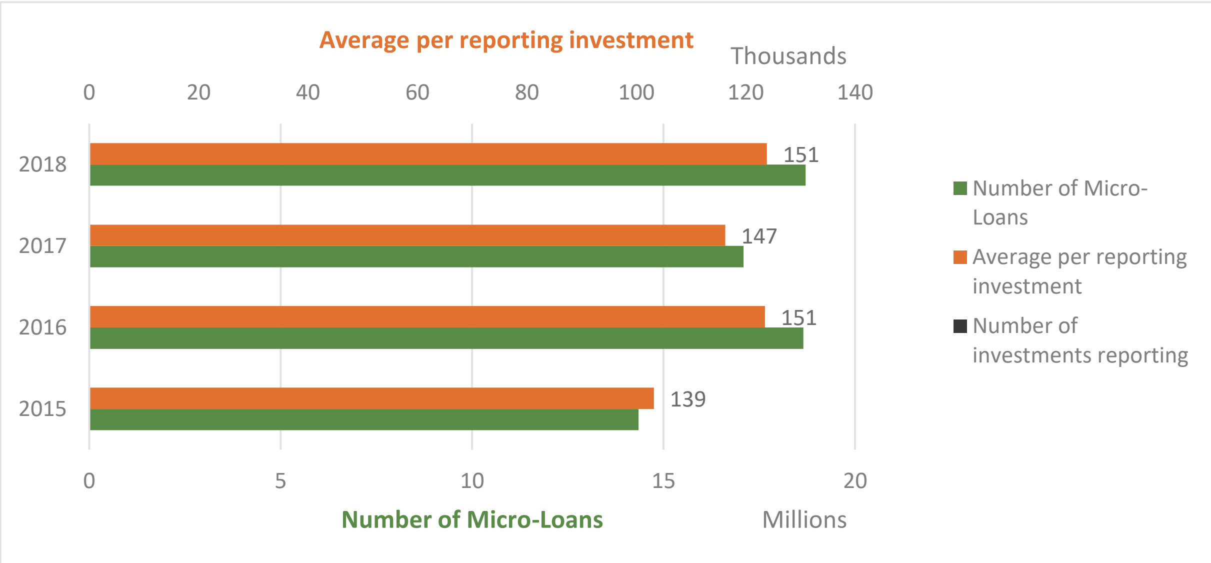


Figure 14 provides comparable data on microloans for the same period. FMO define microloans as being below $10,000. For all the years, we see a similar number of investees reporting, with the number of microloans reported also relatively stable. These FI indicators are reported to FMO using the annual impact reporting template. From an attribution perspective, these indicators seem to reflect the ongoing operations of the institutions, rather than being directly linked to FMO's investments specifically.

[26] We report averages as total figures may be misleading given changes to the number of investees.

Figure 15: **Energy sector impact monitoring: people served with power generation 2015–2018**

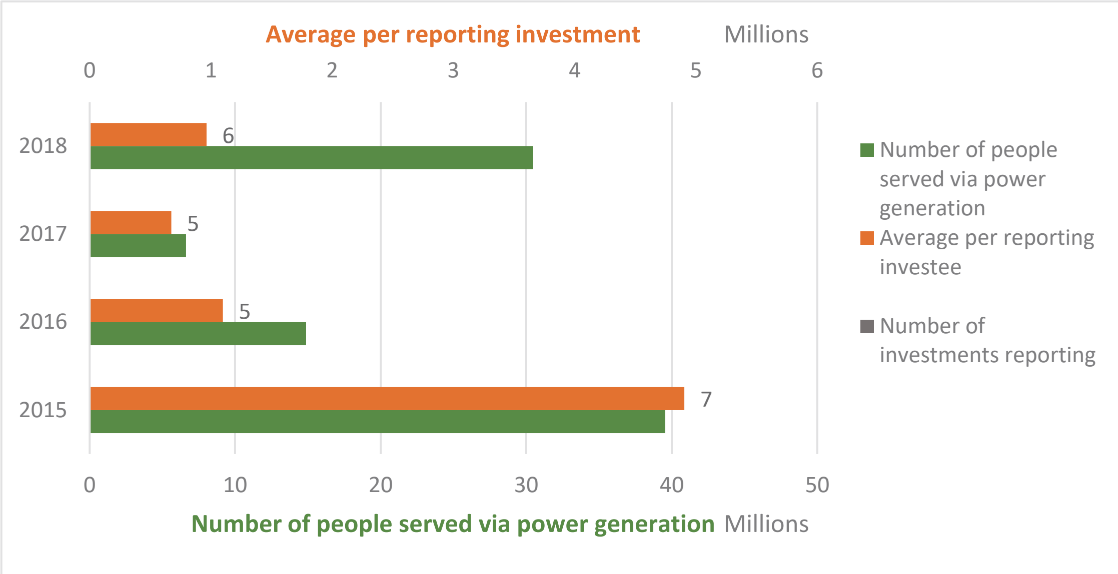
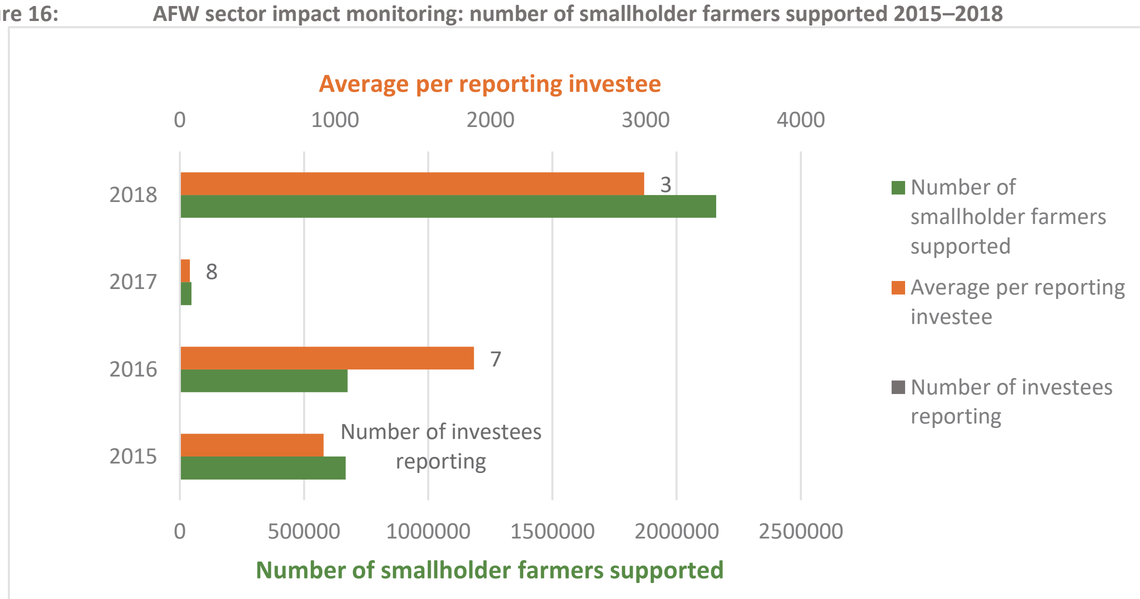


Figure 15 reports people served via power generated by FMO's investees in the Energy sector. After 2015 the average number of people served falls dramatically, suggesting that one or more large Energy investment was exited after 2015. The investments relate to projects connected to the grid, with the result that number of people served is an estimated, rather than actual, figure. The method used to produce this figure is to divide the annual amount of energy delivered to off-takers by the estimated average annual energy use. This is the electricity consumption per capita divided by the electrification rate using World Bank/IEA data. As discussed above, and further below, GHG avoided figures are also produced for renewable energy investments, which is the fossil fuel equivalent of the energy produced.

Figure 16: **AFW sector impact monitoring: number of smallholder farmers supported 2015–2018**



There is a notable steep decline in the number of smallholder farmers in 2017 despite a moderately stable number of investments reporting in comparison with the previous year. Conversely, it seems that one (or more) significant AFW investments may have come onstream in 2018 as the number of smallholder farmers supported increases dramatically despite fewer investments reporting. FMO defines smallholders as 'marginal or sub-marginal farm households that own and/or cultivate relatively small plots of land'. 'Supported' is defined as active support from the client company in order to improve production practices that have beneficial effects on yields, and/or reduce environmental degradation, and/or improve social practices during the reporting period'.

Figure 17: Direct employment impact monitoring 2015–2018

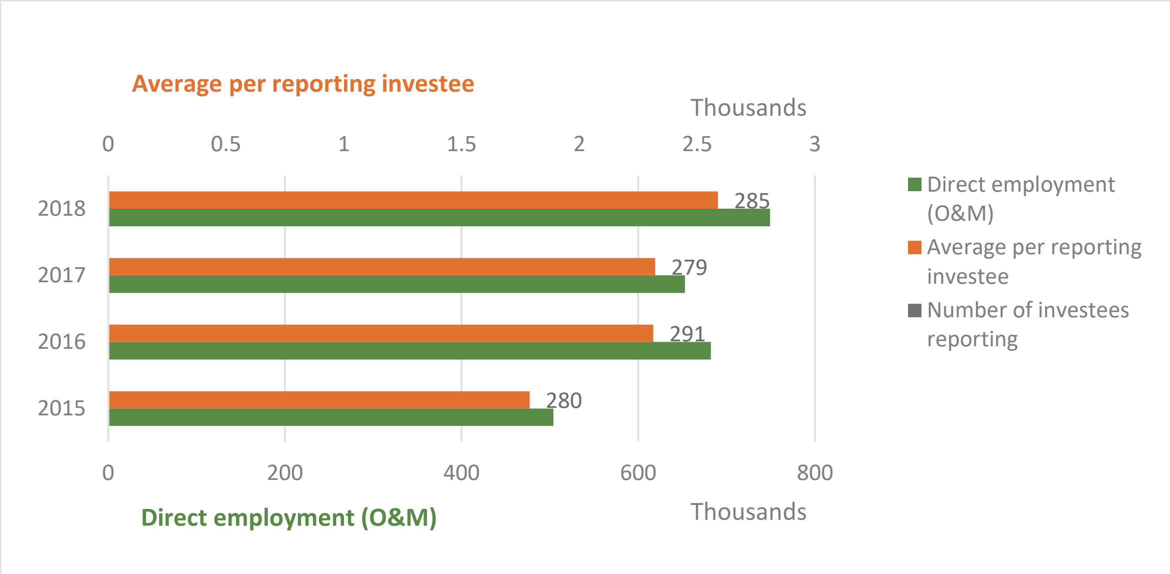
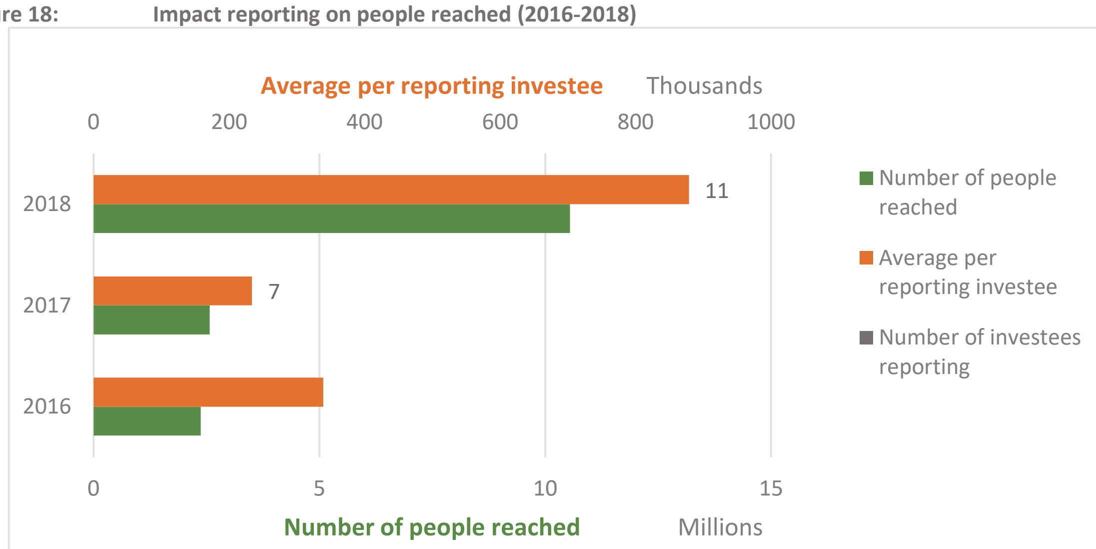


Figure 17 provides total and investee average figures for direct employment from 2015 to 2018. Figures are based on full-time equivalent numbers working for, or contracted by, client companies at each year end. As we can see, total employment increased significantly over the period, as did average employment reported by investees. While this cannot be directly attributed to FMO's investment, particularly if other causal factors are not analysed, it is a positive development.

Figure 18: Impact reporting on people reached (2016-2018)



The final graph presents figures on 'people reached' by FMO. This is a sector-specific indicator where FMO uses different tools, e.g. the 'Energy impact tool' to calculate the numbers of people that the FMO investee has affected through their activities. As we can see from figure 18, only a small number of investees reported on this indicator over the evaluation, with 2016 being the first year it was used.

As discussed previously, FMO's approach to impact monitoring continued to evolve after the evaluation period ended and is now considerably more sophisticated than was the case at that time. The figures presented here are not 'impacts' in the way that this term would be understood in an evaluation framework, where some causality would have to be demonstrated. What we can say is that the data needs to be considered in conjunction with the question of additionality, which would take two main forms. First, FMO's investment could be essential for the creation of survival of an enterprise, i.e. without FMO the entity would not exist. In these circumstances, FMO could reasonably claim responsibility for all of the results achieved, i.e. all the figures presented here. Second, FMO's investment could enable the enterprise to do things it otherwise would not be able to do, such as expand or upgrade operations, enter a new market or start a new business line. In these circumstances, FMO could reasonably claim responsibility for the results of this new activity such as the increase in the workforce. This would therefore be a share of the numbers reported above, which would vary according to the difference achieved through FMO's investment.

It is beyond the scope of this evaluation to address this question, but given that FMO is not a venture capital fund that supports start-ups, it seems more likely that the second type of additionality would apply, where FMO can claim responsibility for some, but not all of the results of its investees. Understanding this properly would require detailed contribution analysis type studies.

4.1.4 Quadrant analysis of loan portfolio: returns, impacts and mobilisation

An important strategic question for FMO is the relationship between returns, impacts and mobilisation. To gain some insight into this, we undertook an analysis based on the quadrant approach described in the Inception Report. This organises loan investments[27] into one of four quadrants:

i. High return/high impact;

ii. High return/low impact;

iii. Low return/high impact; and

iv. Low return/low impact.

In each case, loans are ranked in the portfolio, with those in the top quartile classed as high and those in the bottom quartile classed as low. For returns, the data above on spreads and IRRs is used. For impact, we have two measures which FMO collects for all investments: jobs generated and carbon emissions avoided. For mobilisation, we use figures reported as directly mobilised by FMO under the multilateral development bank (MDB) methodology (as opposed to the Organisation for Economic Co-operation and Development (OECD) version)[28], which implies some causality on the part of FMO, i.e. it is not just co-investment, but co-investment it can claim some responsibility for. Mobilised capital is then expressed in proportion to FMO's investment, ranked and grouped as 'high' or 'low' as above.

We then analyse the relationship with returns in two ways. First, we use a composite measure of impact that includes jobs, CO2 avoided and mobilised investment. Second, we utilise a reduced composite measure of impact that excludes mobilisation. In both cases, averages of the index scores in each area are taken per investment. This is designed to take account of the fact that some investments will be largely focused on avoiding carbon emissions (i.e. renewable energy), while others will be more focused on job creation. In other cases, the main goal may be to mobilise capital, so looking at these calculations in both a combined way and when mobilisation is excluded allows us to capture the difference this makes to the impact of an investment when viewed holistically.

Additionality may relate to income generation and economic development or avoiding carbon emissions or increasing investment into high-impact areas. Understanding how these relate to each other and to the returns that FMO makes from its investments is important, and the analysis presented aims to provide insights on this question. As with the returns analysis, this is organised separately for loans and equities.

Figure 19: Africa loans 2016–18 (including mobilisation)

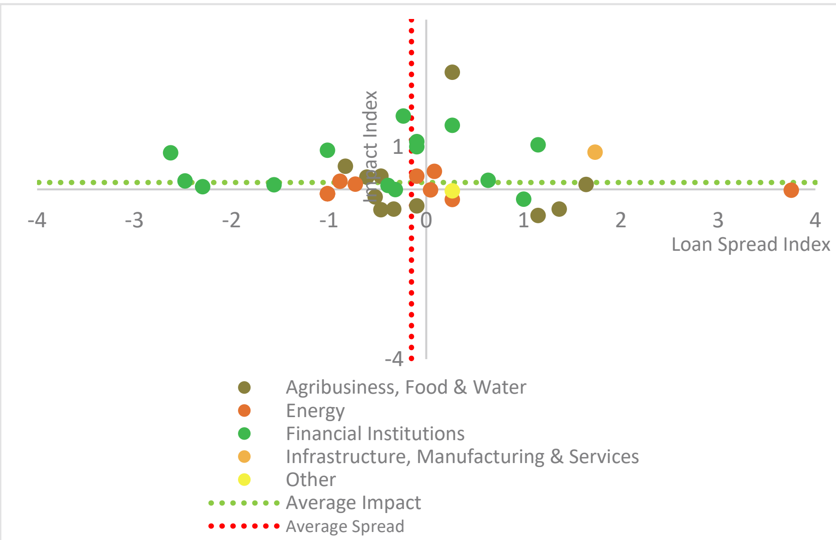
[27] Equity investments are excluded for the reasons previously explained.

[28] The two methodologies are explained in more depth in section 4.3.

Figure 19 combines these elements as described above. The top right quadrant is high impact/high return; the bottom left is low impact/low return. In each case, 'high' means above average for the portfolio and 'low' means below average. The dotted lines in Figure 19 show how Africa loans perform on these measures relative to the full loan portfolio. As we can see, for both impact and returns this is slightly average, with a greater difference from average on the impact than return index.

Within the Africa portfolio, Energy and FI loans are high impact due to high job multipliers, GHG avoidance and/or capacity to mobilise finance compared with agribusiness. Higher Energy and FI averages are also driven by outliers in the upper-right quadrant. Infrastructure loans have high spreads, but few deals.

Figure 20: Total Asia loans 2016–18 including mobilisation

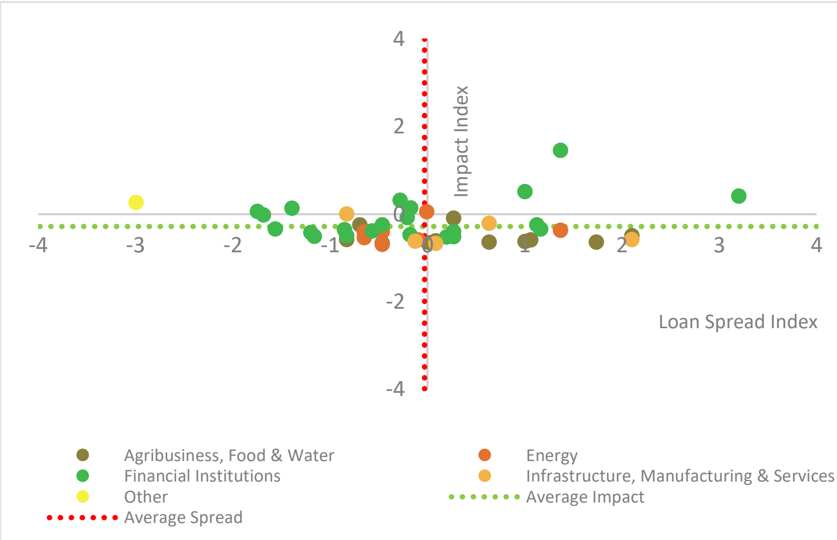


Overall, Energy sector loans are lower impact in Asia than in Africa due to lower amounts of finance mobilised in these deals.

As with Africa, the majority of FI deals are high impact due to high job multipliers and more finance mobilised.

Spreads for FI are diverse as shown by a more equitable dispersion into the four quadrants.

Figure 21: **Europe and Central Asia Loans including mobilisation**



Similar to Asia, FI loans to ECA clients have dispersed spreads making almost equal coverage in all four quadrants. FI loans also make up the large majority of high-impact deals, but this is largely due to the higher amount of FI deals across the ECA portfolio and high GHG avoidance associated with these.

Energy deals in ECA have lower than average returns, with agribusiness tending to have low-impact deals due to low job multipliers/zero GHG avoided.

Figure 22: **Latin America loans 2016–18 including mobilisation**

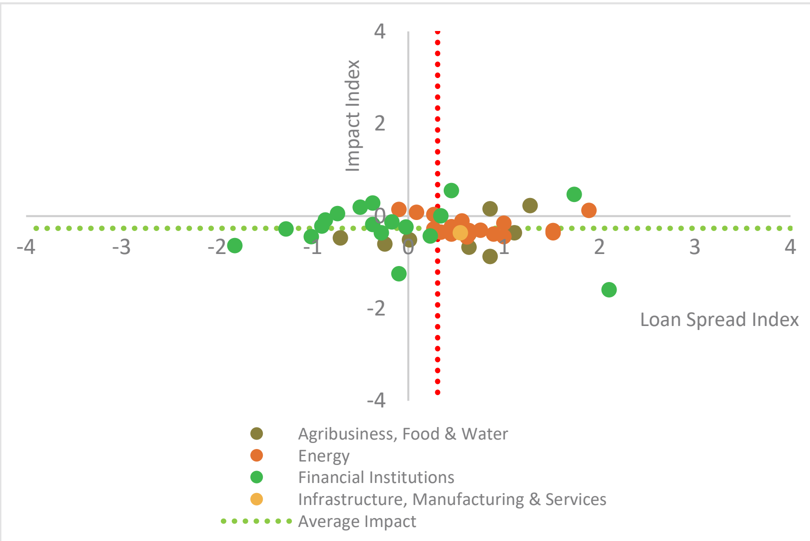


Figure 22 provides information for Latin America and the Caribbean. Similar to the ECA region, agribusinesses tend to be low-impact deals (low job multipliers/zero GHG avoided).

Energy deals have higher spreads as shown by their clustering on the right-most quadrants.

FI loans, in contrast, are predominantly low return, but high impact due to higher amounts mobilised.

This analysis can also be turned round and looked at from the sector perspective, with regional deals organised by quadrant for each sector. These are not included here for reasons of brevity (though available on request), but the summary findings are as follows.

For **Agribusiness, Food and Water**, East Asian deals dominate the high-impact/high return quadrant due to large GHG avoided and relatively high amounts of mobilisation. Latin America and the Caribbean and ECA have lower impacts because of lower job multipliers and zero GHG avoided, while South Asia and sub-Saharan Africa (SSA) have lower than average returns compared to other regions in this sector.

For **Energy**, most high-impact/high return investments are in sub-Saharan Africa, and most of these deals are high impact (regardless of return), driven by high job multipliers. Along with sub-Saharan Africa, Latin American Energy deals show high levels of mobilisation, but tend to be lower impact. ECA and the Middle East and North Africa (MENA) are low impact and mostly low return, but the sample size is low.

For **Financial Institutions**, sub-Saharan African deals dominate the high-impact areas, whereas ECA and Latin America are predominantly low impact, with the difference driven by high job multipliers in the former and low job multipliers in the latter. South Asia has many high-impact Financial Institution deals (especially if mobilisation is excluded), but these are mostly relatively low return.

Table 5 below gives summary statistics on the relative performance of each region in each of these areas. A ranking of 1 means that spreads are higher, more jobs are created, more CO2 is avoided or more investment is mobilised, on average, for loans to that region. It is based on the number of loans per region, unweighted by loan amount. The overall ranking combines these individual ranks.

Table 5: **Regional ranks in the loan portfolio**

	Spread ranking	Job creation ranking	CO2 avoided ranking	Mobilisation ranking	Overall ranking
East Asia & Pacific	1	6	1	1	1
Sub-Saharan Africa	2	1	6	3	2
Latin America & the Caribbean	3	4	5	2	3
Europe & Central Asia	4	3	2	5	3
Middle East & North Africa	5	5	3	6	6
South Asia	6	2	4	4	5
Global	9	5	Not available	9	8

As we can see, returns are highest in East Asia & Pacific, which also has the highest overall ranking. However, this is driven by top rankings in both avoided CO2 and mobilisation. For job creation, this is the worst-performing region. In contrast, sub-Saharan African loans are associated with the most job creation and the least CO2 avoidance, so it is positioned second overall in the rankings. These differences are largely driven by types of investment. South Asia and SSA have the highest job rankings and are the regions with the largest proportions of investments in FIs and Energy (highest job multiplier sectors) and more investments in LICs, which also have higher multipliers. GHG multiplier figures are volatile and difficult to interpret, but regional differences on mobilisation capture the fact that it is easier to mobilise investment in East Asia and Latin America than in ECA, South Asia or Africa.

4.1.5 Points emerging from the portfolio, impact and quadrant analyses

Overview of the Portfolio

- The portfolio has evolved in line with changes in FMO's strategy with greater focus on Africa, Asia and ECA and the three priority sectors, as well as an increase in equity investments in the portfolio.
- The Portfolio became slightly riskier over the period, but remains well diversified by sector and regions.

Financial performance of Loans

- Across the portfolio, loan spreads remained stable, with convergence of sector spreads in 2016. Energy and AFW spreads are consistently higher than FI spreads.
- For new commitments, spreads declined after 2014, particularly for FI and Energy sector loans.
- LAC loan spreads outperform the regional average consistently.
- The post-2014 decline in spreads was driven by ECA, LAC and Asia, with African margins remaining above the rest of the portfolio in recent years despite falling between 2016−17.
- NPLs relatively stable throughout period as a proportion of the expanding loan portfolio.
- Relative to weight in the portfolio, Asia accounts for most NPLs and Africa/LAC least.
- IMS is the worst performing sector by far on NPLs, with FI sector NPLs far lower than would be expected given weight in the portfolio. AFW and Energy sector NPLs are in line with portfolio weight.

Financial performance of equity investments

- For equity investment exited from 2013−18, Africa had the lowest IRR (15.8%) and Asia the highest (33.2%) based on the total amount invested in PE.

- For sectors, Energy sector investments perform worst of the exited investments (-12.7%), and diversified sectors the best (27.2%), with FI equity investments performing almost as well (24.1%).
- For live equity investments made between 2013 and 2016, ECA is the worst performing region by far (-23.9%), but only has a few investments (4) and a small share of paid-in capital (2%).
- Africa and Asia account for almost 85% of equity capital committed over the evaluation period and therefore drive portfolio performance. As of the end of2019, Africa had the second lowest regional IRR (2.7%) and Asia the highest (12.1%).
- For live equity investments by sector, AFW investments are currently the worst performing (-5.7%) and Energy the best (13.4%).[29]

Development impact across the portfolio

- Large numbers of FMO investees report on direct jobs created, which show a significant increase over the evaluation period.
- The impact figures refer to the activities of the enterprises supported by FMO and are unlikely to be fully attributable to FMO in most cases. Understanding the share of these figures that FMO could claim would require detailed contribution analysis type studies.
- Reported job impact results are largely driven by geographical and sectoral multipliers within the FMO impact model, which explains most of the differences we observe in this part of the quadrant analysis. The key drivers of these assumptions are:
  - **sector of investment** (e.g. more or less renewable energy or employment generation potential; there are higher job multipliers associated with FI and Energy investments because of their indirect employment effects);
  - **country of investment** (e.g. driven by relative productivity figures).
- In most cases, therefore, the jobs supported figures reported by FMO are driven by assumptions in the Impact Model and reflect reality to the extent that the model produces accurate estimates.
- Most GHG avoided figures reported by FMO are directly linked to projects and not model generated.

Development impact by sector

- Sector-specific impact data from 2015 shows significant annual distribution of SME loans and microloans from a large number of FI investees.
- In the Energy and AFW sectors, small numbers of investees report large numbers of people served and smallholder farmers supported respectively.

Mobilisation across the portfolio

- Mobilisation potential differs significantly across regions. It is easier to mobilise investment in East Asia and Latin America than in ECA, South Asia or sub-Saharan Africa. This is not a model estimate; however, but is based on actual mobilisation figures reported by FMO.
- Performance in our combined impact index is thus driven by the combination of the above development impact factors and mobilisation factors.

Analysis of overall performance

- Based on the data used for the quadrant analysis, AFW investments display only average performance on impact. The reason is that AFW have lower job multipliers in the Impact Model than FI investments,

[29] The data analysed represents a snapshot in time. These figures will change and FMO expects that AFW investments will still generate additional value.

and do not have the avoided GhG impacts of renewable energy investments. It is also plausible that it is harder to mobilise capital into AFW projects than other FMO sectors, but agriculture is considered key for development because of its role in supporting livelihoods, particularly in low-income countries. It seems clear that the impact model was not capturing these effects, and therefore was underestimating the development impact resulting from AFW investments.

- The regional analysis of returns, mobilisation and impact in the tables above suggests that the highest impacts across all dimensions were achieved for loans in East Asia & Pacific and sub-Saharan Africa.
- As described with respect to agriculture, however, the impact model data we have do not appear to be accurately capturing impacts. Whilst this is a starting point, it would require further analysis, which is reportedly well under way. For example, we understand the new Joint Impact Model will include an agriculture model to better capture impacts in the sector. In the Impact Model used during the evaluation, we understand that reported impacts are suppressed compared to other sectors as total assets are used in agriculture while non-current assets are used in all other sectors. This will be addressed in the JIM.

4.2 Financial Additionality

Despite its importance in development finance, additionality remains a difficult concept to pin down, and it is used in different ways by different development actors.[30] It can be either financial or non-financial. FMO has been set up and has received government support to 'only provide financial services which the market does not provide, or does not provide on an adequate scale or on reasonable/workable terms' as documented in the Agreement between the State and FMO. There are two elements to this within an individual investment. First, FMO's investment should not have been available elsewhere in a form that would have achieved the same result, i.e. there is no alternative finance, or there is, but it is not on 'adequate scale' or 'on workable terms and conditions'. A second form of additionality relates to the output of this investment. In many cases, DFIs aim to mobilise additional investment. This is additional if the mobilised investment would not have happened without the DFIs' input.

In this section, we largely focus on the first form of financial additionality discussed above (i.e. whether FMO's investments are additional to what was available in the market). The second form of financial additionality relating to mobilisation is examined in the section on mobilisation, with non-financial additionality considered in subsequent sections on development impact and environmental and social risk management.

4.2.1 Perspectives from FMO[31]

In general, FMO seeks to achieve both financial and non-financial additionality in each investment, though to varying degrees. In rare cases, an investment may be approved that is not financially additional, but is justified on the basis of the high, non-financial additionality that can be achieved. In this sub-section, we focus on the financial additionality of FMO's investments, with the additionality of mobilised investment considered in the mobilisation section and non-financial aspects discussed under E&S.

Financial additionality is a core aspect of what FMO does. FMO produces internal pricing advice for all investments based on comparable deals in the market or similar deals in other markets where this is not available. The aim is to avoid distorting the market by undercutting (potential) private investors, and FMO clearly takes this seriously. When the actual pricing is at or above the recommended level, no action is needed. Where it is below, a justification is required before the deal can proceed.

[30] See Spratt and Lawlor (2020, forthcoming) *Blended Finance and Evaluation: An Assessment of Core Concepts*, OECD EvalNet, Paris.

[31] Here and in corresponding sections, we pull together perspectives from interviews undertaken with FMO staff at FMO's offices between 2–3 March 2020. This entailed 10 interviews, augmented with a further four interviews. In these sections, we present the main points emerging of relevance to each issue (in this case additionality) rather than link points to particular interviewees.

There are a number of reasons why pricing may deviate. First, DFI co-investors may have already agreed on pricing which differs from FMO advice. Second, riskier investments in challenging countries with high potential impacts may only be viable with pricing below internal advice levels. If this is a large difference, government funds can be used in a blended structure, but if it is within the risk tolerance of the FMO-A portfolio, there is some scope to reduce pricing with the goal of achieving high impacts.

There are limits to this. As one interviewee pointed out, if a high-risk venture fails, there is no impact, and FMO staff are wary of downward pressure on pricing. A concern cited by a number of interviewees was that competition among DFIs in lower-income countries was driving down prices. FMO can choose not to invest of course, but this excludes it from many potentially high-impact transactions.

Table 6: **Proportion of deals with pricing below internal FMO advice 2018**

	Portfolio	FI	AFW	Energy
AFRICA	63.6%	55.6%	80.0%	71.4%
ASIA	32.0%	20.0%	50.0%	50.0%
EUROPE & CENTRAL ASIA	14.3%	22.2%	12.5%	0.0%
LATIN AMERICA & THE CARIBBEAN	47.4%	28.6%	80.0%	42.9%
Total	39.3%	31.7%	48.0%	45.5%

Source: FMO

In line with comments from FMO staff, the proportion of deals priced at levels below internal advice is considerably higher in Africa than elsewhere; this is where the competition between DFIs mentioned above is apparently the greatest.

For sectors, AFW transactions are most often priced below recommended levels, particularly in Africa and Latin America. Energy deals are also likely to be priced in this way in Africa, but less likely in other regions. In contrast, FI deals are far less likely overall to be priced below recommended levels than other sectors. Only in Africa is this the case for the majority of transactions, and there only marginally.

This is an important issue and a significant risk, and it is recognised as such by FMO staff who are clearly not comfortable entering deals with pricing below the level they think appropriate. This is a positive reflection on the institutional culture at FMO, where concerns about distorting the market are taken seriously.

However, it is not the case that FMO finance is always cheap. FMO staff made the point, supported in our case study findings, that they are often more expensive than other investors, including DFIs.

In many cases, financial additionality is clear. FMO provides finance on a longer-term basis than is generally available in the markets in which it operates, and it can also provide flexible financing in terms of currency and other financing terms. The ability to access government funds at concessional rates to transition towards commercial viability is also likely to be additional, but only where it is done rigorously.

4.2.2 Findings from the desk review of sampled investments

In **AFW investments** reviewed, financial additionality is claimed mainly in tenor and volume, providing lengths and amounts which are not available on the local market commercially. In South Asia Case Study Country 1, for example, banks face single borrower limits restricting the credit they can extend to an individual firm. In many low- and lower-middle income countries, the long-term funding that FMO is able to provide is both essential for a project’s success and unavailable on the private market. AFW investments reviewed in the West Africa Case Study Country and South Asia Desk Review Country cited this as the basis for financial additionality, which is a plausible claim.

As well as tenor, another basis for financial additionality is the ability to be flexible as circumstances change. As shown in the desk review, FMO extended an investee’s loan by five years in 2018. Commercially a 1-year extension is the maximum that would have been available, but this would have most likely been insufficient to ensure the solvency and long-term prospects of the borrower. Also, as will be documented elsewhere in this report, FMO have shown considerable flexibility with investees because of Covid-19.

In the **Energy investments** reviewed, financing gaps and tenor were again the most prominent sources of additionality that were cited. Energy investments are inherently long term and beyond what commercial investors are willing to finance. While they can be financed by repeated rounds of shorter-term financing, this is high-risk and expensive (including in transaction costs), and the viability of investment is likely to require a stable, long-term investor to anchor the project and provide confidence to other investors. In this regard, FMO was seen as playing a key anchor role in a number of Energy investments, enabling additional capital to be mobilised.

Another aspect of financial additionality is the form of financing available. In this regard, FMO's ability to provide local currency financing was seen as unusual and additional. Local financiers can provide local currency, but are unwilling to do so on the terms required, as previously discussed. International investors, including other DFIs, can provide long-term financing, but not always in local currency. This is important for hedging currency risk and avoiding excessive currency mismatches between revenues and liabilities (i.e. where revenues are in domestic currency but debt is in international currency, a project is vulnerable to adverse exchange rate movements that can sharply increase debt service costs, threatening project viability).

FMO can provide both debt and equity to suit the requirements of the project and fill gaps in the financing they can source from elsewhere, and this was also seen as a source of additionality. FMO made an equity investment in South Asia Case Study Country 1/PE 1, for example, which had previously only been able to secure a government fund loan and which then enabled them to manage and spread risks more effectively than more debt would have.

The types of additionality cited in **Financial Institution** investments were more varied than other sectors reviewed. The most common were financing gap/market development, tenor and mobilisation, but these were often far more deal specific than the general market issues cited in other sectors. Committing to funds early can provide comfort to other lenders, potentially changing their perceptions of how financeable an institution is. South Asia Case Study Country 2/FI 3, for example, was described as 'timely' and a 'landmark' in changing investors' perceptions of the availability of liquidity. From a market development perspective, helping an equity fund to close can send a positive signal to the wider market, as in the case of South Asia Case Study Country 2/PE 2, West Africa Case Study Country/PE 5 and East Africa Case Study Country/PE 3.

Financial additionality in the banking sector is somewhat different. Banks have access to finance in general terms, but require different forms of financing as part of a balanced capital structure. Another question is whether it is of the right form to enable the bank to evolve in the most developmental, impactful way. With South Asia Case Study Country 1/FI 1, for example, the assessment was that the bank was not ready for commercial financing, with DFIs coming in to build capacity to reach this point. According to a FMO staff member: 'We were the first foreign lender to [FI 1], so we hit the additionality on the head'.

Tenors of sufficient length are important in FI, as is long-term partnerships. FMO has a number of partnerships with financial institutions which they see as enabling themselves to influence investee's evolution in areas such as E&S, while providing the long-term patient capital needed to support this process. The prospect of developing a long-term relationship was seen as an important rationale for the investment in Central Asia Desk Review Country 1/FI 6, for example.

Perhaps the most fundamental aspect of financial additionality is being prepared to invest in places that others will not. For West Africa Case Study Country/FI 4, for example, a FMO staff member claims that 'FMO reached out to [FI 4] when no one else dared to go into [West Africa Case Study Country]'. This is an interesting example of the nuances around financial additionality. Clearly, FI 4 could have accessed finance elsewhere, but this may not have been the case with international sources because of the country's reputation, including from DFIs. FMO's investment cannot be seen as financially additional in a pure sense, and it needs to be justified on the basis of what its particular terms allowed the investee to achieve that would otherwise not be possible (e.g. to start or expand a new credit line with high development impacts), and/or FMO's influence over the activities of the investee (i.e. non-financial additionality in areas like E&S).

For the **Infrastructure and Manufacturing Services investment** reviewed, significant additionality was claimed in South Asia Desk Review Country/IMS 1 by providing long-term financing in a constrained economy. The timing of the investment was seen as particularly key.

4.2.3 Findings from case studies

To provide some context for the findings from the case studies, below is an overview of some key information regarding each of the investments sampled for the case study analysis.

South Asia Case Study Country 1

Energy 1 - Debt investment, non-renewable alternative to coal.

AFW 1 - Debt investment, food production.

PE 1 – Equity investment, non-renewable alternative to coal.

FI 1 – Debt investment, bank.

South Asia Case Study Country 2

Energy 2 – Debt investment, renewable energy.

Energy 3 – Debt investment, renewable energy.

Energy 4 – Debt investment, renewable energy.

PE 2 – Equity investment, fund.

FI 3 – Debt investment, NBFI.

East Africa Case Study Country

PE 3 – Equity investment, insurance company.

Energy 5 – Debt investment, logistics company.

AFW 2 – Debt investment, microfinance provider.

West Africa Case Study Country

FI 4 – Debt investment, bank.

AFW 3 – Debt investment, providing farmers with a key product.

PE 4 – Equity investment, bank.

PE 5 – Equity investment, fund.

South Asia Case Study Country 1

Three of the four sampled investments required financing from DFIs to make their business or project viable through lower interest rates or longer tenors (PE 1, FI 1, Energy 1). Of these, two companies required financing on terms that were only available from FMO (PE 1 and FI 1). PE 1 needed a foreign currency loan at a lower interest rate than was available locally to reduce their sales price in an increasingly competitive market.[32] FI 1 required a longer tenor than was available and a lower interest rate to pass on to their customers and remain competitive. According to the co-arranger, in addition to

[32] FMO offered PE1 a longer tenor of seven to 10 years, but PE1 preferred a shorter tenor to minimise their FX risk.

providing finance that was not available from commercial investors, FMO was willing to provide longer tenors (of five years) that were not available from other DFIs either.[33]

For South Asia Case Study Country 1/Energy 1, long-term commercial financing to green-field projects in the country was not available internationally at that time, particularly as Energy 1 was one of the first movers in the sector. Domestic commercial funding was also not appropriate as they were partnering with a state-owned company and needed to diversify capital outside of the country.[34] Although this demonstrates FMO's additionality to the commercial market, FMO was one of many DFIs that invested in Energy 1 with another DFI as arranger, and it is likely that this DFI could have found an alternative DFI to FMO.[35]

It is likely that AFW 1 would have been able to secure local commercial financing for the food production project, but they would not have been able to get the longer tenor[36] that they preferred, and they would have had to use second or third tier banks due to single borrower limits. Reportedly, AFW 1 wanted to partner with DFIs to gain support on E&S, which would help them access international commercial funding in the future.[37] Due to the large improvements required in E&S, international commercial investors were not available to them at the time of FMO investment.[38] Another DFI was in the lead for this transaction and brought in FMO through the Friendship Facility. The lead DFI investor believes the deal may not have gone ahead without FMO as the ticket size was too big for many other DFIs and the strategic focus did not fit with others in terms of sector or geography.[39]

For the investment in FI 1, while FMO's loan was at a higher cost than offered by other DFIs[40], both management at FI 1 and the co-arranger were prepared to pay the higher cost as FMO were seen as particularly accommodating and understanding of clients and their context.[41]

Given the high interest rates in South Asia Case Study Country 1 and lower rates offered by DFIs, there is risk that DFIs, including FMO, may distort the market in South Asia Case Study Country 1. A national stakeholder reflected that there may be some distortion to the market, but that it is already fragile and distorted, and DFI engagement results in firms receiving faster and more effective support than they could from local banks only.[42]

South Asia Case Study Country 2

Three of the four sampled investments were additional as there was insufficient finance available in the market for Energy 2, PE 2 and FI 3 when FMO invested. This is supported by Energy 2 management at the time of FMO's first investment[43] and by PE 2 not reaching its fundraising target.[44] FMO invested into FI 3 during a nationwide liquidity crunch.[45] For both FI 3 and PE 2, FMO staff members indicated that the primary drivers for these investments were financial additionality and impact, as well as portfolio diversification in the case of PE 2.[46] On the other hand, Energy 3 and Energy 4 (renewable energy projects

[33] National stakeholder, South Asia Case Study Country 1.
[34] Investee.
[35] Investee.
[36] FMO staff member.
[37] Other investor.
[38] Other investor.
[39] Other investor.
[40] Investee.
[41] Investee; national stakeholder.
[42] National Stakeholder.
[43] Investee.
[44] FMO staff member.
[45] Investee.
[46] FMO staff member (affirmed by two separate interviews).

run by the same company) could have been fully financed by their two other investors if FMO had not invested.[47]

Although local currency financing was referenced by FMO as being important to Energy 2, Energy 3[48] and Energy 4[49], this was not mentioned by clients, and this could imply that the financing itself was more significant to clients than the nature of the finance. Energy 3 and 4 preferred international lenders and IREDA because their capital was lower risk than domestic lenders (who require uncapped sponsor support and liability).[50]

East Africa Case Study Country

Evidence from the case studies suggests that the sampled investments in East Africa Case Study Country were additional to the market as they offered finance on terms not available in the market and which were needed to support investees' operations. Although all the sampled investments had access to commercial loans and other finance, FMO provided longer tenors compared to local banks.[51] In the case of AFW 2, the longer tenor of FMO's loan enabled the client to offer a two-year loan to farmers which is reported to be highly valuable to this group. Reportedly, AFW 2 could not have offered this loan to farmers without FMO's investment as the local lenders only provided short-term loans.[52] In the case of PE 3, the insurance company in which PE 3 invested had access to other finance (including from other DFIs), but a broad consortium was needed to spread the risk among partners as they did not want to make the investment alone.[53] Energy 5 had access to commercial loans, but it was reported that the DFIs provided more favourable terms and conditions.[54] All borrowers would prefer finance on more favourable terms of course, and it is not clear what the DFI financing enabled that would not have been possible with other forms of finance.

FMO's ability to provide funding in different currencies was also additional. The company which owns AFW 2 trades in US dollars (USD), and FMO was able to provide AFW 2 with a loan in USD which was not available from local lenders.[55]

Interviewees held different views on the pricing of loans. One reported that FMO's loan is equivalent to commercial loans, while another client reported that the money from FMO's investment helped with debt repayment with a commercial bank before it matured, as FMO's loan was cheaper.[56] Unfortunately, we do not have FMO pricing data for the period of the evaluation, but only for 2018. This shows that in 100% of commitments in that year in East Africa Case Study Country, FMO's pricing was below that recommended by the FMO pricing department as being in line with the local market. This does not show that this was the case in previous years, but it does show that it is possible that pricing in East Africa Case Study Country has been below advice.

Financial additionality has also been claimed on the basis of the financial flexibility offered to clients.[57] As well as being able to offer a range of financial products, FMO was flexible on loan restructuring and repayment period. This was cited as key for business growth across the sampled investments.[58]

West Africa Case Study Country

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[47] Investee.
[48] FMO staff member (affirmed by two separate interviews).
[49] FMO staff member (affirmed by two separate interviews).
[50] Investee.
[51] Investee; FMO staff member (affirmed by two separate interviews); other investor; national stakeholder.
[52] Investee.
[53] Investee; FMO staff member.
[54] FMO staff member; other investor.
[55] FMO staff member.
[56] Investees (affirmed in two separate interviews).
[57] Investee; FMO staff members (affirmed in two separate interviews).
[58] Investee.

In all but one case, FMO's sampled investments can be considered financially additional. In PE 5, FMO and other DFIs provided finance at a time when many commercial investors held back from investing in Africa.[59] As part of the PE 4 consortium investing into a bank in West Africa Case Study Country (PE 4's investee hereafter),[60] FMO was additional within the type of financing it could provide,[61] but we do not know if PE 4's financing was additional, as they were not informed of who the other bid competitors were.[62] FMO's AFW 3 investment was described as financially additional because of its size, i.e. it was a very large transaction for the food and agriculture sector, and so it needed all lenders on board, including DFIs (like FMO) and commercial lenders.[63]

It is not clear whether FI 4 could have sourced a workable financial product from the commercial market at the time of FMO's investment. However, FI 4 could have accessed funding from another DFI instead of FMO. FI 4 chose to go with FMO's syndicated loan instead, however, because of the non-financial additionality FI 4 receives in the form of FMO's support on E&S.[64]

The primary way in which FMO's funding is additional is through the provision of longer tenors than are available in the market.[65] This was the case for PE 4's investee, where FMO provided long-term financing, hedged against FX exposure.[66] Similarly, in the AFW 3 deal commercial banks took the short tenor, while DFIs, including FMO, took the longer tenor.[67] Although outside of the timeframe of interest for this evaluation, FI 4 benefited from FMO's flexibility when FMO converted its loan in FI 4 to equity, enabling the bank to meet requirements for banks to hold additional regulatory capital.[68] The additionality DFIs provide with respect to flexibility and speed compared to other investors in West Africa Case Study Country was noted by another stakeholder as well.[69]

One stakeholder suggested that DFI co-investments with PE funds may not be financially additional as there could easily be commercial investors willing to co-invest with a fund[70]. However, we recognise that the commercial attractiveness of a portfolio company would vary from case to case and we cannot conclude with certainty that FMO is crowding out commercial investors by co-investing as they have with PE 5.

4.2.4 Synthesis of findings

- **The ability to provide longer tenors is the main source of FMO additionality.** FMO also appears to have the capacity to provide longer tenors than the commercial markets. This is scarce in all of FMO's markets, particularly lower-income countries, and it may be a more acute issue in some sectors, notably agriculture. An important source of long-term funding is the DFI community. While the development importance of agriculture is well understood, and some DFIs prioritise the sector as a result, others have withdrawn or heavily scaled back their engagement due to large losses in the past. This suggests that providing long-term finance in AFW sectors, particularly in lower-income countries, is likely to be strongly additional. More generally, FMO also appears to be able to provide longer tenors than other DFIs in many instances.
- **The provision of patient, flexible and countercyclical financing in different currencies to suit the needs of investees is additional.** Other DFIs have some of these capacities, but few if any have all.

[59] Investee.
[60] Another PE Fund assembled the PE 4 consortium (other investor).
[61] Other Investor.
[62] FMO staff member.
[63] FMO staff member.
[64] Investee.
[65] National stakeholder.
[66] Other investor.
[67] FMO staff member; other investor.
[68] FMO staff member.
[69] Other investor.
[70] Other investor.

FMO is able to tailor financing more than all commercial investors and most DFIs and has also shown flexibility in adjusting financing terms when necessary, most recently with Covid-19.

- **Where finance is available but on less favourable terms, it is important to be clear about why the FMO terms are needed**. This will indicate whether the investment meets FMO's definition of additionality: providing a 'financial product that is not readily available from commercial banks/investors on workable terms and conditions, at the time of approval'. All borrowers prefer cheaper financing, but this is not itself a development rationale. An invitation from a DFI with which FMO has strong links to co-invest alongside them also does not provide sufficient evidence of FMO's additionality in an investment. In most of the cases reviewed, there was a rationale for why FMO's terms were needed, but not in all cases. Where a rationale was lacking, providing finance on more favourable terms than what is locally available risks distorting domestic financial sector development.
- **While financial additionality can be significant for Financial Institution (FI) investments, it is less obvious than other sectors and needs to be further justified and demonstrated.** While Financial Institutions have access to a range of sources of finance, they require different forms of financing within an overall capital structure, and finance from FMO can be additional in the form it takes. While FI investments can be less obviously additional than projects in other sectors (AFW, for example) this does not mean they are not additional. In many cases, FMO investment can be justified on the basis of the types of activities it enables FIs to conduct (e.g. long-term financing from FMO supporting long-term green lending by a financial institution) or the borrowers it supports (e.g. women entrepreneurs), but this requires more demonstration than in other sectors where a general scarcity of capital is evident.
- **FMO may provide finance that is not available commercially in line with its additionality principle, but when part of a DFI consortium, there is also a need to show why FMO was needed.** Often this is because a certain scale is needed that requires all interested DFIs to participate, but it is not always clear whether FMO is providing financing that is not available from other DFIs. This could be that other DFIs are not willing to invest as there is not a good fit with their strategy or they have reached country or sector limits, for example, or there is potential financing from DFIs, but they cannot provide the required tenor or currency. A rationale on FMO's additionality compared to other DFIs would provide some mitigation of potential risks outlined below related to DFI competition.
- **While the use of government funds in blended structure has the potential to be highly additional, it also comes with significant risks**, which are very much recognised within FMO. The risk, particularly in an environment of competition between DFIs, is a 'race to the bottom' with DFIs offering financing on increasingly concessional terms, supporting projects that will never be commercially viable and distorting markets. The strong commercial culture at FMO and greater experience than most DFIs with blended finance makes FMO better placed than most to mitigate the risks.

4.3 Mobilisation

Mobilisation generally refers to the attraction of commercial finance to a particular investment. Related terms are 'leverage' and 'catalysation'. In some contexts, these terms are used interchangeably. In others they have somewhat different meanings, or at least different emphases. An important aspect of mobilisation for FMO is through the funds managed by FMO-IM, where deals that meet FMO-IM's eligibility criteria are automatically available for the funds to participate, with the decision on whether to do so being taken by the funds themselves. The second level of mobilisation, for FMO as with other DFIs, involves attracting co-investment into a deal from entities outside the FMO structure. At this level, mobilisation will be an important aspect of some investments (e.g. where FMO is the lead DFI), but less so in others where FMO's investment rationale is focused on a different objective.

DFIs report mobilisation under two methodologies: the OECD and MDB approaches. The key differences between the two with respect to mobilisation are: (i) what qualifies as mobilised finance (e.g. the OECD includes full value of instruments guaranteed, while MDB only includes the proportion guaranteed), and (ii) how responsibility for the mobilised funds is allocated between official parties.

For the latter, the OECD broadly takes a pro rata approach based on the proportion of finance provided weighted for risk; e.g. equity providers claim a larger amount of mobilised finance due to the extra risk involved relative to loans. The MDBs give more weight to the lead arranging MDB, reverting to a pro rata approach where this is unclear or not relevant. Despite quite large differences in methodological approaches, estimates for mobilised funds do not differ hugely at the institution level.

The MDB framework also distinguishes between 'private direct mobilisation' (PDM), where a causal link can be made to an MDB/DFI, and 'private indirect mobilisation' (PIM), where there is co-investment in a deal, but no causal claim is made. Thus, within this framework mobilisation may be investment that is 'caused' by the DFI (PDM), or co-investment in the same deal but where the presence of the DFI was not necessarily the causal factor, or there is no evidence to show this.

In terms of accounting for blended finance, the approaches differ significantly. The OECD approach includes all funds mobilised by DFIs in its estimate of blended finance. In the MDB framework, however, only finance mobilised using concessional resources counts as 'concessional blended finance', which is a relatively small sub-set of the larger quantity of mobilised investment they report. For FMO, therefore, only mobilised funds that contained concessional elements, through the use of government funds, for example, would be reported as 'blended concessional finance' under the MDB framework. The OECD would also see mobilisation through FMO's A portfolio with no concessional element as blended finance.

In the portfolio analysis, the mobilisation data used is reported under the MDB framework as PDM, where FMO claim some level of causality. This is akin to the second form of financial additionality discussed in the previous additionality section and is the meaning used in the current section.

Mobilisation will vary by the type of investment. For loans, this will generally involve a leading role in creating a syndicate of lender, while for private equity the most important mobilising actor is the anchor investor, who commits at an early stage and provides a significant proportion of the fund's total capital. In some cases, the provision of one form of finance may be instrumental in mobilising another, with scarce equity investment often being a precondition to attract providers of debt, or the provision of long-term finance being the foundation needed to mobilise providers of shorter-term investment. FMO may seek to play any of these roles, but can also be mobilised itself by other investors, particularly other DFIs, where the rationale for the investment is likely to be based on other objectives than mobilisation.

4.3.1 Perspectives from FMO

Mobilising investment has increased in strategic importance for FMO in recent years. The logic is simple: the sustainable development goals funding gap is so large that a huge increase in private investment is needed. FMO-IM was established with the goal of attracting private investment, particularly from institutional investors, into FMO target markets. For FMO this is a clear example of crowding in (i.e. financial additionality), as these investors are typically unfamiliar with these markets and are only prepared to invest because of the comfort provided by FMO and its experience with these types of investments.

In other cases, FMO's dual mandate of being additional and mobilising investment is much more difficult. There is a trade-off between these goals in some instances. FMO investment in challenging, high-risk, capital scarce environments is most likely to be additional, but these are the circumstances where it is most difficult to mobilise private capital. On the other hand, if it is relatively easy to mobilise private investment, this raises questions about how necessary FMO's investment was in the first place.

An increasingly important way of addressing this issue is with blended-finance structures. Many DFIs now have some access to concessional financing, which can be used to improve the risk-return characteristics of transactions such that it is possible to mobilise private investment. Through its management of government funds, FMO has developed considerable experience with blended finance.

Like all DFIs, however, FMO is concerned with avoiding distorting the market. As one interviewee put it, the premise of blended finance is that there is a set of investments that are not commercially viable now, but with strategic support with concessional finance, they can become so in the future. Blended finance therefore offers a bridge to enable this process and mobilise the private investment needed to make it possible.

The risk is that this hypothesis is not true, or only partly true, and that blended finance is used to support projects that will never be commercially viable, and by doing so, prevents the emergence of a vibrant, self-sustaining private sector. The DFI Working Group on Concessional Blended Finance, of which FMO is a leading member, has established a set of principles that are designed to protect against this risk. This is important because the potential of blended finance is as real as the risks that it creates.

4.3.2 Findings from desk review of sampled investments

Of the straight **AFW investments** reviewed, no mobilisation was claimed. The only mobilisation associated with AFW was a financial institution with a focus on agriculture, discussed below with respect to FI. This is not to say that mobilisation was not an objective of AFW deals, Latin America and the Caribbean 2/AFW 6, for example, did intend to mobilise investment, but was unsuccessful in mobilising private finance.

Discussion of East Africa Case Study Country/AFW 2 highlights some of the issues, where, despite it being the sort of deal that other DFIs could have an appetite for (another DFI investor was reported as being interested), the more recent transaction was too small to invite others to participate, i.e. it would be below their minimum investment threshold. The company's five-year development plan did not contain any ambition to acquire additional funding.

For the **Energy sector investments** reviewed, a variety of forms of mobilisation are reported. In many cases, this is the mobilisation of other DFIs rather than private investment, with FMO reporting the mobilisation of DFI finance in South Asia Case Study Country 1/PE 1 (mobilised by another DFI), South Asia Case Study Country 2/Energy 2 (FMO & another DFI bringing a third DFI) and East Africa Case Study Country/Energy 6 and East Africa Case Study Country/Energy 7 (a facility, which is funded by a range of European DFIs and agencies).

There is some more commercial finance reported as being mobilised, such as a sustainability driven bank mobilised in the case of East Africa Case Study Country/Energy 6 and Energy 7. FMO-IM sees most if not all of its investors as being motivated by sustainability concerns, which is a key reason why these investors are attracted to FMO-IM in the first place.

In other cases, the problems raising private capital are highlighted. For example, there is limited commercial appetite for investment in the distributed Energy sector[71] in South Asia Case Study Country 2.

An important role of DFIs is to help increase the commercial viability of projects (and sectors more widely), increasing the prospect that private capital can be mobilised in the future. An interesting example of this is the presence of DFI investors helping PE 1 to win a bid for a significant energy project in South Asia Case Study Country 1. While not in the commercial sector, this builds the capacity and credibility of the company, improving its long-term prospects.

For **Financial Institution investments**, mobilisation is strongly linked to being an anchor investor or lead arranger. Of the 15 FI investments reviewed, FMO performed this role in seven, enabling it to claim significant mobilisation. This was the case in West Africa Case Study Country/PE 5, where FMO was the only DFI investor and played a key role, and with South Asia Case Study Country 1/FI 1, where again FMO was the only DFI investor at the outset, paving the way for future investment by a group of European DFIs. For private investors, $30 million of private capital is reported as being mobilised for Central Asia Desk Review Country/FI 6.

[71] Distributed energy systems are where energy is generated in a number of different locations rather than a centralized facility. Rooftop solar panels with a connection to the grid are an example of such a system.

Mobilisation is unlikely to be binary, with FMO having some influence in this regard in cases where full responsibility cannot be proven or claimed. The involvement of FMO is often cited as improving an investee's standing in the market, which is likely to help with fundraising. FMO also does not claim direct mobilisation in South Asia Case Study Country 1/FI 3, but an impact investor and another DFI seem to have been positively influenced to commit by FMO's presence.

For the **IMS investment** (IMS 1) in South Asia Desk Review Country, in the desk review sample FMO mobilised the consortium of lenders, taking on additional risk and leading on due diligence. This is considered to have created an important signalling effect to the market, supporting subsequent investments in the country/sector.

4.3.3 Findings from case studies

South Asia Case Study Country 1

In one of the four sampled investments (South Asia Case Study Country 1/FI 1), FMO made introductions to investors who went on to invest.[72] In the remaining three investments, there was no direct mobilisation of other investors. For FI 1, the co-arranger reported that FMO was the first to commit, and other DFIs were happy to do so once FMO was on board.[73] FMO took the opportunity to another DFI investor[74] and supported a roadshow of FI 1 in Europe with the co-arranger.[75] The co-arranger noted that potential investors specified that they wanted FMO or one of three other named European Development Finance Institutions (EDFIs) in the first tranche to provide them with the comfort to invest.

In the case of South Asia Case Study Country 1/PE 1, FMO helped to build credibility with potential commercial and DFI investors, who reportedly believed that FMO's involvement indicated that the necessary Corporate Governance (CG) and E&S policies and procedures would be in place.[76] While FMO did not introduce PE 1 to another DFI investor, FMO's equity investment made it easier for PE 1 to convince this DFI to invest. An international commercial co-investor stated that FMO's involvement gave it confidence that the project was financeable, especially as that this was its first investment in South Asia Case Study Country 1.[77]

In the two remaining investments FMO did not attract investment directly, but similar deals have since taken place at least in part because of the 'demonstration effect' created by the success of the FMO-invested projects. Energy 1 was the first of its kind in South Asia Case Study Country 1, and a similar project has since received commercial financing.[78] As a result of FMO's investment in AFW 1, a local bank invited FMO to co-finance a similar project,[79] and improvements in the group who own AFW 1's approach to E&S policies allowed them to engage productively with an international bank.[80]

South Asia Case Study Country 2

Of the four sampled investments in South Asia Case Study Country 2, only Energy 2 mobilised investors, albeit indirectly. For FI 3 and PE 2, FMO did not expect to have a catalysing role.[81] FMO did not mobilise capital and was itself partly mobilised by another DFI's investment in Energy 3 and 4.[82]

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[72] Investee.
[73] National stakeholder.
[74] Investee.
[75] National stakeholder.
[76] Investee.
[77] Other investor.
[78] Investee.
[79] FMO staff member.
[80] Other investor.
[81] FMO staff member (affirmed in two separate interviews).
[82] FMO staff member.

Energy 2 senior management believe that FMO sent a signal to the market through its investment when their sector of renewable energy financing was niche, and again when Energy 2 had difficulties with one area of the business in 2018.[83] FMO invested with another DFI which Energy 2 claims was very catalysing, including leading to another DFI investor coming on board.[84]

While FMO did not mobilise investors into FI 3 or PE 2, it is thought to have provided some additional comfort to other DFIs (and impact investors) who were considering investing. FI 3 has current interest from a DFI, impact investor and sustainability driven bank, all of whom are reported to be comforted by FMO's involvement, and the impact investor is requesting a reference from FMO.[85] Another DFI indicated that it would have invested into FI 3 even if FMO had not invested, but the timing and size of the FMO investment meant that it could make a sizeable investment itself.[86] FMO validated PE 2 by investing in its second fund and in doing so, positively influenced two other DFIs to invest.[87]

It is noteworthy that FMO did not make successful introductions between PE 2 and potential investors and that PE 2 did not reach its fundraising target.[88] This may be in part because FMO does not have a reputation and network in the sector, though we have no direct evidence to support this.

FMO may not have been as well positioned to play a catalysing role in South Asia Case Study Country 2 as in other smaller markets. As noted by another DFI investor, FMO's involvement indicates that the client will have a good level of governance, but this may be more valuable in niche markets and less relevant to more developed markets like South Asia Case Study Country 2.[89]

East Africa Case Study Country

FMO did not focus on mobilisation across the sampled investments in East Africa Case Study Country. All investment officers reported that mobilisation was not a strategic priority for FMO in these investments,[90] however this was for different reasons. In the case of Energy 5, for example, FMO was itself mobilised, with FMO brought into the deal by another DFI investor after it had already gone through a loan cycle with the client.[91] For AFW 2, the second transaction was reportedly too small to invite other investors in the deal, so FMO decided to re-invest alone.[92] It is important to note that AFW 2 was initially invested into through a government fund[93] as the investment was too small to qualify for FMO-A, and it was considered too high-risk as a young entity without a strong asset base.[94] As AFW 2's assets grew, these risks reduced, and FMO-A extended the original government fund loan for five years.[95] No further investment is planned, with AFW 2 being able to fulfil its business plan with reinvested earnings.[96] While not a primary objective, two respondents claimed that FMO's long-standing relationship with the insurance company which PE 3 invested in gave confidence to other DFIs to invest in the PE 3 consortium.[97]

While not linked to specific mobilisation, it was widely reported[98] that FMO's investments increased the credibility of investees, which in the future will help with accessing local commercial loans and other

[83] Investee.
[84] Investee.
[85] Investee.
[86] Other investor.
[87] Investee.
[88] FMO staff member.
[89] Other investor.
[90] FMO staff members (affirmed in three separate interviews).
[91] FMO staff member; other investor.
[92] FMO staff member.
[93] Government funds are funded by the Dutch Government and focus on higher risk transactions.
[94] FMO staff member.
[95] FMO staff member.
[96] Investee (affirmed in more than one separate interview).
[97] FMO staff member; investee.
[98] FMO staff member; investee (affirmed in several separate interviews); other investor.

capital. As well as reputation in the market, this also relates to specific actions, with FMO helping to improve risk management and due diligence of businesses, improving their ability to access finance in the future.[99]

Exits are an important opportunity for mobilisation. In this regard, PE 3 are looking at an exit strategy in two or three years' time, but the market for one of their products is still relatively small in the country, which might be a limiting factor for them in mobilising other investment.[100] In a more general sense, it was suggested[101] that FMO could introduce its clients to Dutch private investors to increase their visibility in the international market, as it is difficult for businesses in East Africa Case Study Country to attract international capital. These two examples highlight an important challenge, however, as pension and insurance funds are very large institutions and are unlikely to be interested in directly investing at the scale of most FMO investments, particularly smaller, high potential impact investments such PE 3, where support that enabled them to scale-up would be particularly valuable.

West Africa Case Study Country

There is evidence that FMO has mobilised financing from other investors in West Africa Case Study Country, both in some of the sampled investments, and in other cases cited by interviewees. For example, FMO's investments in the follow-on fund for PE 5[102] and FI 4[103] appear to have attracted other European DFIs to invest. In PE5 and its follow-on fund[104] and PE 4,[105] FMO's investment reportedly helped attract commercial investors. In contrast, with AFW 3 FMO was itself mobilised by other DFIs and commercial investors.[106]

It was reported that FMO's involvement helped secure funding from other DFIs because they can trust that FMO has done robust due diligence, giving other DFIs confidence with respect to ESG performance.[107] The tendency among DFIs to attract each other is reportedly very strong, with FMO used as a reference for other DFIs and commercial investors when raising capital for PE5's follow-on fund.[108]

FMO's reputation for development impact and E&S also helped mobilise other investors, including impact investors,[109] and in the case of PE 4, family offices as well.[110] FMO was reportedly also able to mobilise local, commercial financing through its role as an anchor in PE 5. [111]

Returning to the issue of tenor, stakeholders stated that when FMO provides long-term debt to a company, this attracts local and international commercial investors who can provide short-term capital, and gives them confidence as to the long-term stability of the borrower.[112]

One investee suggested that FMO could play a more critical role in mobilising finance in the future if it had a local office in West Africa Case Study Country, as some DFIs now have.[113]

99 Investee (affirmed in two separate interviews).
100 Investee; FMO staff member.
101 Investee.
102 Investee.
103 FMO staff member; investee.
104 FMO staff member; investee.
105 Other investor.
106 FMO staff member.
107 National stakeholders (affirmed in two separate interviews); FMO staff member (affirmed in two separate interviews); investee.
108 Investee.
109 Investee.
110 Other investor.
111 FMO staff member; investee.
112 National stakeholder; other investor.
113 Investee.

4.3.4 Synthesis of findings

- **Mobilisation is not a priority in every investment FMO makes, but we do find evidence of successful mobilisation**. In more challenging environments, mobilisation is more likely to involve other DFIs than private investors, reflecting the trade-offs described above.
- **Mobilisation is often hard to prove and should not be seen in a binary way in that FMO either has fully mobilised or has not mobilised anything.** In a number of cases, FMO's participation gave comfort to other investors and is likely to have positively influenced their decision to invest. FMO did not claim mobilisation where it could not be proven, but these more subtle effects may be very significant. Given these subtle influences, it is almost certain that FMO is responsible for more mobilisation than is reported both directly in the investments that it makes and indirectly through the demonstration effects that these investments generate. Capturing these effects, however, would require in-depth contribution analysis type studies, which would need to take full account of other causal factors, and estimate FMO's share of responsibility for mobilisation in different investment contexts.
- **An increasingly important way of addressing the trade-off described above is with blended finance**, which can be used to improve the risk-return characteristics of transactions and mobilise private investment, enabling investees to become commercially viable.
- **There is a risk that concessional finance does not enable a commercial transition, but instead supports non-viable enterprises, wasting scarce financial resources, or that it supports commercially viable enterprises, distorting market development**. FMO has significant experience that can help protect against this risk, both individually and through the DFI Working Group on Concessional Blended Finance.
- **The goal of DFIs is to transition to commercial funding where they are not needed, but in some cases where DFI funding dominates this may be difficult to achieve**. Some borrowers may prefer DFIs, which can bring value through the terms of financing available and other support (e.g. on E&S). A more systematic approach, ideally coordinated between DFIs, may be needed to support transitions to commercial models over time.
- **Mobilising capital from institutional investors needs bigger tickets, but more impact (and additionality) may pull in the opposite direction.** Pension and insurance funds are very large institutions and would only invest at scales above FMO's current operations in most cases. At the same time, the direction of travel in terms of impact and additionality (see below) is towards smaller projects. This is particularly true of AFW investments which tend to be relatively small.
- **FMO-IM is a clear example of crowding in (i.e. financial additionality), as these investors are typically unfamiliar with these markets and are only prepared to invest because of the comfort provided by FMO and its experience with these types of investments.** They are only likely to be interested in a sub-set of the investments FMO would want to make, e.g. not in the highest risk categories or loans in local currency.
- **Mobilising domestic investment would likely be assisted by a local presence in partner countries to support the mobilisation of domestic investment.** This could take the form of local offices, or formal relationships with local partners. In both cases, national and/or regional approaches are possible depending on the size of markets and local conditions.

4.4 Development Impact

According to the OECD/DAC evaluation criteria, impact is 'the extent to which the intervention has generated or is expected to generate significant positive or negative, intended, or unintended, higher-level effects'.[114] These are the transformative effects of interventions, which might include structural

[114] OECD, 'Better Criteria for Better Evaluation: Revised Evaluation Criteria Definitions and Principles for Use', 2019.

changes to policy, systems, norms, culture and so on. OECD/DAC distinguishes impact from outcomes, and outcomes from outputs within a ToC framework that starts with activities and inputs.

DFIs such as FMO have a narrower focus, with a focus on PSD, and more recently the environment. For the period of this evaluation (2013–18), FMO had an evolving approach to impact if impact is seen in the light of the strategic goals the organisation was seeking to achieve.

4.4.1 Perspectives from FMO

As part of the 2013–2016 strategy, the Strategic Horizon for Impact and Footprint Transition was developed to provide a roadmap to the 2020 goal of doubling FMO's development impact and halving its environmental footprint. In 2014, the strategic direction to 2020 was developed to focus on inclusive green investments, expansion, greater mobilisation and working more closely with Dutch business and managing government funds. A 'green' label was introduced in 2015, with a second label 'reducing inequalities' introduced in 2018. An FMO-wide target to achieve a certain proportion was in place from 2015, with this becoming a sector level target in 2018 when the 'reducing inequalities' label was added. These labels were intended to be a means by which to steer the portfolio towards the 2025 strategy.

As described in the background section, FMO measures impact in two ways. First, sector-specific indicators have been collected for each investment since 2014, and second, *ex ante* assessments of impact are generated by the FMO Impact Model for jobs, economic output and GHG emissions associated with FMO investments. Separately, FMO collects and reports data on GHG avoided, largely for renewable Energy investments where generated renewable energy is assumed to replace the equivalent quantity of fossil-fuel generated energy.

4.4.2 Findings from desk review of sampled investments

As part of the evaluation, we extracted impact data from investment documentation, including the Clearance in Principle (CIP), Financial Proposal (FP), Client Credit Reviews (CCRs) and impact reports where available. This allowed us to assess the extent to which sampled investments were reporting impact data in line with FMO guidance.

Since 2019, FMO has set development impact targets at the contracting stage of the investment in line with IFC principles. However, in our sample of 30 investments between 2013 and 2018, only some set impact targets at the contracting stage. Reporting on development impact targets post-contracting also varied between investments. This has led to considerable variation on reporting. While some investees provided limited information, others such as South Asia Desk Review Country/AFW 4 went into precise detail, reporting on non-standard indicators in addition to those required. This range in reporting on development impact made evaluation difficult.

FMO has clearly made moves towards more uniform impact reporting, and an impact table has been used by some investees in recent years. We found that those using the impact table format were generally reporting in more detail than those who did not. To assess whether impact reporting had improved since our evaluation period, we looked at the 2019 CCRs and other relevant documents of that year and found that nine of 29 investments used this table format to report on development impact. Of these, eight were Energy investments. No financial institutions used the table format to report on impact, though this had begun to change by 2020. There appears to be a shift towards more detailed impact reporting taking place.

While other indicators are included in different parts of the CCR, keeping them together in the impact section would make this data more accessible. There is a rich set of data within the different investment documents, and collating evidence of impact in one place would be a simple and sensible step.

The six **AFW investments** in the Desk Review sample reported against indicators in a varied manner. Four cited job creation and direct employment as an impact, although numbers were not presented in three of these. 200 jobs were reported over the six investments. Three investments cited that smallholder farmers would be supported. 166,485 smallholder farmers were reported to have been supported by FMO investments. 'Hectares of forests under management' was not applicable to the six AFW investments in our sample. Other indicators reported against consistently include total assets and corporate tax. There were also examples of investments reporting impact outside of the 'usual' indicators. One AFW investment in Asia measured and reported an increase in their coverage chain over 11 cities. The employment of 29 women was also reported by the same investment.

A range of impacts were reported for the **IMS investment,** which became part of AFW during our reporting period. One example of impact is that an increase in access to mobile phones improved employment prospects, learning opportunities and access to finance in South Asia Desk Review Country.

For **Energy investments**, renewables are seen as high impact on the basis of avoided GHG emissions. Less polluting fossil fuel investments can qualify on the same grounds, e.g. South Asia Case Study Country 1/Energy 1 produces less GHG than coal (and is the most likely alternative fuel in the country). While the emissions avoided are less than would be the case with renewables, they are still deemed significant enough to justify a 'green' label. Contributing towards a reliable power supply in South Asia Case Study Country 1 is also seen as important for overall development impact. Finally, as a Least Developed Country (LDC), investments in South Asia Case Study Country 1 automatically obtain a 'reducing inequalities' label.

All eight Energy loans in our sample (the ninth Energy investment was equity) were reporting on impact in both a structured and detailed way by 2019. The results are synthesised in Table 7 below.

Table 7: **Reported impacts of sampled Energy investments**

Indicator	***Impact (from 2019 CCR)***
Total generation/output (GWh)	1,101
GHG emissions avoided (tCO2eq / year)	863,787
GHG emissions avoided per EUR million invested (tCO2eq/year average)	6,511
Total capacity (MW)	3,580.5
People reached/equivalent people served via power generation	405,772
Employees supported – Operations and Maintenance	1,340
Employees supported – Operations and Maintenance per Euro million (average)	7.8
Employees supported – Construction	406
Employees supported – Construction - per Euro million (average)	4.2

Reported impacts for **Financial Institutions** and private equity funds vary by type of institution. Private equity funds, for example, have fewer targets or reporting in place compared to loans to financial institutions. The rationale is that it is difficult to set targets for funds at the investment stage as you don't know what portfolio companies will be invested in.

Financial Institutions are also required to report on the key indicators such as direct employment, in addition to other indicators, including but not limited to corporate tax, assets and where relevant GHG emissions avoided. Earmarked green funds were also frequently reported. It must be noted that financial institutions generally did not report on impact in as much detail as other sectors. For example, in 2019 three out of nine FI debt investments in our sample cited job creation, but provided no figures to back this up. There is certainly scope to make this reporting more detailed in future.

As described, with respect to additionality most financial institutions can access finance of some kind. A key rationale for FMO investment is that its investment enables the institution to do things it otherwise could not. In this regard, we find details on earmarking loans for on-lending to areas such as agri-business, Small and Medium Enterprises and women-owned businesses for all of the nine loans to banks in the desk review sample.

Many of FMO's investees have their own approach to impact, which is not always the same as FMO's and which can cause some issues. In one case an FMO staff member states: 'The work that they do is so meaningful…indicators like green or inclusive for [FI 3] feels like FMO is trying to fit their impact view on [FI 3]. Whereas the client has a much larger impact in the country. [FI 3's] work is value adding to the sector'.

In some cases, FMO may have a broader view of impact than investees, creating positive incentives. On the other hand, where FMO has a narrower view of impact than its investee, it could create pressure for the investee to narrow the scope of its activities, with the opposite effect to FMO's development impact intentionality. For example, South Asia Case Study Country 2/FI 3 is seen by FMO almost as a DFI itself, with a sophisticated and holistic understanding of the development impacts it is trying to create, which extend far beyond – and should not be restricted by – FMO's set of standard indicators and labels.

4.4.3 Findings from case studies

South Asia Case Study Country 1

Of the sampled investments, two provide clean energy (PE 1 and Energy 1) and one provides green and SME financing (FI 1). PE 1 is primarily focused on activities to reduce GHG emissions and improve household health. They have also created approximately 500 jobs in total. Energy 1 supplies cleaner energy (than coal) to the national grid, supporting the power-up of dormant power plants that previously had insufficient fuel.

FMO strongly influenced FI 1's green and SME investment portfolios by asking the co-arranger to support FI 1 to develop funds that would meet FMO's impact goals.[115] As a result, FI 1 invested in a large renewable energy project in South Asia Case Study Country 1, an energy efficient factory and a waste water improvement project. FMO's loan made these investments possible, with the long tenor passed on to these businesses.[116]

AFW 1 does not seem to fit FMO's impact priorities. It replaces an existing plant, so is not likely to generate permanent jobs, though 770 jobs will be created for the construction process. Its key inputs are imported, so there are no benefits for local smallholders as would normally be targeted with agribusiness and food investments.[117] The new plant operates more efficiently creating environmental benefits,[118] which was the basis for it receiving a 'green' label, but the same would be true of any new facility. Likewise, FMO assume that a more efficient plant will be more productive, thereby contributing to economic growth. It should be noted, however, that as with the argument for environmental effectiveness, the same case could be made for successful investment that improved the productivity of any growing business. Given this, it is hard to see how this investment, which will not generate benefits beyond these areas that many other investments potentially could, was the optimal use of FMO's scarce resources.

FMO did not set specific impact indicators and targets at the contracting stage. During preparation of the Financial Proposal for Energy projects, an internal tool is used to estimate the number of people that will be reached through the project and estimates of the GHG emissions avoided.[119] Energy 1's technical consultant estimated how much demand could be met by the project,[120] but it is unclear how

115 Deal facilitation expert.
116 FMO staff member; deal facilitation expert.
117 FMO staff member.
118 Other investor.
119 FMO staff member.
120 Investee.

performance compares to this estimate.[121] PE 1 estimates GHG emissions avoided by assuming its output replaces fossil fuels.[122]

The three investments with a clear development impact rationale appear to be reaching under-served segments of society. Energy 1 is bringing power to an area where 60% of people did not have access to energy at the time of investment.[123] PE 1's distribution is widespread across South Asia Case Study Country 1 and therefore is anecdotally reaching those who had not considered using this alternative to coal previously.[124] PE 1 also supplies its product in a humanitarian setting, which is reported to have avoided further deforestation of the local area.. [125] FI 1 also reports having a specific portfolio targeted at the poorer segment of society, for which they use some FMO funds.[126]

South Asia Case Study Country 2

All of the four investments intended to meet either or both of FMO's core development impact metrics (jobs supported and GHG avoided), though impact targets were generally not specific[127] and attainment is hard to quantify. As renewable energy companies, Energy 3, Energy 4 and Energy 2 were intended to avoid GHG. Energy 3 and 4 does not have data on GHG avoided beyond the *ex ante* estimates produced at the pre-investment stage, however Energy 2 reports the specific quantity of GWs generated through its current portfolio and estimated through its construction pipeline. These reported figures significantly contribute to South Asia Case Study Country 2's current renewable energy capacity,[128] displacing fossil fuel energy sources. FMO also co-invested in one of PE 2's portfolio companies. During due diligence, FMO spent a lot of time on impact which PE 2 appreciated.[129]

Both FI 3 and PE 2 monitor development impact, but in sectors that do not fit neatly with FMO's approach to impact. FI 3's impact is broader than FMO's view of green or inclusive investments.[130] As an FI investment, FMO collects data on its lending using the indicators described previously, but this does not fully capture the impacts it has. Its green bond, for example, has focused largely on transport, with 29% going to water, sanitation and hygiene investments, none of which are captured by FMO's impact monitoring.

Both Energy 2 and FI 3 have reported impact monitoring data to FMO through the CCR process. Energy 2 reported to FMO that it has achieved 554,806 GHG emissions avoided annually in 2019, compared to the most likely alternative, and reported 539 employees supported through its operations and maintenance.[131] The most recent CCR for FI 3 indicates that 54% of loans were in the microfinance segment in FY2019 and that 50% of the exposure was invested in green businesses.[132]

However, we found that PE 2 had not reported any impact monitoring data through the CCR process, despite having data available in its own systems which were not captured by FMO reporting. PE 2 does not have any agreed indicators or targets with FMO, but it has a system of standardised indicators for portfolio companies.[133] It uses impact data for internal decision-making and guidance from another DFI to

[121] Investee.

[122] Investee.

[123] FMO staff member.

[124] Investee.

[125] Investee.

[126] Investee.

[127] PE 2 partners recall detailed discussions with FMO on women's employment, gender, quality of education, development of well-rounded students (rather than just academic success) and FMO's focus on the bottom of the pyramid. PE 2 also has its own indicators from across its portfolio companies. However, these considerations are not reflected in the *ex ante* estimations of PE 2's follow-on fund's development impact.

[128] Investee.

[129] Investee (affirmed by two separate interviews).

[130] FMO staff member.

[131] Energy 2 CCR 2019.

[132] FI 3 CCR 2019.

[133] Investee.

link impact to revenues and commercial data so that portfolio companies can also make use of the data.[134] It has also started tracking progress against a gender scorecard in response to a request from a further DFI. [135]

There is impact data available on the co-investment between FMO and PE 2 into a portfolio company including measures against specific and relevant outcomes, which was key for investors during due diligence.[136] Targets for the indicators were set with FMO, PE 2 and another DFI investor, but they are not linked to disbursements.[137] FI 3 does not have specific targets, beyond the requirement for a proportion of FMO's investment to be disbursed towards seven green products. It does have monitoring data of its customer base to track its beneficiary groups, but this is not subject to limits or targets from FMO.[138] Despite Energy 3 and 4 not reporting impact data, it believes the majority of the discussions that it has had with FMO over the past six years have focused on development[139].

FMO provided extensive support to Energy 2 in South Asia Case Study Country 2 to achieve the expected development outcomes, including running a workshop on sustainability, and facilitating peer learning by arranging a visit to another FMO client in an African country. These activities may also be considered as E&S capacity building; however, conceptually, the support to Energy 2 was seen as managing both E&S and impact, with 'E&S as flipside of impact'.[140] FMO also provided support to PE 2 to achieve its impact through provision of a toolkit.[141]

East Africa Case Study Country

The case study evidence suggests that FMO contributed to inclusive development, particularly by reaching under-served sections of society through PE 3 and AFW 2. PE 3's investment into an insurance company aimed to improve livelihoods through increased access to their product in East Africa Case Study Country and in other countries in East Africa. The insurance company aimed to fill the gap for insurance targeting low-income households,[142] partnering with the group which owns AFW 2 to provide this service to farmers and informal workers.[143] However, as customer profiles are not available, there are some limitations in capturing the extent to which the investment has contributed to development impact, as the use of insurance by the customers is not clear. PE 3 is developing an innovative mobile application where customers can buy insurance, check policies, access customer services and pay premiums,[144] and is looking at insurance cover related to the effects of Covid-19. [145]

FMO's investment in AFW 2 enabled over eighty-thousand smallholder farmers to have access to credit,[146] overcoming barriers to access to commercial loans or loans through Rural Savings and Credit Cooperatives,[147] and providing credit at more affordable rates.[148] As a result of FMO's investment, AFW 2 has also been able to develop a mobile money platform.[149] While there is no systematic monitoring of how loans are used, they are assumed to be used for investment, increasing yields and income.[150] Anecdotal

[134] Investee.
[135] Investee.
[136] Investee.
[137] Investee.
[138] Investee.
[139] Investee.
[140] FMO staff member.
[141] Investee.
[142] Investee.
[143] Investee.
[144] Investee; FMO staff member.
[145] Investee; FMO staff member
[146] AFW 2 Impact Reporting.
[147] Investee.
[148] Investee.
[149] Investee.
[150] FMO staff member; investee.

evidence suggests that in some cases smallholders used credit to diversify livelihoods and cover expenses for school fees,[151] however due to the lack of monitoring the understanding of development impact is limited.

There are reports that FMO investments has enabled job creation, although this is not always corroborated by reports available to the evaluation team. For PE 3, one respondent claimed that expansion had created 90 jobs, with the percentage of women employees said to have grown since the investment.[152] It was also reported that Energy 5 created more jobs following expansion,[153] and the number of female staff had increased, though details were not available.[154] [155]

Across the sampled investments, development impact targets were not set at the decision-making stage by FMO for any of the investments and have therefore not been monitored consistently. For PE 3, it is not clear whether impact targets were set or if there are tracking systems in place.[156] For Energy 5, it was reported that impact targets were set by the co-investor (other DFI investor) at the decision-making stage and FMO was not involved in this or in subsequent monitoring.[157] The co-investor reported that it has not established benchmarks so there is no assessment of performance, including targets on reducing emissions.[158] It was assumed that new, fuel-efficient operations would see greenhouse gases reduced.[159] For AFW 2, FMO assumed the investment would produce strong impacts as it focused on inclusive finance for smallholder farmers, but specific targets were not set and results were not monitored.[160] Job creation and GHG avoidance were not part of the discussion at the time of the investment as the focus was on increased access to microfinance.[161]

West Africa Case Study Country

Of the sampled investments, reportedly only FMO's investments in PE 5 and FI 4 resulted in job creation.[162] PE 5 invests in SMEs, with most of FI 4's clients being corporations.[163] FMO's investment in AFW 3 has led to increased crop yields for smallholder farmers through access to a key product.[164] It is unclear what impact PE 4's investee has achieved due to a lack of *ex ante* development impact rationale and data.

In three of the four investments, FMO took into account potential development impact prior to making the investments. During due diligence, for example, PE 5 provided evidence of job creation and taxes paid,[165] and FI 4 forecasted job creation from lending to women-owned businesses.[166] FMO gave the AFW 3 investment a 'green' and 'inclusive' label because it related to SDGs 10 and 13 (energy efficiency) and SDG 2, working with smallholder farmers and increasing West Africa Case Study Country's supply of a key product.[167]

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151 FMO staff member; investee.

152 Investee.

153 FMO staff member; investee.

154 In one investment document (Energy 5 CCR 2019), the evaluation team found a 'number of employees supported' but it is not clear from the documentation if this number refers to employees supported since the investment.

155 FMO staff member.

156 FMO staff member; investee.

157 FMO staff member; other investor.

158 Other investor.

159 FMO staff member (affirmed in two separate interviews).

160 FMO staff member; investee (affirmed in two separate interviews).

161 FMO staff member; investee.

162 Investee (affirmed in two separate interviews).

163 FMO staff members (affirmed in two separate interviews).

164 FMO staff member.

165 Investee.

166 Investee.

167 FMO staff member.

PE 4 is the exception; reportedly the PE 4 investee's systems prior to FMO's investment were such that it would have been hard to assess its development impact *ex ante*.[168] However, FMO did influence members of the PE 4 consortium to increase the prominence of development impact.[169]

The sampled clients report impact data to FMO in various ways, often as part of a wider reporting approach that was not requested by FMO. While there is evidence of FMO influencing or encouraging these investees to increase their impacts, we are not clear how much this was informed by the available data. PE 5 regularly reports impact data, but not all of it is shared with FMO.[170] FMO has asked PE 5 to consider investing in clean energy.[171] FI 4 reports on its own benchmarks on a quarterly basis, but this was not something requested by FMO.[172] We infer that this data prompted FMO to ask FI 4 to increase its SME portfolio and FMO has signed a letter of interest with FI 4 to do this.[173] FMO also wants PE 4's investee to increase its SME client base.[174] AFW 3 has shared information on yield increases with FMO.[175]

FMO is keen to see PE 5's impact on women with respect to job creation, women-owned businesses and women on boards.[176] FI 4 reports on the number of women it lends to, e.g. 1,000 women have grown their businesses with loans from FI 4, with a turnover of one billion naira.[177] In both cases, FMO has supported and encouraged these investees to support women but FMO was not the catalyst for this behaviour. As previously noted, AFW 3 supports smallholder farmers by increasing the supply of a key product, but also directly by providing training, and this was one of FMO's motivations in choosing to invest in AFW 3.

4.4.4 Synthesis of findings

- **FMO's approach to *ex post* impact monitoring was evolving in the period under review and has subsequently improved further.** Sector specific indicators began to be collected from 2014. While these indicators are valuable in tracking progress in key areas, it is dependent on sufficient reporting and disaggregation. For example, gender indicators only became available towards the end of the period. A more fundamental issue (which is common to the DFI community) is that these types of indicators are not directly linked to FMO's investments in a causal sense, making it difficult to assess how much responsibility FMO could reasonably claim for the reported figures. In all the areas reviewed, there is clear evidence of steady improvement in the quality and coverage of indicators gathered, and FMO's *ex post* impact monitoring framework today has significantly improved since the period of the evaluation.
- **The introduction of the 'green' and 'reducing inequality' labels and targets had a strong effect on investment decisions, which is likely to have increased impact.** Before this point, targets on deals per country and sector had prominence, with the potential impact of deals less scrutinised. According to FMO, the requirement to demonstrate that a deal was green or inclusive and to defend this in the face of challenge in FMO's internal processes, has caused a major change in incentives. FMO calculates the proportion of 'green' in an investment in order to award a label or not, but the fact that an investment either obtains a label or does not, means that the incentive is to fill the quota with qualifying investments, rather than to seek to maximise how green or inclusive they are.
- **FMO's impact model produces a partial view of impact, particularly for AFW investments where impacts appear underestimated.** There is value in focusing on jobs and GHG avoided, but this means

168 Investee.
169 Investee.
170 Investee.
171 FMO staff member.
172 Investee.
173 FMO staff member.
174 Investee.
175 FMO staff member.
176 Investee.
177 Investee.

that many impacts were not captured in the model, particularly in the case of AFW investments. While this is offset with the sector specific indicators, these do not help with comparing investments or potential investments between sectors. The model has strong value in capturing indirect, holistic effects of investments, but only if this is done accurately. The fact that an agriculture module is being added to the new JIM is a very positive step in ensuring that the indirect effects of AFW are captured fully. The collaborative way that the JIM is being developed with other DFIs, and is currently being tested and used by a number of prominent public and private institutions, should enhance its accuracy and effectiveness. As well as increasing its use and helping to standardise practice, the fact that the JIM will be open source, is a further guarantor of its accuracy going forward.

- **The balance between achieving positive impact and reducing negative impacts is difficult to get right.** In some investments it is easy to see positive impacts generated with little downside. In other cases, FMO may help an investee improve their performance, reducing negative effects rather than creating positive ones. Should FMO divest itself of all fossil fuel investments as some NGOs would like, or seek to reduce the extent to which investees are involved with the sector? This is discussed further below.
- **Concessional funds in blended finance structures have the potential to increase impact, but need to be used carefully**. Blended finance enables projects which otherwise would not happen. Many have potentially high impacts, but as one interviewee put it, if they fail the impact is a one-off that is neither scaled nor replicated. Distinguishing between investments that will never be commercially viable and those that could be with the support of concessional finance at a key stage, is an extremely difficult task, but not an impossible one.

4.5 Environmental and Social (E&S) and non-financial additionality

Non-financial additionality covers factors beyond the straight financial transaction. For DFIs, this is often termed 'value additionality', and may refer to inputs that improve the commercial prospects of an investee, or to governance or environmental & social issues[178]. For DFIs, this is generally specific to a particular deal, but can also take a wider market or sector approach.

In their Harmonized Framework for Additionality in Private Sector Operations (2018), the MDBs identified four types of non-financial additionality: (i) risk mitigation; (ii) policy, sector, institutional or regulatory change; (iii) standard-setting/helping projects and clients achieve higher standards; and (iv) knowledge, innovation and capacity building. While these forms of additionality are also generally associated with particular deals, they may also have the broader ambition to improve the overall investment climate. FMO's sector initiatives are closer to these types of non-financial additionality.

FMO's approach to E&S is discussed in detail in Annex A. Here we present complementary findings from the three sources discussed above, in each of the sectors within which FMO operates. Corporate Governance and Technical Assistance were outside the scope of the review, and are only referenced where information emerged from the case studies or other interviews that adds value to the evaluation.

The evaluation team also undertook a benchmarking of FMO's E&S policies against peer institutions (IFC, CDC, Proparco, DEG and AfDB), as well as assessing FMO's E&S practices within the four case studies. The benchmarking comprised of: (i) documenting the IFC Performance Standards and underlying objectives; (ii) reviewing FMO documentation and establishing the policies and processes that exist to support achievement of each standard; (iii) collating and reviewing peer organisations' publicly available information on their E&S management, and establishing the policies and processes that each institution has to comply with each standard; (iv) interviewing FMO's E&S management on FMO's approach to managing E&S risk; (v) interviewing a representative from each peer institution about their perspective of FMO's practices. This work was compiled with the analysed data from the case studies, and interviews with civil society organisations and with the manager of the ICM to develop a comprehensive analysis of

[178] FMO refers to 'ESG additionality' and defines it as 'derived from value addition in the field of ESG standards. Hereby ensuring that outcome/returns to society will be higher than would otherwise be the case with other parties. ESG additionality is considered as an element in a financing package that cannot be easily obtained from other market parties.

FMO's policies, processes and practices on E&S risk management and complaints management, as well as how they are perceived to be performing.

Overall, FMO's E&S policies, its practices in the case studies and its reputation amongst peer DFIs indicate that it is performing well on E&S risk management and is seen as a leading DFI on this issue. Its policy framework is in line with the IFC Performance Standards and similar to those of CDC, DEG and Proparco. Many of the investments sampled in the case studies demonstrated positive improvements in E&S management and outcomes. Other DFIs were positive about FMO's approach to E&S and frequently noted the relatively high level of FMO resourcing. Peers commented that this allows FMO to have a more in-depth understanding of E&S issues within investments by building personal relationships with clients and conducting site visits. It was thought by other DFIs, that this leads to FMO being more ambitious in its plans to develop the E&S capacity of clients through Environmental & Social Action Plans (ESAPs) and technical assistance. FMO was seen as a leading DFI in the area of human rights in particular.

However, like many DFIs, FMO continues to face challenges associated with being a European-based investor with limited on-the-ground presence at the site of its investments. NGOs in the Netherlands and internationally continue to raise credible E&S concerns about FMO's investments. Strengthening in-country networks and engaging more pro-actively with civil society and other sources of local knowledge in advance of deals should help FMO to bolster its E&S risk management.

4.5.1 Findings from FMO

Non-financial additionality, particularly for E&S (but also governance) is central to what FMO does, and perhaps the area where it believes it brings the most value relative to other DFIs. As mentioned in the context of financial additionality, FMO is often more expensive than other DFIs, but it believes that clients may still choose to go with it because of the additional value it brings in areas such as E&S. Findings from the case studies presented below support this view.

FMO brings value to investees in areas such as gender and the environment, and also the identification and management of E&S risk through the development of robust E&S management systems. It also appears to be more advanced on these issues compared with other European DFIs, particularly, for example, on human rights, where it is more in line with Nordic institutions.

Another important aspect of FMO's approach is that it takes a constructive and incremental approach that prioritises direction of travel. FMO has more capacity and a greater appetite for E&S risk than some other DFIs and is more likely to work with the client to develop and implement a feasible ESAP. Some other DFIs/MDBs have less appetite for E&S risk, which can complicate co-investments. Although FMO sees some E&S issues as needing to be addressed immediately, e.g. paying at least the minimum wage or stopping pollution, but believes that can be addressed over time. Where FMO would exclude an investment is where it does not believe that an investee can or will make the necessary changes in an acceptable timeframe.

FMO also sees E&S issues as central to the long-term success of the companies in which it invests. This is different from a compliance-based approach, and also linked to the incremental approach it takes, i.e. the better clients do on E&S, the further their long-term prospects are enhanced over time.
E&S management is woven into FMO's investment processes; at the client selection stage initial checks are carried out against the exclusion list and an initial desk-based E&S risk assessment is conducted during the CIP stage, drawing on information from a variety of sources. This information is then used to check the potential investment against the IFC-PS, before an initial risk categorisation is assigned. The risk assessment at the CIP stage serves to inform the design of the due diligence stage, and highlights areas for further investigation. Due diligence almost always involves a field visit by FMO staff (for all investees rated A or B+ for E&S risk, and for B-rated investees where this is considered necessary), and independent consultants are hired to conduct third party risk assessments. ESAPs are then developed and negotiated as necessary to manage risks, which are built into contractual agreements if the investment goes ahead. Following disbursement, E&S performance is closely monitored by FMOs teams who have internal targets

for the overall improvement of portfolio E&S performance. In addition, FMO has developed toolkits for private equity funds and financial intermediaries to monitor and manage E&S risk within their own portfolios.

In 2018, FMO introduced the ESG Performance Tracker, a new application to track the ESG performance of high-risk ESG clients (risk category A and B+). The Tracker is used by ESOs (Environmental and Social Officer)/CGOs (Corporate Governance Officers), and in some cases IOs and PAs, to identify and weight risks, as well as to assess the performance of the client in mitigating those risks. Being able to track all the ESG risks with one tool will provide portfolio management information and increase improvements to ESG outcomes and performance.[179]

Another important issue in this area is FMO's approach to complaints. A short review of this issue is contained in Annex C. There are four main findings to report. First, FMO is to be commended for establishing an Independent Complaints Mechanism (ICM), which is unusual amongst bilateral DFIs. Second, while it is still a relatively new mechanism, the ICM is learning and evolving and approaching complaints in professional and serious way. Third, FMO could be more proactive about the existence of the ICM. At present investees are not required to publicise the existence of the ICM, with the result that local stakeholders may not know of its existence and therefore not be in a position to file a complaint. Fourth, more needs to be done to ensure that progress is made during the monitoring of complaints and to ensure consistent documentation and publication of progress made.

4.5.2 Findings from desk review of sampled investments

All the **AFW investments** were B or B+ rated with respect to ESG risk. When co-investing with other DFIs, FMO requested additional E&S elements in a number of cases. With the group owning South Asia Case Study Country 1/AFW 1, for example, FMO followed another DFI investor which undertook the due diligence, and had an existing relationship with the investee. This is usually sufficient, but FMO requested extra elements to be included in the Environmental and Social Action Plan and disbursements linked to these. During a field visit in May 2019 it became clear that the group owning AFW 1 had problems not only in implementing ESAP requirements but also with understanding them. FMO's decision to link disbursement to ESAP conditions was essential in securing the required improvements.

In the West Africa Case Study Country/AFW 3 investment, FMO brought a more stringent approach to human rights and gender than other DFIs. FMO requested a social and human rights impact assessment. This was done by AFW 3 and resulted in the Social Impact plan used by AFW 3, which has had significant effects.

Findings show that FMO is generally active on E&S and corporate governance, even when non-financial additionality is not claimed. With East Africa Case Study Country/AFW 2 for example, non-financial additionality is not claimed as AFW 2 is a successful business, yet FMO shared its experience from its microfinance network on client protection principles (the SMART campaign), widening its shareholder structure, and taking deposits from the public sector. AFW 2 saw FMO's input as highly additional: 'The compliance requirement for FMO loan to [AFW 2], has improved the overall portfolio risk management for the microfinance institution (MFI)'.[180]

Energy investments reviewed were all given a B+ rating except South Asia Case Study Country 1/Energy 1. This was graded A, despite the fact that another DFI has categorised it as a B due to its limited impact. FMO generally follows this DFI on E&S so it is interesting to see this divergence in the Energy sector.

For the Energy 2, Energy 3 and Energy 4 investments in South Asia Case Study Country 2, FMO took the leading role on E&S despite the fact that another DFI is leading on the transaction. Again, this is because this DFI sees this type of renewable energy investments in South Asia Case Study Country 2 as inherently low risk, but FMO takes a different view. During contracting with Energy 3 and 4, for example, FMO was

[179] FMO (2018) ESG Performance Tracker Process Manual.
[180] Investee.

concerned about the impact on livelihoods so it insisted on a livelihood impact assessment. FMO also added to the other DFI's due diligence by ensuring that the rights of indigenous people were reviewed, due to the government land acquisition.

FMO may take the lead when co-investing with other DFIs, in the same way as the DFI mentioned above. In the East Africa Case Study Country/Energy 5 investment, for example, another DFI investor was the formal lead on E&S, but FMO claims that in reality it did most of the E&S work. This is because while the other DFI investor is more or less equal in size to FMO, it has less in-house ESG expertise.

Non-financial additionality reported included South Asia Case Study Country 2/Energy 2, where FMO's ESO coached the E&S management team, and provided various capacity building modules, including an FMO client exchange. FMO describes its approach as follows: 'When they wanted to know about examples elsewhere, we flew them to [country]. When they wanted to know how they should talk at Board level about sustainability, we ran a workshop for them. We have been there for them as a critical friend. FMO has made a difference to the company'.[181]

Of the nine Energy investments reviewed, five claimed ESG additionality.

Financial investments have a greater range of ratings, ranging from C to A. Banks with exposure to oil and gas (i.e. all banks in West Africa Case Study Country) are automatically rated A. For funds, each portfolio company has different risks making it difficult to assign a risk rating *ex ante*, for the same reason it is hard to develop *ex ante* development indicators.

FMO reported significant non-financial additionality in the FI sector, which included putting on conferences, corporate training and helping to improve E&S practises by hiring E&S consultants. FMO also developed an ESG toolkit for fund managers, which was described as useful by multiple fund investees.

In South Asia Case Study Country 1, FMO has a significant portfolio in the financial sector and a strong reputation for ESG additionality. In 2015, FMO put on a series of E&S risk management training sessions for five FI clients to help them learn from each other. They stated that this was the 'first time that they saw each other as companions rather than competitors'.[182] When FMO contacted FI 1 for a comment, it said that it had heard about this training and liked that it was not just about DFI requirements but also ERM guidelines for Central Bank.[183]

The **IMS investment** (South Asia Desk Review Country/IMS 1) reviewed was given an E&S Category A. The main risks identified related to its environmental and social management system, contractors' health and safety practices, community relations, land acquisition and security management. FMO reports that the company manages its E&S professionally, has conducted an intensive effort on the environmental and social management system audit, and is moving from a reactive to proactive approach in its work with communities. Outstanding issues relate to community complaints about the loud generators, and FMO monitors ESG activities with visits.

4.5.3 Findings from case studies

South Asia Case Study Country 1

FMO is leading on E&S with PE 1 and FI 1, where the focus has been on establishing E&S management systems and training and capacity building. For example, FMO recommended that PE 1 recruit an E&S specialist, and provided support (including funding) to meet two ISO certification processes; PE 1 have

[181] FMO staff member.
[182] FMO staff member.
[183] FMO staff member.

now received certification.[184] Another DFI in the investment has not been involved in E&S as they categorise PE 1 at B and focus on compliance, however they value the support FMO has provided.[185] [186]

FMO provided training for FI 1 and other FI clients in South Asia Case Study Country 1, with a focus on meeting new central bank requirements and DFI requirements. FMO also supported FI 1 in the development of an IT system for staff to assess E&S risks, resulting in an E&S summary and categorisation for each client, with ESAPs where necessary.[187] This is the first system of its kind in a bank in South Asia Case Study Country 1,[188] and prior to FMO's engagement FI 1 did not have E&S procedures.[189]

For the two remaining investments, FMO is not the E&S lead, but has still provided some support to the lead DFI or to the client. In the AFW 1 investment, FMO pushed the DFI lead to link progress on ESAP actions to disbursements. While some disbursements have been made despite the fact that the client has still has not achieved all the ESAP targets, the latest disbursement has been postponed due to unresolved ESAP issues.

FMO provided minimal E&S support to Energy 1 as another DFI took the lead, but it was actively engaged in discussions.[190] With the support of DFIs, Energy 1 has engaged with a local university to mitigate the impact on local habitat impacts, as well as with the local community and NGOs.[191] PE 1 senior management note that FMO's involvement gave other investors' confidence as discussed above,[192] while another investor felt that DFIs' E&S standards can be frustrating and costly, but that the costs were outweighed by the positive outcomes.[193]

The main E&S challenge for both PE 1 and AFW 1 has been with respect to third party workers.[194] PE 1 ensured that they get the same package as permanent staff,[195] with FMO providing support to enable this.[196] FMO and the lead DFI commissioned social surveys of workers at AFW 1 following a visit that raised concerns, and followed this with another survey this year to assess progress.[197] AFW 1 put the workforce on the payroll to mitigate the issues with enforcing standards through sub-contractors.[198]

South Asia Case Study Country 2

All sampled investments included an assessment of E&S during due diligence, with the development of an ESAP linked to the contract with FMO.[199] FMO's investments into Energy 3 and 4 came with an extensive ESAP, but there were many disconnects between FMO's expectations and Energy 3 and 4's understanding of what was required and necessary.[200] The various issues included land acquisition, worker conditions and compensation for lost livelihoods. The client that implements the projects for Energy 3 and Energy 4 has still not met the requirements, including the implementation of a Livelihood Development Program,

184 Investee.
185 FMO staff member.
186 Investee.
187 FMO staff member.
188 Investee.
189 National stakeholder.
190 FMO staff member.
191 FMO staff member.
192 Investee.
193 Other investor.
194 FMO staff member.
195 Investee.
196 Investee; FMO staff member.
197 FMO staff member.
198 Other investor.
199 FMO staff member.
200 FMO staff member; investee.

which has been further delayed due to Covid-19.[201] Some positive actions were taken by the client, such as installing rainwater harvesting facilities and hiring from communities who lost land.[202]

FMO was satisfied with FI 3's approach to E&S.[203] Given previous MFI issues in South Asia Case Study Country 2, the focus of FI 3's E&S efforts has been on on-lending policies; FMO assessed these and did not require the implementation of anything in addition to the South Asia Case Study Country 2 industry standards.[204] Another investor shares FMO's perspective.[205]

PE 2 received support from FMO on E&S and corporate governance, where FMO reportedly wanted to improve E&S processes rather than audit them. FMO was the only DFI, for example, that did not add its own template for E&S reporting, stating that it was not concerned about the format but rather the content, alleviating the burden of reporting. [206] FMO invited PE 2 fund managers to E&S masterclasses, shared its E&S toolkit for fund managers and supported the integration of E&S and CG into PE 2's due diligence and training for companies.[207] FMO also delivered highly regarded training on governance for a co-invested portfolio company, and funded and conducted a challenging but well-received CG audit of the co-invested portfolio company.[208]

FMO provided support to improve Energy 2's E&S management systems.[209] Support started before the investment was made and focused on: (i) revamping Energy 2's E&S system to manage E&S at scale; (ii) recruiting a centralised E&S specialist to support this; and (iii) conducting quarterly E&S monitoring.[210] FMO also conducted a workshop for management to introduce land acquisition procedures and provided capacity building each year throughout the investment.[211] Energy 2's community development program has been copied by two of their competitors,[212] indicating that Energy 2's focus on E&S has had a demonstrably successful effect.

FMO's approach to E&S in South Asia Case Study Country 2 appeared to go above and beyond other DFIs' requirements, particularly within the sub-sector of renewable energy that the case study focused on. An independent E&S consultant noted that FMO has a positive approach to E&S, focusing on areas for improvement rather than a 'box-ticking approach'.[213] Another DFI rates the particular sub-sector of renewable energy as low risk in South Asia Case Study Country 2, so its E&S team are less involved, so FMO has to prioritise E&S when the two organisations co-invest.[214] While other lenders would not visit the site for a similar size project, FMO does go to site, has discussions with E&S consultants and clients on E&S issues and does not reduce the E&S budget. [215]

East Africa Case Study Country

The sampled investments in East Africa Case Study Country contain little of significance on E&S risk. Insurance and microfinance are generally considered by FMO as a low risk for E&S, which explains the low focus on E&S.[216] It was reported that another investor from outside of the PE 3 consortium, leads the E&S

[201] FMO staff member.
[202] Investee.
[203] FMO staff member.
[204] Investee.
[205] Other Investor.
[206] Investee.
[207] FMO staff member.
[208] Investee.
[209] Independent E&S consultant.
[210] Investee.
[211] Investee.
[212] FMO staff member.
[213] Independent E&S consultant.
[214] FMO staff member.
[215] E&S consultant; independent E&S Consultant.
[216] Investee.

monitoring.[217] For Energy 5, the lead co-investor (other DFI investor) conducts the monitoring and reporting for E&S, focusing on safety.[218] It was reported that the E&S for this deal focused more on safety and efficiency rather than reducing GHG emissions.[219]

In general, national stakeholders in East Africa Case Study Country report a positive perception of FMO in the national market in terms of E&S risk management.[220]

West Africa Case Study Country

FMO provided support in E&S in all four of the sampled investments. During the due diligence stage for FI 4, FMO produced an E&S report that was highly valued by the members of the loan syndicate,[221] and ensured that ESG was part of the PE 4 consortium's agenda.[222] FMO and other DFIs contributed to AFW 3's ESAP, with another DFI in the lead.[223] FMO also requested the risk assessment for AFW 3 to be repeated because it did not consider risks to the community.[224] Post investment, FMO provided E&S training to staff at PE 5, PE 4 and FI 4,[225] and worked with PE 5 and PE 4 to ensure both had environmental and social management systems in place.[226] FMO also provided informal ESG advice and mentoring to PE 5,[227] and has worked with one of its investee companies on E&S.[228]

FMO's support has reportedly improved investees' E&S understanding, capacity and performance. As a result of FMO, PE 5 hired a senior E&S member of staff and PE 5's ESG performance has improved.[229] PE 4's investee has more capacity to assess E&S issues and has integrated FMO's ESG lending policies.[230] FMO's work within the PE 4 consortium significantly increased the engagement of co-investors with E&S,[231] and AFW 3 has taken measures to mitigate the E&S risks identified in its risk assessment. The most significant E&S impact has been through FI 4, where FMO worked with the West Africa Case Study Country Central Bank, local commercial banks and another DFI to establish the West Africa Case Study Country Sustainable Banking Principles. FI 4 now plays an important role nationally in taking forward these principles.[232] FMO also pushed for FI 4 to be accountable with respect to taxes.[233]

There is little evidence of negative consequences in terms of E&S impacts. Where there are reports that FMO's focus on E&S is considered excessive by some commercial investors,[234] this does not seem to have adversely affected investments. While all DFIs are seen as concerned with E&S issues,[235] FMO appears to have taken the lead on E&S in most of the sampled investments. Multiple DFIs were involved in AFW 3's ESAP for example, but FMO pushed for human rights and gender issues to be included.[236] One stakeholder claimed that some DFIs treat E&S as a tick-box exercise, but FMO works through E&S issues with clients.[237]

[217] FMO staff member.
[218] FMO staff member; other investor.
[219] FMO staff member; other investor.
[220] National stakeholders.
[221] FMO staff member.
[222] Other investor.
[223] FMO staff member; other investor.
[224] FMO staff member.
[225] Investee.
[226] FMO staff member (affirmed by two separate interviews).
[227] FMO staff member.
[228] FMO staff member.
[229] FMO staff member (affirmed by two separate interviews).
[230] Investee.
[231] Other investor.
[232] FMO staff member; investee.
[233] FMO staff member.
[234] Other investor.
[235] National stakeholder.
[236] FMO staff member.
[237] National stakeholder.

The reliance on the oil and gas sector, and the myriad E&S risks that this involves remains a serious E&S issue in West Africa Case Study Country. FMO has encouraged PE 4's investee to diversify away from oil and gas because of the risk involved, and their oil & gas numbers are declining.[238] Like all West Africa Case Study Country banks however they retain a significant oil and gas portfolio.

4.5.4 Synthesis of findings

- **FMO remains a leading DFI on E&S issues.** FMO needs to continue to actively engage with other DFIs and investments to push the boundaries in areas such as human rights.
- **FMO's sector initiatives bring particular value.** This point was made by all stakeholder groups, i.e. within FMO, investees and peer organisations. In the long-term, improvements in E&S may support commercial objectives of investees, in the short-term they can come at a cost. In order to avoid putting those that invest most in E&S at a competitive disadvantage, raising the bar on E&S across the sector is a clear win-win to the extent that standards are implemented across the sector.
- **Supporting E&S improvements through TA funds is necessary in some cases.** Not all E&S improvements that come at a cost can be addressed through sector wide initiatives. Having the ability to draw on TA funds is seen by other DFIs as a valuable resource available to FMO.
- **FMO's incremental approach to E&S has value but needs to be better communicated.** If FMO were to divest from fossil fuels as argued by some NGOs, it would have to disinvest from all West Africa Case Study Country banks. This would prevent it from being able to positively influence these banks, who would be likely to find alternative sources of finance. This is not a straightforward issue, but FMO's approach seems reasonable if (i) its engagement really does lead to as much positive change as can be achieved, and (ii) this is communicated to stakeholders in partner countries and the Netherlands in a transparent way.
- **Engaging with a wider set of stakeholders rather than relying on clients for information is crucial to identifying and managing E&S risks.** Before, during and after investments are made, FMO could engage more proactively with a wider set of stakeholders than is currently the case. Local knowledge is essential in identifying E&S risks that may affect different stakeholder (and which the client may be unaware of) and managing these risks effectively. There is no substitute for an engaged local presence, and/or a stronger set of local partnerships. As well as local stakeholders, this could include Dutch and other international NGOs which are active in partner countries, and other agencies involved in Dutch development cooperation such as national embassies.
- **A more open, self-reflective approach to E&S would add value**. This includes discussing where things went wrong, and is an important way of building understanding of the trade-offs that FMO has to manage.
- **The establishment of an Independent Complaints Mechanism is very positive**, but it currently has less visibility than it could among local stakeholders and more could be done to ensure that initial recommendations are followed up on and documented.
- **FMO recognises that it needs to have better visibility of E&S issues at the portfolio level.** This is in place on a deal-by-deal basis, but if E&S is to have a similar steering effect as the 'green' and 'inclusive' labels, a portfolio level view is needed to support this. The evaluation team understands that the process is underway within FMO to develop a sustainability information system to support Environmental, Social and Governance (ESG) visibility at the portfolio level.

4.6 Strategic positioning of FMO

FMO seeks to be additional (both financially and non-financially), to mobilise investment and to achieve the maximum possible impact. It also needs to maintain a stable balance sheet. This requires a mix of

[238] FMO staff member.

large and small, high-risk and low-risk investments. Larger, low-risk investments provide the resources to invest in higher-risk ventures. Some sectors are more high-risk than others. AFW investments are relatively high-risk, and FI investments relatively low-risk. If the AFW weighting is too high the portfolio becomes too high-risk; if the FI weighting is too high the impacts achieved may be too low.

As a bank supervised by the Dutch Central Bank, FMO is implementing the Basel banking regulations (Basel III-IV), which stipulate minimum capital requirements for different types of lending. In this regard, many of the things that FMO does, such investing in higher risk markets and sectors, and private equity investments, have required (or will require over the next few years) increased capital to be put aside. For FMO, these changes have not restricted what it can do, but this could happen in the future, particularly if FMO was to increase the risk profile of its portfolio and/or invest more in the private equity sector. FMO is aware of the impact of such regulatory changes, and are examining the options to ensure that these changes do not restrict its ability to effectively pursue its strategic goals.

FMO also manages government funds that can be invested on concessional terms, and growing experience with blended finance structures. This allows FMO to do things that the balance sheet constraints preclude, but comes with some risks, as described in various parts of this report.

In this final section on findings, we consider the question of FMO's strategic direction using the same three previous sources of the process review, desk review and case studies.

4.6.1 Perspectives from FMO

FMO staff working on specific sectors unsurprisingly tend to focus on their relevant sector as a strategic priority, however there are some commonalities. There is an agreement that FMO needs to avoid investing in mature parts of each sector, and should move to nascent areas where commercial finance is scarce and the long-term development potential is high. Often, although not always, this means smaller, higher-risk ventures, and also those with a more direct development impact/SDG association. In relation to Energy, this means off-grid, mini-grid projects that enhance the development prospects of disadvantaged groups. In finance, it means new financial institutions that provide financial services to the same groups or to existing financial institutions where the investment from FMO sees them start or expand their exposure to similar groups. In AFW, the strategic focus is again on linking to disadvantaged groups, often with a strong sustainability element. For products, the presumption is more on equity as compared to loans, as this enhances the ability of FMO to have a positive influence particularly on ESG grounds.

A common feature of these strategic priorities is that they are likely to increase the level of risk of the portfolio, and this is reflected in the fact that most FMO interviewees expected the use of blended finance to increase in the future, as more concessional finance will be needed to improve the risk-return characteristics of these types of projects before they can reach commercial viability.

4.6.2 Findings from desk review of sampled investments

Strategically, FMO and another DFI investor both identified **AFW** sectors as priorities and aimed to increase exposure in these areas. Their approaches have diverged however, with the other DFI investor taking a broader approach and FMO focusing on specific sectors. 'FMO has developed a deep level of expertise in agriculture, but I'm not sure if this is the symptom or the cause of a good strategy'.[239]

FMO is seen as having considerable experience in investing in microfinance designed for the AFW sectors, but may need to augment this with more technical support, for example in supporting the digitisation process with East Africa Case Study Country/AFW 2.

[239] Other investor.

The ability to move between using Massif and FMO-A is also useful for investees, and allows FMO to be flexible in its funding. Given the commercial difficulties in some AFW investments[240] which may ultimately prove to produce very high development impacts, this is likely to continue to be necessary, and may even need to increase, however this would require a more systematic framework than currently exists.

In the **Energy** sector, FMO seems to be seeking to do more smaller Energy projects where it can influence the E&S rather than financing six-month solar builds (which are not considered a 'sweet spot' for FMO). While FMO has fewer Energy investments than another DFI investor, it is more heavily involved on E&S issues, partly as it does not take the view that these are low risk, as was the case with the Energy sector investments we sampled where this DFI was a co-investor.

There is a potential trade-off between non-financial additionality through influencing smaller projects and mobilisation. Pension and insurance funds have billions to invest, but would only be prepared to take 10% of the balance sheet of a renewables project. A $500 million project would be challenging for FMO to deliver, but is so small it would not show up on the pension funds balance sheet.

Another trade-off is that FMO's influence and potential to increase impacts may run counter to the appetite and ability of investees to grow rapidly by attracting large-scale investment during upturns. With South Asia Case Study Country 2/Energy 2, for example, the objective of FMO is impact and additionality, however: 'This objective can sometimes contradict the potential investee's goals for growth',[241] as meeting these objectives requires a greater investment of time and resources into activities that do not directly result in business growth.

The perception among **Financial Institutions** reviewed is that FMO 'bring in something as well as the bucks'.[242] South Asia Case Study Country 1/FI 1had cheap funding from another DFI investor, and FMO's loans were more expensive than those from two other DFI's. It considered that communication with FMO was better and so ultimately decided to work with FMO, which is a very strong argument for additionality. FI 1 ultimately became a catalysing investment for FMO which led the process, but from a position of having positively influenced the trajectory and evolution of the bank.

It is important going forward, to think about market evolution and how FMO can best exert influence in this area. In South Asia Case Study Country 2, FMO's strategy is to target MFIs through larger banks and vehicles such as FI 3. This makes sense, but needs to be followed consistently with complementary investments at key points in the value chain.

The PE 2 investment is interesting in this regard. Although the sector-specific fund does not invest in a focus sector, FMO has included this due to its ability to contribute to SDGs. FMO was also looking for diversity in the portfolio and PE 2 fitted that strategy. This can be justified completely on its own terms, but so could many investments in many sectors, and it is not clear how PE 2 fits with a long-term strategic approach, or enables FMO to build and leverage capacity and expertise in key sectors.

When FMO considers entering new countries/frontier markets, going in with a current partner makes sense. One client, for example, helped FMO to invest in the Democratic Republic of Congo and has also asked FMO to move into Mozambique.

A strategic approach to market entry is also important. In the **Infrastructure and Manufacturing Services investment** (South Asia Desk Review Country/IMS 1) reviewed, an earlier evaluation report highlighted the need for DFIs to lead consortia with private banks/enable the private equity environment in South Asia Desk Review Country.

[240] FMO argue that the difficulties are largely confined to investments involved with farmer finance, which represent a small part of the AFW portfolio.

[241] FMO staff member.

[242] National stakeholder.

4.6.3 Findings from case studies

South Asia Case Study Country 1

South Asia Case Study Country 1 has been on a strong growth trajectory, aiming to transition to middle-income status in the coming years.[243] Stakeholders believe FMO can play a critical role in supporting this in the following ways:

- Demonstrating that there are investable opportunities in South Asia Case Study Country 1.[244]
- Supporting businesses to meet international E&S standards.[245]
- Encouraging a long-term approach to economic growth and protecting the environment.[246]
- Identifying and investing in future growth areas as a 'first mover'.[247]

In the renewable energy sector, mini grid, off-grid,[248] solar, wind and LPG projects[249] are seen as important, particularly for smaller businesses which cannot access finance from commercial sources.[250]

In the water sector, FMO could support projects in waste water[251] or water use for agriculture as part of a broader strategy to support a shift from smallholder subsistence farming to value chain development.[252]

This would require a different type of investment, from providing more equity to innovative approaches to blending, working with EU or World Bank grants and private investors.[253]

A financing gap was also identified between the SMEs that are supported by financial institutions that FMO fund (i.e. up to $0.5 million) but smaller than the usual DFI ticket sizes of $10 million.[254]

South Asia Case Study Country 2

South Asia Case Study Country 2 is a large, rapidly maturing market with many active DFIs, international and domestic impact and commercial investors. It is therefore important for FMO to further consider how it can continue to play a strategically useful role. Stakeholder suggestions can be grouped in the following approaches:

Renewable Energy: investment into large-scale solar projects is now financeable by commercial investors and so no longer appropriate to FMO's strategic objectives. FMO now needs to assess where in the market it can be a 'first mover', with potential opportunities arising in mini grids, storage and distributed energy. Investment in this area may require concessional funding as costs can be high, particularly for high-impact, last mile solutions.[255]

Fintech: this is a growing sector in South Asia Case Study Country 2 in which FMO is reportedly interested in contributing. To do this successfully FMO would need to develop its expertise and assess the market for a sufficient pipeline of opportunities that fit FMO criteria.[256]

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[243] National stakeholder.
[244] National stakeholder; investee.
[245] National Stakeholder; investee; deal facilitation expert.
[246] Other investor.
[247] FMO staff member.
[248] FMO staff member.
[249] Investee; national stakeholder.
[250] National stakeholder.
[251] FMO staff member (affirmed in two separate interviews).
[252] National stakeholder.
[253] FMO staff member (affirmed in two separate interviews).
[254] Other investor.
[255] FMO staff member (affirmed in two separate interviews).
[256] FMO staff member.

Education: education presents an opportunity for FMO to build on its experience, from the perspective of some stakeholders, seeking more fund managers with education-specific portfolios, and which are compatible with FMO's sector strategies that preclude debt investment.[257] Development impact opportunities through education are considered high,[258] and the co-invested portfolio company attracted publicity[259] and reputational gains for FMO.[260]

'Multiplier effects': effects beyond the project level could be potentially be achieved through the use of more corporate level investments rather than project finance investments. This was effective in Energy 2 in establishing E&S systems at management level that cascaded into project level E&S procedures, thereby affecting more projects.[261]

DFIs such as FMO can also play a significant role in difficult times, as with Covid-19, by making countercyclical investments which demonstrate confidence in the market and encourage others to invest.[262]

East Africa Case Study Country

The case study shows that the potential for development impact is high when FMO invests in clients that specifically target under-served segments of society, in this case smallholder farmers or informal workers. However, because impact has not been systematically tracked and there are no records of customer profiles it is not possible to prove this.

In this regard, it will be important to systematically track development impact in the future, as this will enable FMO to demonstrate the extent to which investments contribute to reaching under-served segments of society. Recent developments on impact monitoring at FMO suggest that this now recognised.

Beyond this issue, when investees were asked about areas where FMO can play a useful and unique role in the market in East Africa Case Study Country in the future, the following areas were identified:

- Investments along the agri-processing value chain, including renewable energy for agribusinesses, in particular mini-grids and smart agriculture.[263]
- Off-grid Energy investments, which are financially higher-risk but bring together opportunities for additionality, E&S and impact. [264]
- Investments in higher-risk sectors and businesses, as there is an increased need for smaller investments ($250,000–$1 million) in SMEs which struggle to access capital.[265]
- To enhance development impact, FMO should look at start-ups led by young people and women.[266]
- Growing potential for digital services in the country as demand for digital products expands.[267]
- The insurance sector is a growing sector with significant potential, particularly from digitalisation.[268] FMO would need to invest with partners as it is not seen as an expert in the insurance sector.[269]

[257] FMO staff member.
[258] FMO staff member.
[259] Investee.
[260] Investee.
[261] Investee.
[262] National stakeholder.
[263] National stakeholder (affirmed in several separate interviews); FMO staff member.
[264] FMO staff member.
[265] National stakeholder (affirmed in two separate interviews).
[266] National stakeholder.
[267] FMO staff member; investee; national stakeholder.
[268] Investees (affirmed in two separate interviews); national stakeholder (affirmed in two separate interviews).
[269] FMO staff member.

- Greater use of blended finance was considered essential to scale up investment in the future, and it was suggested that more partnerships are required to reach out to potential private investors.[270]
- During and in the aftermath of the Covid-19 pandemic, there is scope for investment in the health sector for medical supplies, protective equipment, machinery, etc.[271]

There is a common perception amongst interviewees that FMO is less visible and known in the market than other DFIs, and raising FMO's profile is a pre-condition to playing a more important role in the market.[272]

West Africa Case Study Country

In West Africa Case Study Country, FMO provides countercyclical, long-term capital and liquidity, especially in times of crisis, e.g. during Covid-19.[273] This is highly valued and additional to what is available in the market. FMO also mobilises capital through its network of DFIs and impact investors, and brings a 'stamp of approval' through its investments.[274] With respect to development impact FMO has had some successes, for example, FI 4's issue of a green bond on the local market started from early conversations with FMO.[275]

Going forward interviewees suggested the following areas where FMO could achieve greater impact:

- FMO could back more private equity funds to support this element of the West Africa Case Study Country economy,[276] however it is important that FMO, and all DFIs, avoid crowding out commercial investors.[277]
- One stakeholder suggested FMO develop an easy ESG guide for other Limited Partners to become 'ESG Limited Partners'.[278]
- Many interviewees suggested that FMO should establish a permanent in-country presence. This would help provide operational expertise to clients[279] and positively influence the enabling environment through closer work with the Central Bank in West Africa Case Study Country and national institutions.[280]
- Mobilisation should be less of a focus in smaller transactions, for example where there is only space for one DFI, and one domestic commercial bank.[281]
- Stakeholders were in support of FMO's green investments, stating that renewable energy was an area for expansion in West Africa Case Study Country,[282] however there was an implication that FMO's green targets are too ambitious to be commercially viable.[283]

[270] FMO staff member; investee.
[271] National stakeholder (affirmed in two separate interviews).
[272] National stakeholder (affirmed in several separate interviews).
[273] Investee; national stakeholder.
[274] Investee.
[275] Investee.
[276] Investee (affirmed in two separate interviews).
[277] Other investor.
[278] Other investor.
[279] Other investor.
[280] FMO staff member (affirmed in two separate interviews); investee.
[281] Other investor.
[282] Investee (affirmed in two separate interviews).
[283] FMO staff member.

- Others suggested FMO could consider investing in SMEs through innovative structures, in areas such as healthcare, affordable housing,[284] smaller banks, MFIs and digital banks.[285]

4.6.4 Synthesis of findings

- **FMO sector staff expect a greater focus on more nascent areas where commercial finance is scarce and long-term development potential high**. Often, although not always, this means smaller, higher-risk ventures, and also those with a more direct development impact/SDGs association.
- **For products, the presumption is more on equity compared to loans**, as this enhances the ability of FMO to have a positive influence particularly on ESG grounds.
- **If implemented at scale, these changes would be likely to increase the riskiness of the investments that FMO manages**. This is reflected in the fact that most FMO interviewees expected the use of off-balance sheet blended finance to increase in the future, as more concessional finance will be needed to improve the risk-return characteristics of these types of projects before they can reach commercial viability.
- **There is a trade-off between a focus on less commercially attractive, smaller investments and the goal of mobilising investment from large institutional investors.** Again, blended finance may be key to unlocking this.
- **This issue could be addressed by adjusting the portfolio to maintain the same level of overall risk, or by taking on more risk and adjusting FMO's structures to support this.** There are various ways these adjustments could be made, which are discussed briefly below, however it is outside the scope of this evaluation to analyse these options.
- **There is an opportunity to support the way the clean Energy sector develops and ensure that E&S issues are properly addressed in larger projects**. For another DFI, Energy projects are classed as low risk on E&S, but FMO has brought value to these projects by prioritising these issues, particularly for the rights of affected communities. If FMO stops doing these types of larger projects, which would be justified by the need to remain financially additional, it is not clear whether other investors would take a similar approach.
- **FMO strategic sector focus brings significant value**. The shift from a diverse to a more focused portfolio has enabled FMO to develop stronger sector expertise, and also positively affected the performance of the portfolio. However, there are still examples of investments being made outside of these priorities. While these can no doubt be justified on their individual merits, there is an opportunity cost to these investments that also needs to be taken into account.
- **A more systematic, coordinated approach to blended finance is needed**. As described above, many FMO staff members consider the strategic priority being in the types of investments where blended finance is required. FMO also faces strong competition from other DFIs in many markets, with it being difficult to identify good investments at sensible prices. A solution is to shift to higher risk markets and investments, which would be positive for impact, but only if the focus is on projects that are viable long-term. This requires a very careful and systematic approach to the use of blended finance. FMO has more experience than most in this regard, and would be well placed to lead an international initiative through the DFI Working Group to develop a robust framework that would operationalise the existing principles of the Working Group.

[284] National stakeholder.
[285] FMO staff member.

5. Conclusions and Recommendations

FMO's portfolio grew over the period in question with an expansion of equity investments, a greater focus on Africa and a strategic shift to three priority sectors: Financial institutions, Energy and Agribusiness, Food and Water. These changes are in line with the evolution of FMO's strategy as discussed above.

The evaluation team has grouped the Evaluation Questions and sub-questions according to the key principles within the agreement between the state and FMO, and other significant themes within the EQs. This enabled the team to synthesise evidence across different EQs and generate findings, conclusions and recommendations according to MoFA and FMO's strategic objectives and priorities for FMO-A. The conclusions and recommendations are presented according to these themes, which are mapped against the EQs in the table below. This table is a summarised version of the information presented as Table 1 in section 3.2.

Key theme	Relevant evaluation question
Portfolio Analysis	EQ1. How has FMO's portfolio developed? Including EQ1A, EQ1B, EQ1C.
Mobilisation	EQ4. To what extent do FMO's investments catalyse additional (private) resources? Including EQ4A, EQ4Bi, EQ4Bii, EQ4Biii.
Additionality	EQ3. To what extent would other commercial or private investors be available for FMO-investments? Including EQ3Ai, EQ3Aii, EQ3Aiii, EQ3C.
Development Impact	EQ2. To what extent has FMO contributed to the advancement of productive enterprises in developing countries and to inclusive development? Including EQ2A, EQ2B, EQ2C, EQ2D, EQ2E.
E&S and non-financial additionality	EQ3D. What is FMO's non-financial additionality and its value-added to FMO clients compared to other DFI's and market parties?
Strategic positioning of FMO	EQ3B. How does FMO ensure its additionality in a rapidly changing market environment with more private players entering the market? EQ2F. What has been the role of the Dutch State in ensuring that FMO maintains a good balance between risk, development results and financial targets? EQ2G. How does FMO's banking license contribute to its mandate? Is FMO's current set-up the correct form to execute its mandate? EQ5. How do the State funds influence FMO's own portfolio FMO-A? EQ6. How should FMO position itself in the evolving development finance landscape to maximise synergies between the goals of additionality, mobilisation and impact?

On the question of financial additionality, we find that:

- FMO was financially additional in most of the reviewed investments.
- The ability to provide longer tenors is the main source of FMO additionality.

- The provision of flexible and counter-cyclical financing in different currencies to suit the needs of investees is additional to what is available commercially, and FMO has added value compared to other DFIs.
- Where alternative finance was available on less favourable terms, it is important to specify why better terms are needed; while this was generally evident, it was not clear in some cases.
- While financial additionality can be significant for Financial Institution investments, it is less obvious than other sectors and needs to be further justified and demonstrated.
- FMO may provide finance that is not available commercially in line with the Agreement between the State and FMO. However, when part of a DFI consortium, it would be preferable to indicate why FMO was needed. This was not always clear in the reviewed investments.
- While the use of government funds in blended structures has high potential for additionality, it comes with risk of a 'race to the bottom' with DFIs offering financing on increasingly concessional terms. The strong commercial culture at FMO, and the fact that it has greater experience than most DFIs with blended finance, makes FMO better placed than most to mitigate these risks.

Financial additionality recommendations:

- **Expand the range of financial products** that FMO can provide to build upon FMO's flexibility in areas such as local currency at range of tenors, risk-sharing facilities and FX hedging products. Expanding the equity portfolio relative to loans has positive implications for additionality, given the relative scarcity of equity capital. As it is widely accepted that equity investments provide greater potential to influence investees (e.g. through a seat on the board), there is also greater scope for non-financial additionality through a continued expansion of the equity portfolio relative to loans.
- **Link financing structure to impacts** in *ex ante* and *ex post* framework to systematically identify the value-add of different financing products and terms. Where FMO has provided long-term finance (or concessional finance in blended structures), for example, the value of this relative to other forms of financing could be evaluated in different contexts, with the results used to inform the optimal financing structure of investments.
- **Develop specific frameworks to assess Financial Institution additionality,** and use to allocate resources within the sector to maximise additionality. FMO accepts that non-financial additionality is more important for FI investments and has a framework to assess this. We suggest this is developed into a holistic financial sector additionality tool that combines financial and non-financial elements systematically.
- **Ensure the rationale for joining DFI consortia is clearly articulated,** and linked to DFI exit strategy as part of transition to commercial viability, even if this transition is a gradual process, where DFI involvement will remain essential for a long period.

On mobilisation, we find that:

- It is important to recognise trade-offs between additionality and mobilisation. Investment in high-risk environments are likely to be additional, but also the most difficult to mobilise private capital.
- While not always a priority, in every FMO investment we find evidence of successful mobilisation. In more challenging environments, mobilisation is more likely to involve other DFIs.
- In some cases reviewed, FMO did not claim mobilisation which may have been significant despite not being 'provable'. These more subtle effects may be a very significant form of mobilisation.
- An increasingly important way of addressing the trade-off described above is with blended finance, which can be used to improve the risk-return characteristics of transactions, and mobilise private investment enabling investees to become commercially viable.

- There is a risk that concessional finance does not enable a commercial transition, but instead supports non-viable enterprises, wasting scarce financial resources, or that it supports commercially viable enterprises, distorting market development. FMO has significant experience to help mitigate this risk.
- Mobilising capital from institutional investors needs bigger tickets. In most cases, large pension funds would only invest at scales above FMOs current operations.
- FMO-IM is a clear example of crowding in (i.e. financial additionality), as these investors are typically unfamiliar with these markets, and are only prepared to invest because of the comfort provided by FMO and its experience with these types of investments. They are only likely to be interested in a sub-set of the investments FMO would want to make.
- Mobilising domestic investment would be assisted by a local presence in partner countries through local offices or formal relationships with local partners at either national or regional level. This would also support other strategic objectives.

Mobilisation recommendations:

- **Develop disaggregated mobilisation strategy linked to strategic objectives**, where capital from different types of development actors over differing time frames is targeted systematically.
- **Initiate research to better understand FMO's indirect mobilisation effects, for example through demonstration effects,** and develop long-term strategy to build upon this tailored to different country contexts.
- **Expand FMO-IM suite of funds** to link investors with different risk appetites, ticket sizes and investment modalities with identified investment gaps and the SDGs (whilst ensuring not to distort the market of private, commercial service providers).
- **Develop strategies and local partnerships,** including considering the option of establishing local offices where feasible and desirable, aimed at raising mobilisation of local investment without distorting local markets.

On development impact, we find that:

- FMO's approach to impact monitoring evolved significantly over the period of the review and has subsequently improved further. As is usual among DFIs, links between reported impacts and FMO's activities remain weak.
- The introduction of 'green' and 'reducing inequalities' labels had a strong effect on investment decisions, which is likely to have increased impact.
- FMO's model produces a partial view of impact, particularly for AFW investments where impacts appear underestimated. The new JIM is likely to correct current issues and add further value from being open source.
- There is a difficult balance to strike between achieving positive impacts and reducing negative ones. In West Africa Case Study Country, for example, FMO can reduce negative impacts by encouraging banks to reduce their exposure to the oil and gas sector. Alternatively, FMO could focus on supporting financial institutions that do not have such exposures and, for example, target the SME sector. This would exclude them from the West Africa Case Study Country banking sector, however, where all banks have significant oil and gas exposure.
- Concessional funds in blended finance structures have the potential to increase impact but need to be used carefully. Blended finance enables projects to happen that otherwise would not take place. Many have high impacts, but as one interviewee put it, if they fail, the impact is a one-off that is neither scaled nor replicated. Distinguishing between investments that will never be commercially viable and

those that could be viable with the support of concessional finance at a key stage, is an extremely difficult task, but not an impossible one.

Development impact recommendations:

- **Ensure impact measurement frameworks accurately capture the full range of impacts**, and use these frameworks to direct *ex ante* project selection. Indicators should be relatively few, sector-specific, consistently maintained over the long-term and derived from a structured ToC development process.
- **Develop a 'green' and 'reducing inequalities' label approach** to incentivise maximisation in both areas, i.e. a scoring system to capture and promote the degree of 'greenness', for example.
- **Integrate the Joint Impact Model into decision-making framework as far as possible.** The current model has not been used to inform decision-making due to its limitations, particularly the fact that its accuracy is greatest at the portfolio level. While this problem will remain with the JIM it should be reduced due to improvements in the model. More generally, a powerful and accurate model that can capture both direct and indirect impacts should have some usefulness in decision-making as well as reporting.

On E&S risks and non-financial additionality, we find that:

- FMO remains a leading DFI on E&S issues.
- FMO's sector initiatives bring particular value.
- Supporting E&S improvements through Technical Assistance is necessary in some cases.
- FMO's incremental approach to E&S has value but needs to be better communicated.
- Engaging with a wider set of stakeholders rather than relying on clients for information is crucial to identifying and managing E&S risks.
- A more open, self-reflective approach to E&S, including discussing where things went wrong, is an important way of building understanding of the trade-offs FMO has to manage.
- FMO's Independent Complaints Mechanism is a valuable innovation that is unusual among DFIs, but could have greater visibility amongst local stakeholders and more could be done to ensure that initial recommendations are followed up on and documented.
- FMO recognises that it needs to have better visibility of E&S issues at portfolio level.

E&S and non-financial additionality recommendations:

- **Adopt an open and self-reflective approach to E&S issues**, which engages with a wide range of stakeholders in the Netherlands and partner countries, examines the trade-offs facing FMO, and communicates more clearly the value of its incremental approach to E&S.
- **Develop the sector initiative approach systematically,** based upon an assessment of sectors where raising E&S standards has high potential impacts but may come at a short-term cost for implemented firms. Consider prioritising sectors where FMO is likely to invest less in the future but where has significant E&S experience (e.g. large-scale energy)
- **Develop FMO's E&S capacity in key partner countries** to engage proactively with stakeholders (including pre-investment), and identify and mitigate E&S risks more effectively. This can be done directly with a presence on the ground or through local partners. While the latter may make more sense in terms of available resources, there is a case for a dedicated FMO presence in country (and/or region) in areas that are strategic priorities for FMO, and Dutch development cooperation broadly.
- **Publicise widely, and require investees to publicise widely, the existence of the Independent Complaints Mechanism in the local language** of the countries of operation.

- **Continue to lead on E&S issues with the DFI community** and take the lead on Dutch priority issues such as human rights. Engage with Dutch and partner country stakeholders on a regular basis to help set priorities in this regard.

On FMO's future strategic positioning, we find that:

- FMO strategic sector focus brings significant value.
- FMO sector staff expect to focus on more impact-focused projects in more challenging investment environments.
- This would be likely to increase the risk level of the portfolio and FMO staff expect the use of blended finance to increase in order to support this increased risk.
- There is a potential trade-off between these changes and the goal of mobilising investment from large institutional investment.
- Both risk effects and the trade-offs described could be addressed by balancing the portfolio with larger, more commercially attractive investments elsewhere, or by increasing the overall level of risk in the portfolio.
- Increased use of concessional funds (i.e. greater blending of government funds with the A portfolio) could enable FMO to absorb more risk if carefully managed.
- More broadly, blended finance has the potential to overcome the trade-offs facing FMO in its parallel objectives of additionality, impact, mobilisation and returns, but only if a more systematic and coordinated approach is developed.
- FMO would be well placed to lead an international initiative through the DFI Working Group to develop a framework to operationalise existing principles of the Working Group.

Future strategy recommendations:

- **Undertake ToC process to refresh strategy** in terms of sector prioritisation (FMO level ToC) and within target sectors (sector-level ToC).
- **Link outcomes of processes to options for either maintaining the same level of risk through diversification or increasing the overall level of risk.**
- **Expand the use of blended finance products in line with preferred options** to support mobilisation in more challenging environments.
- **Develop a robust blended finance framework** to operationalise principles of the DFI Working Group on Concessional Blended Finance. To ensure that the risks associated with blended finance are mitigated a systematic framework is needed for all DFIs that: (i) accurately measures the degree of concessionality (including non-financial); (ii) designs structures to systematically minimise concessionality; and (iii) incorporates dynamic elements to taper the degree of concessionality over time as part of the transition to commercial viability.
- **Ensure that FMO has the necessary commercial and institutional culture, and experience of blended finance required to lead this process within the DFI community.**
- **Ensure that FMO has the resourcing required to meet the E&S recommendations outlined.**
- **Ensure that FMO structures are compatible with strategy.** FMO is constrained in its operations by international and national regulatory frameworks, for example on the amount of regulatory capital it must set aside for its operations. As these frameworks change, e.g. as Basel IV takes effect, FMO will need to ensure its structures continue to enable it to pursue its objectives effectively.
- **Ensure E&S capacity expands as needed to address any increased activities in challenging environments.**

Annex A: E&S Benchmarking

The following sets out an analysis of FMO's approach to the management environmental, social and governance (E&S) risk, benchmarked against international best practice and peer institutions (CDC, Proparco, DEG and AfDB). Stakeholder feedback has been incorporated from interviews conducted with staff, clients, partners and NGOs, and recommendations for future improvements to E&S management are set out.

Best practice in E&S policy

No single set of guidelines exist for best practice on DFI E&S policy, with most DFI's seeking to adhere to a wide range of norms and standards as set by international organisations such as the IFC, ILO, UN, World Bank, OECD and others. However, within this array of E&S standards, most DFIs consider the IFC's Performance Standards (IFC PS) to be the primary set of guidelines for E&S risk management.

The IFC PS is comprised of eight standards which clients (both direct investee businesses and financial intermediaries) are expected to comply with. The first standard relates to overall risk management systems, with standards two–eight detailing expected performance on a number of specific topics (labour, resource efficiency, community, land resettlement, biodiversity, indigenous peoples, and cultural heritage).

The IFC PS are the primary set of standards referenced in EDFI Principles for Responsible Financing of Sustainable Development, to which FMO subscribes.

FMO's approach to managing E&S risk

E&S policies

FMO's approach to managing E&S risk involves a range of policies and tools that together form the FMO Sustainability Policy Universe. Published in 2016, FMO's current Sustainability Policy is the guiding document within this framework, setting out the vision, principles, and guide for operational implementation of E&S risk management. The primary standards at the heart of the Sustainability Policy are the IFC PS and World Bank Group Environmental Health and Safety Guidelines, although a range of other international standards and policies are also adhered to.[286]

Alongside the Sustainability Policy itself, other key components of the Sustainability Policy Universe include:

- Position statements: setting out FMO's stance on a range of specific issues such as gender, human rights, animal welfare, etc.
- Exclusion list: setting out no-go investment areas (e.g. child labour or forced labour, the destruction of high-value conservation areas, etc.).
- Disclosure policy: setting out the guidelines for disclosing details of investments to the public (including for a period of 30 days prior to contract signing).
- Complaints mechanism: for clients and communities.

[286] Including the Equator Principles, OECD Guidelines on Multinational Enterprises, UN Guiding Principles on Business and Human Rights, ILO Declaration on Fundamental Principles and Rights at Work, UN Principles for Responsible Investment, EDFI Principles for Responsible Financing, G20/OECD Principles of Corporate Governance/Dutch Corporate Governance Code, and SMART Campaign Client Protection Principles.

- E&S governance: detailing the processes and protocols used to manage E&S risk, including client environmental and social action plans (ESAPs), internal FMO targets and monitoring of E&S performance, FMO E&S team structure and staffing and stakeholder engagement processes.

E&S in practice

In practice, E&S management at FMO is woven into the entire investment process (Figure 23). At the client selection stage initial checks are carried out against the exclusion list. An initial desk-based E&S risk assessment is conducted during the clearance in principle (CIP) stage, drawing on information from the client, publicly available online information, knowledge of the country and sector and local intelligence from civil society stakeholders, embassies and other partners.

Figure 23: The investment process

This information is used to check the potential investment against the IFC-PS, before an initial risk categorisation is assigned. Direct investments are graded: A ('potential significant adverse risks'), B+ ('potential adverse risks'), B ('potential limited adverse risk'), or C ('minimal or no adverse risk'). Financial intermediaries (FI) are assessed on their overall existing or proposed portfolio, and categorised as FI-A, FI-B, or FI-C, with A again representing the high risk and C representing minimal or no risk. Private equity (PE) funds are given a risk categorisation of: A if >15% of the fund is invested (or will be) in businesses graded A or B+, and B if this figure is <15%. Higher risk investments (typically A or B+-rated investments and their FI or PE equivalents) are assigned a dedicated Environmental and Social Officer (ESO) who leads on E&S risk appraisal and management.

The initial risk assessment at the CIP stage serves to inform the design of the due diligence stage, highlighting areas for further investigation. Due diligence will almost always involve a field visit by FMO staff, and independent consultants will be hired to conduct third party risk assessments. ESAPs will be developed and negotiated as necessary to manage risks, which are built into contractual agreements if the investment goes ahead.

FMO's disclosure policy requires that investment details (including details of the E&S risk categorisation and any IFC performance standards that have been flagged as risk areas) are published at least 30 days prior to contract signing.

Following disbursement, E&S performance is closely monitored by FMOs teams who have internal targets for the overall improvement of portfolio E&S performance. In addition, FMO has developed toolkits for private equity funds and financial intermediaries to monitor and manage E&S risk within their own portfolios.

The development of FMO's E&S policies over time

Over its history FMO has undergone a process of raising its ambitions with respect to E&S management, with corresponding organisational changes seeing internal E&S capacity upgraded and mainstreamed within the organisation. Broadly, the emphasis has shifted from one of basic compliance to one where professional handling of E&S issues is understood as being central to the success of investees, with E&S value addition becoming a key offering of FMO.

E&S first began to be significantly institutionalised within FMO in the early 2000s. In 2006, FMO adopted the IFC-PS as guiding standards, by which point 10 dedicated ESOs were employed at FMO. The 2007–2008 reorganisation at FMO saw E&S staff being moved from back-office to front-office, thereby becoming more directly integrated with the investment process. At the same time, FMO played a leading role in the development of harmonised EDFI E&S standards, and developed its E&S risk management toolkits for private equity funds and microfinance institutions. A Sustainability Team was established and tasked with creating FMO's first Sustainable Development Strategy in 2009–2010.

During the period under review (2013–2018), the Sustainability Team was merged with the Evaluations Team to form the Development Impact and Sustainability Team (DI-SUS, 2015), and a Sustainability Committee (SUSCO) was formed, chaired by the Chief Investment Officer. In 2017 a new matrix management structure was introduced, bolstering E&S capacity across all front-office departments and ensuring that E&S management was a priority across the organisation. Today, some 32 full-time employees are tasked with E&S management at FMO.

E&S policy review

Comparison with peers

A map of FMO's E&S policies against the IFC-PS is set out in Annex B, along with a comparison with the policies of CDC, Proparco, DEG and AfDB.

FMO shares broadly similar approaches to E&S policy as its DFI peers, guided by the IFC-PS. This is particularly true in light of the harmonisation efforts undertaken through EDFI, as well as close collaboration specifically with DEG and Proparco. As a non-DFI comparator, AfDB takes a somewhat different approach and is governed by its Integrated Safeguards System, although the same themes and safeguards are broadly addressed by this framework (see Annex B for details).

Whilst they appear similar on paper, there is a lot of discretion in how these international standards are applied, and understanding the nature and quality of compliance requires a more nuanced assessment.

> *"IFC performance standards are not very prescriptive. They will tell you that you need to consult with local communities, but they don't tell you what tools to use to do that – so you can have a very good, thorough, participatory process with a range of people from the community that it is compliant, but you can also do something a lot less good that is still compliant."*
>
> Investment case study interviewee

Interviews with peer DFIs revealed a generally positive view of FMO's work on E&S management. Most notably, other DFIs frequently mentioned the relatively high level of E&S resources that FMO have at its disposal, with FMO having almost double the E&S capacity of some similarly sized DFIs. These extra resources allow FMO's E&S staff to invest more time in building direct personal relationships with their clients rather than relying predominantly upon external consultants; they are also able to spend more time in the field conducting site visits and getting to understand E&S issues in person, and also to be more ambitious in its plans to develop the E&S capacity of clients through ESAPs and technical assistance.

FMO is also known for its philosophy of seeing E&S as central to its business model and its clients' business models, rather than a compliance issue. As well as the resources noted above, the team structure at FMO, with E&S staff embedded in front-office investment teams, helps to ensure that E&S is a central function of any deal.

On an issue-by-issue basis, the interviewed DFIs do not differ greatly, and all collaborate closely through standard harmonisation efforts of, for example, EDFI, or through co-investment in deals. In the latter case, the lead DFI will take primary responsibility for E&S, with co-investors seeking to verify the findings in order to satisfy their own requirements, but largely being trusting of one another's policies and staff; this is a product of close inter-DFI relationships over the years particularly in the collaboration between FMO, Proparco and DEG.

On occasion, an individual DFI may take a lead on a specific topic, often driven by the political agenda of its own government, but DFIs will tend to collaborate on issues and ultimately harmonise approaches. Peer DFIs noted FMO's additional work on human rights in recent years, seeking to bolster its E&S protocols on the topic with an emphasis on United Nations Guiding Principles (UNGP) on Business and Human Rights. Debate is ongoing in the DFI community as to whether the UNGP framework generates significant value above and beyond the human rights considerations of the IFC-PS.

Findings from investment case studies

Overall, the investment case studies carried out as part of this evaluation in South Asia Case Study Country 1, South Asia Case Study Country 2, West Africa Case Study Country, and East Africa Case Study Country revealed ambitious and diligent E&S work on the part of FMO. In a number of cases, FMO were found to have sought stricter safeguards than partner DFIs in cases where multiple DFIs co-invested.

> *"What I like about FMO is that they are very much involved - other lenders wouldn't visit the site for similar sized projects. They come to the site with us and they discuss with us and they discuss with the client, so I like that."*

Case study interviewee

A number of E&S consultants interviewed as part of the evaluation reported that compared to other organisations, FMO sees E&S and the development and implementation of ESAPs, as part of its core mission rather than as a compliance or 'box ticking' exercise. FMO is perceived as investing above-average resources in E&S, and in making E&S improvement a key priority on each of its deals. One E&S consultant, tasked with annual reviews of a client's progress against its ESAP, reported that despite having fulfilled all of the ESAP criteria FMO asked him to work with the client to find additional ways to improve E&S performance beyond the original ESAP requirements.

> *"Contracts with FMO are different to other lenders, others have a more squeezed budget on E&S. The emphasis on how to improve more beyond compliance is something that FMO brings more than other lenders."*

Case study interviewee

In West Africa, FMO supported a bank in working with the banking regulator to design and implement the Sustainable Banking Principles and continues to support further discussions within the sector on climate change, a clear sign of FMO having ambitions beyond its immediate clients to the wider business environment.

Findings from civil society stakeholders

Many NGOs with environmental and social missions see themselves as 'watchdogs' for DFI investment activities globally, drawing attention to potential risks and negative impacts and advocating on behalf of local communities. Whilst relationships between NGOs and DFIs can at times encounter friction or even conflict, healthy engagement with civil society can also be a major asset to DFIs, with NGOs serving as eyes and ears on the ground in support of E&S goals.

As with most DFIs, the distance between FMO and the E&S risks associated with its investments creates a number of challenges. This is true both in terms of the geographic distance from FMO's European offices to its global investments as well as the distance along the chain of actors within a given deal; FMO is always once or twice removed from the communities and ecosystems affected by its investments.

Access to local intelligence is therefore particularly important when seeking to appraise and monitor E&S risks. The importance of strong relationships with NGOs and other local organisations for the purpose of

E&S monitoring has become particularly apparent to FMO during the COVID-19 pandemic, which has severely restricted FMO staff travel. The increased dependency on client self-reporting during COVID-19 was flagged by NGOs as a significant risk for E&S accountability at present, and yet was also flagged by FMO staff as an opportunity to innovate and strengthen its ties with local partners.

Regardless of the pandemic, routine field visits by FMO staff or independent consultants are limited in their ability to quickly and accurately assess complex social and environmental risks, particularly in the absence of local country offices. Would-be investee hosts naturally have an incentive to portray a positive picture in order to secure investment. Interviewed NGOs were of the view that more proactive engagement with civil society prior to investment could help FMO to tap into vital local knowledge and spot important 'red flags' before becoming unknowingly exposed to significant risks.

The issue of distance also means that affected communities may also not be aware of FMO's involvement in a project (or even aware of who FMO are), which undermines the effectiveness of FMO's grievance mechanisms and disclosure policies. Without knowing where the money comes from communities cannot access these services. It was noted in NGO interviews that investment through financial intermediaries amplifies these issues as FMO is one step further removed from any E&S risk involved. FMO does require that clients have their own grievance mechanisms in place, which should in theory provide communities with a channel for complaints without having to contact FMO, but it is unclear how effective these channels are across the portfolio.

Some NGOs spoke positively about their personal relationships with E&S staff at FMO, noting that frank and honest one-to-one discussions were possible in a way that was not always the case with other DFIs. However, there was a belief that at the institutional level FMO still presents a degree of resistance to scrutiny, as well as a lack of transparency and self-reflection around past mistakes made regarding E&S risk. This was considered to be true of both high-profile cases, such as the 2016 murder of the Honduran activist Berta Cáceres in relation to the proposed Agua Zarca hydroelectric dam, as well as more routine E&S work.

Despite FMO's disclosure policy, a general perception still exists that negative E&S issues are unlikely to be made public in any significant degree of detail unless they are brought to light independently by civil society actors. However, it was also acknowledged that a high degree of transparent self-reflection has the potential to attract disproportionate media attention that could limit the ability of FMO to take risks and deliver on its mandate.

Finally, an issue was also raised around FMO investments in financial intermediaries (particularly larger banks) with significant fossil fuel investments within its portfolios. It was argued that fossil fuel divestment should be a priority for FMO climate change policy going forwards.

Conclusions and recommendations

Overall, FMO's E&S policy framework, the investment case studies conducted for the present evaluation and the views of peer DFIs make a case for FMO as a leading DFI on E&S issues. A well-resourced team and an emphasis on E&S as being central to the business model of both FMO and its clients, supported by significant organisational development around E&S over the period 2013–2018, has placed ambitious E&S goals at the heart of the portfolio. Positive improvements in E&S management and outcomes have been witnessed in a number of clients.

However, like many DFIs, FMO continues to face challenges associated with being a European-based investor with limited on-the-ground presence at the site of its investments. High profile cases such as Agua Zarca have demonstrated the potentially grave consequences of this, but NGOs both in the Netherlands and internationally continue to raise credible E&S concerns about FMO's investments more broadly. Strengthening in-country networks and engaging more pro-actively with civil society and other sources of local knowledge in advance of deals should help FMO to bolster its E&S risk management.

Recommendations:

- Strengthen pro-active engagement with local civil society organisations in advance of deals in order to benefit from nuanced local knowledge and be better able to anticipate and manage risks.
- Continue efforts to increase transparency, with an emphasis on ensuring that affected communities have knowledge of FMO's role in projects and are able to access to grievance mechanisms and disclosed information on investments.
- Conduct reviews on thematic E&S issues (e.g. land rights, gender and climate change) to extract learnings from FMO's experiences managing these specific risks and share best practice with peer DFIs. Whilst sensitivities around some issues may limit what can feasibly be made public, frank acknowledgement of past shortcomings is important for the generation of useful lessons.
- Expand the FMO position statement on coal power to cover other fossil fuels (oil and gas) as part of FMO's broader climate change commitments.

Annex B: Benchmarking against the IFC Performance Standards for E&S risk management

IFC performance standards		*Source documents numbered in square brackets are listed in the 'references' table below*				
Standard	Objectives	FMO	CDC	DEG	Proparco	AfDB
1 **Assessment and Management of Environmental and Social Risks and Impacts**	To **identify and evaluate** environmental and social risks and impacts of the project.	Potential investments are appraised for E&S risk with a desk review at the clearance in principle stage, followed by a more in-depth analysis during the due diligence phase, typically accompanied by a site visit and contracting of independent E&S consultants as necessary [A2].	E&S assessments required for any areas where potential risks relating to IFC PS are identified [B2].	ESG baseline assessments and forecasts carried out by dedicated sustainability team during due diligence and throughout implementation [C1]. Benchmarked against the harmonised EDFI standards, which includes the IFC PS and WBG EHSG [C2].	ESG appraisals conducted prior to investment in line with harmonised ESG guidelines using the IFC PS framework [D1].	E&S risk is evaluated following the guidelines under Operational Safeguard 1 of the AfDB Integrated Safeguards System [E1] and the guidelines on environmental and social assessment procedures [E4].
	To adopt a **mitigation hierarchy** to anticipate and avoid, or where avoidance is not possible, minimise, and, where residual impacts remain, compensate/offset for risks and impacts to workers, Affected Communities, and the environment. To promote improved environmental and social performance of **clients** through the effective use of **management systems.**	ESAPs are contractually agreed with clients to manage risks and improve ESG performance. Internally, FMO staff is incentivised to improve portfolio ESG performance [A2].	Companies are required to create ESG Action Plans including SMART targets and details of responsibility for implementation, cost, and deadlines [B6]. CDC may provide TA for the development of ESG management systems [B2].	ESAPs are used to improve E&S performance over the lifetime of the investment; TA provided to support investees on E&S performance; regularly monitored E&S risk reported in DEG's Environmental and Social Indicator System (EaSI) [C1].	ESG improvement plans are put in place and monitored to remedy ESG risks and/or offset their impacts; Proparco provides TA as necessary [D1].	Environmental and social management plans (ESMP) and environmental and social management systems are put in place for borrowers and monitored during the course of implementation [E4]. Operational Safeguard 1 describes the mitigation hierarchy of risk avoidance, or if risks cannot be avoided then mitigating or compensating for impacts [E1].
	To ensure that **grievances** from Affected Communities and external communications from other stakeholders are responded to and managed appropriately.	Independent complaints mechanism [A13] allows for clients and/or affected communities to report grievances. Collaboration with Proparco and DEG [C4].	Grievance mechanism and follow-up actions in place [B2].	Independent complaints mechanism in collaboration with FMO and Proparco [C4].	Independent complaints mechanism in collaboration with FMO and DEG [D3].	Borrowers / clients are required to set up local grievance mechanisms under Operational Safeguard 1 of the Integrated Safeguards System [E1].
	To promote and provide means for adequate **engagement with Affected Communities** throughout the project cycle on issues that could potentially affect them and to ensure that relevant environmental and social information is disclosed and disseminated.	Disclosure policy [A16] requires all investments to have their E&S categorisation (A, B+, B, C) and relevant IFC PSs that have been triggered to be published a minimum of 30 days before contract signing.	Stakeholder engagement plans required for any instances where IFC PS may not be met [B2].	Unclear from available documentation.	Unclear from available documentation.	Environmental and social issues relating to projects are made public throughout the Integrated Safeguards Tracking System (ISTS), under the bank's Disclosure and Access to Information policy (OS1) [E1].

IFC performance standards		*Source documents numbered in square brackets are listed in the 'references' table below*				
Standard	Objectives	FMO	CDC	DEG	Proparco	AfDB
2 **Labour and Working Conditions**	To promote the fair treatment, non-discrimination, and equal opportunity of workers.	Child labour/forced labour on Exclusion List (following ILO standards) [A9]. All other topics are assessed as per the process set out above and included in ESAPs as necessary [A2].	Workplace health and safety explicitly protected [B2]. Projects judged to involve relevant issues in this area are required to (a) comply with IFC PS / EHS; (b) develop a stakeholder engagement plan; (c) conduct an E&S assessment; and (d) develop an action plan to comply with the relevant standards within a reasonable timescale [B2]. Non-discrimination labour policy set out [B2]. Minimum wage compliance enforced [B2]. Compliance with ILO standards is promoted [B2]. Child labour/forced labour explicitly excluded; grievance mechanism open to workers; protections for unions and collective bargaining [B2].	Child labour/forced labour excluded under harmonised EDFI exclusion list [C3]. All other topics to be assessed as per process set out above and included in ESAPs as necessary [C1].	Risks are assessed as per the IFC PS guidelines and improvement plans established with clients to reduce and/or offset negative impacts [D1]. Additional guidelines have been put in place for workplace health and safety under COVID-19 [D2].	Risks in this area are covered under Operational Safeguard 5 of the AfDB Integrated Safeguards System ('labour conditions, health and safety') [E1].
	To establish, maintain, and improve the worker-management relationship.					
	To promote compliance with national employment and labour laws.					
	To protect workers, including vulnerable categories of workers such as children, migrant workers, workers engaged by third parties, and workers in the client's supply chain.					
	To promote safe and healthy working conditions, and the health of workers.					
	To avoid the use of forced labour.					

3 **Resource Efficiency and Pollution Prevention**	To avoid or minimise adverse impacts on human health and the environment by avoiding or minimizing pollution from project activities.	Hazardous substances (including ozone depleting substances, PCBs, radioactive materials, asbestos, other hazardous chemicals) on Exclusion List [A9]. All other topics are assessed as per the process set out above and included in ESAPs as necessary [A2].	Business related to ozone depleting substances; hazardous chemicals, pesticides, waste, pharmaceuticals; asbestos; radioactive materials are excluded [B2]. Projects judged to involve relevant issues in this area are required to (a) comply with IFC PS / EHS; (b) develop a stakeholder engagement plan; (c) conduct an E&S assessment; and (d) develop an action plan to comply with the relevant standards within a reasonable timescale [B2]. Compliance with ISO 14001 (environmental management	Hazardous substances excluded under harmonised EDFI exclusion list [C3]. All other topics to be assessed as per process set out above and included in ESAPs as necessary [C1].	Risks are assessed as per the IFC PS guidelines and improvement plans established with clients to reduce and/or offset negative impacts [D1].	Risks in this area are covered under Operational Safeguard 4 of the AfDB Integrated Safeguards System ('pollution prevention and control, hazardous materials and resource efficiency') [E1].
	To promote more sustainable use of resources, including energy and water.					

IFC performance standards		*Source documents numbered in square brackets are listed in the 'references' table below*				
Standard	Objectives	FMO	CDC	DEG	Proparco	AfDB
	To reduce project-related GHG emissions.		systems) promoted [B2]. Projects must comply with climate change policy [B7] and coal power policy [B8]. Compliance with ISO 14064-65 (on GHG emission accounting and verification) promoted [B2].			
4 **Community Health, Safety, and Security**	To anticipate and avoid adverse impacts on the health and safety of the Affected Community during the project life from both routine and non-routine circumstances. To ensure that the safeguarding of personnel and property is carried out in accordance with relevant human rights principles and in a manner that avoids or minimises risks to the Affected Communities.	Potential risks are assessed as per the process set out above and included in ESAPs as necessary [A2].	Projects judged to involve relevant issues in this area are required to (a) comply with IFC PS / EHS; (b) develop a stakeholder engagement plan; (c) conduct an E&S assessment; (d) develop an action plan to comply with the relevant standards within a reasonable timescale [B2].	Hazardous substances excluded under harmonised EDFI exclusion list [C3]. All other topics to be assessed as per process set out above and included in ESAPs as necessary [C1].	Risks are assessed as per the IFC PS guidelines and improvement plans established with clients to reduce and/or offset negative impacts [D1].	Community impacts are addressed under Operational Safeguard 1 of the Integrated Safeguards System [E1] and guidelines for environmental and social assessments [E4].
5 **Land Acquisition and Involuntary Resettlement**	To avoid, and when avoidance is not possible, minimise displacement by exploring alternative project designs. To avoid forced eviction To anticipate and avoid, or where avoidance is not possible, minimize adverse social and economic impacts from land acquisition or restrictions on land use by (i) providing compensation for loss of assets at replacement costs; and (ii) ensuring that resettlement activities are implemented with appropriate disclosure of information, consultation, and the informed participation of those affected. To improve, or restore, the livelihoods and standards of living of displaced persons. To improve living conditions among physically displaced persons through the provision of adequate housing with security of tenure at resettlement sites.	Potential risks are assessed as per the process set out above and included in ESAPs as necessary [A2].	Projects judged to involve relevant issues in this area are required to (a) comply with IFC PS / EHS; (b) develop a stakeholder engagement plan; (c) conduct an E&S assessment; and (d) develop an action plan to comply with the relevant standards within a reasonable timescale [B2]. Compliance with Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forestry in the Context of National Food Security are encouraged [B2].	All topics to be assessed as per process set out above and included in ESAPs as necessary [C1].	Risks are assessed as per the IFC PS guidelines and improvement plans established with clients to reduce and/or offset negative impacts [D1].	'Risks in this area are covered under Operational Safeguard 2 of the AfDB Integrated Safeguards System ("Involuntary resettlement land acquisition, population displacement and compensation") [E1].'

IFC performance standards		*Source documents numbered in square brackets are listed in the 'references' table below*				
Standard	Objectives	FMO	CDC	DEG	Proparco	AfDB
6 **Biodiversity Conservation and Sustainable Management of Living Natural Resources**	To protect and conserve biodiversity. To maintain the benefits from ecosystem services. To promote the sustainable management of living natural resources through the adoption of practices that integrate conservation needs and development priorities.	Illegal wildlife trade and unsustainable fishing on Exclusion List [A9]. Hazardous substances (including. ozone depleting substances, PCBs, radioactive materials, asbestos, other hazardous chemicals) on Exclusion List [A9].	Projects judged to involve relevant issues in this area are required to (a) comply with IFC PS / EHS; (b) develop a stakeholder engagement plan; (c) conduct an E&S assessment; and (d) develop an action plan to comply with the relevant standards within a reasonable timescale [B2]. Business related to ozone depleting substances; hazardous chemicals, pesticides, waste, pharmaceuticals; asbestos; radioactive materials are excluded [B2]. Illegal wildlife trade and unsustainable fishing are excluded [B2].	Illegal wildlife trade, unsustainable fishing, destruction of high conservation areas excluded under EDFI harmonised exclusion list [C3]. All other topics to be assessed as per process set out above and included in ESAPs as necessary [C1].	Risks are assessed as per the IFC PS guidelines and improvement plans established with clients to reduce and/or offset negative impacts [D1].	Risks in this area are covered under Operational Safeguard 3 of the AfDB Integrated Safeguards System ('biodiversity and ecosystem services') [E1].
7 **Indigenous Peoples**	To ensure that the development process fosters full respect for the human rights, dignity, aspirations, culture, and natural resource-based livelihoods of Indigenous Peoples. To anticipate and avoid adverse impacts of projects on communities of Indigenous Peoples, or when avoidance is not possible, to minimise and/or compensate for such impacts. To promote sustainable development benefits and opportunities for Indigenous Peoples in a culturally appropriate manner. To establish and maintain an ongoing relationship based on Informed Consultation and Participation (ICP) with the Indigenous Peoples affected by a project throughout the project's life-cycle. To ensure the Free, Prior, and Informed Consent (FPIC) of the Affected Communities of Indigenous Peoples when the circumstances described in this Performance Standard are present.	Potential risks are assessed as per the process set out above and included in ESAPs as necessary [A2].	Projects judged to involve relevant issues in this area are required to (a) comply with IFC PS / EHS; (b) develop a stakeholder engagement plan; (c) conduct an E&S assessment; (d) develop an action plan to comply with the relevant standards within a reasonable timescale [B2].	All topics to be assessed as per process set out above and included in ESAPs as necessary [C1].	Risks are assessed as per the IFC PS guidelines and improvement plans established with clients to reduce and/or offset negative impacts [D1].	Impact on indigenous people is addressed under Operational Safeguard 1 of the Integrated Safeguards System [E1] and guidelines on social and environmental assessment [E4].

IFC performance standards		*Source documents numbered in square brackets are listed in the 'references' table below*				
Standard	Objectives	FMO	CDC	DEG	Proparco	AfDB
	To respect and preserve the culture, knowledge, and practices of Indigenous Peoples.					
8 **Cultural Heritage**	To protect cultural heritage from the adverse impacts of project activities and support its preservation. To promote the equitable sharing of benefits from the use of cultural heritage.	Potential risks are assessed as per the process set out above and included in ESAPs as necessary [A2].	Projects judged to involve relevant issues in this area are required to (a) comply with IFC PS / EHS; (b) develop a stakeholder engagement plan; (c) conduct an E&S assessment; (d) develop an action plan to comply with the relevant standards within a reasonable timescale [B2].	All topics to be assessed as per process set out above and included in ESAPs as necessary [C1].	Risks are assessed as per the IFC PS guidelines and improvement plans established with clients to reduce and/or offset negative impacts [D1].	Cultural heritage is addressed under Operational Safeguard 1 of the Integrated Safeguards System [E1].

References for E&S benchmarking

Reference in text	Title	Year
FMO		
A1	FMO sustainability policy universe	2016
A2	FMO sustainability policy	2016
A3	Implementing FMO's sustainability policy	
A4	Sustainability policy - from compliance to value add	
A5	History of Sustainability and ESG at FMO	2019
A6	The value-add approach	
A7	Risk appetite framework	2020
A8	Risk and Capital Adequacy Report 2020-Q1	2020
A9	Exclusion list	
A10	Impact and ESG high-level organisational overview	2019
A11	ESG performance tracker - Guidance for the assessment of the performance level using the ESG Performance Tracker	2018
A12	ESG performance tracker - Process manual	2018
A13	Independent complaints mechanism policy	2017
A14	Independent complaints mechanism - Guide for complainants/communities	2017
A15	Independent complaints mechanism - Guide for FMO clients	2017
A16	Disclosure policy	
A17	Disclosure statement	
A18	Disclosure FAQs	
A19	Client disclosure policy/procedure	2016
A20	General investment criteria	
A21	Position statement - Animal welfare	
A22	Position statement - Gender	
A23	Position statement - Human rights	
A24	Position statement - Land governance	
A25	Position statement - Coal	
A26	Position statement - Hydro power	
A27	Position statement - Responsible tax	
A28	Position statement - Conflict of interest	
A29	Position statement - Anti-bribery and corruption	
A30	Position statement - Know your customer and anti-money laundering	
A31	Human rights - An integral part of our investment approach - Progress report (Oct 2017-Sep 2018)	2019
A32	Supporting the Dutch private sector in implementing responsible business conduct in its international activities - Evaluation of RBC frameworks for private sector instruments	2019
A33	FMO annual report (2019)	2019
A34	FMO ESG Toolkit	
A35	SRQ ESG Toolkit - Data	
A36	2018 Corporate Governance Toolkit - Banks NBFIs and MFIs	
A37	Manual for Corporate Governance Toolkit - FI	
A38	Corporate Governance Toolkit for Corporates	
A39	Manual Corporate Governance Toolkit for Corporates	
A40	FMOs MFI Sustainability Guidance	
CDC		
B1	Investment policy (2017-2021)	2017
B2	Code of responsible investing	2017

B3	Environmental and social checklist	2015
B4	Risk management policy	2020
B5	Template for an annual ESG report	
B6	ESG action plan template	
B7	Climate change policy	2014
B8	Policy on coal-fired power generation	2014
DEG		
C1	Disclosure statement - operating principles for impact management	2020
C2	DEG guideline for environmental and social sustainability	
C3	Harmonised EDFI exclusion list	2011
C4	Independent complaints mechanism	
Proparco		
D1	Sustainable development report - analysis of the results and impacts of projects financed in 2018	2018
D2	Good practices for environmental and social management and corporate governance during the COVID-19 crisis	2020
D3	Independent complaints mechanism	2019
AfDB		
E1	Integrated safeguards system - policy statement and operational safeguards	2013
E2	Assessment of the use of ’Country Systems’ for environmental and social safeguards and their implications for AfDB-financed operations in Africa	2015
E3	The African Development Bank’s involuntary resettlement policy: Review of implementation	2015
E4	Environmental and Social Assessment Procedures (ESAP)	2015
E5	Integrated Safeguards System Guidance Materials - Volume 1: General Guidance on Implementation of OS 1	2015
E6	Integrated Safeguards System Guidance Materials - Volume 2: Guidance on Safeguard Issues	2015
E7	Integrated Safeguards System Guidance Materials - Volume 3: Sector Keysheets	2015
E8	Disclosure and access to information - The policy	2012

Annex C: Review of FMO's Independent Complaints Mechanism

6 Total complaints received by FMO in the period 2014-2018

4 Complaint admissibility confirmed

2 Complaint admissibility denied

3 Complaints from the energy sector

1 Complaint from the logistics sector

3 Complaints from Africa (Senegal, Togo)

1 Complaint from Central America (Panama)

3 Complaints under monitoring

1 Complaint under compliance review

As part of their commitment to act responsibly and transparently, FMO and DEG established the Independent Complaint Mechanism (ICM) in 2014, to ensure individuals and communities who believe to have been negatively affected by an FMO/DEG investment have the right to be heard. Proparco joined the mechanism in 2019. The ICM consists of the Complaints Offices of FMO, DEG and Proparco and an Independent Expert Panel (IEP), composed of three independent members appointed for a period of four years. The IEP assesses the admissibility of complaints, conducts preliminary reviews and either performs a compliance review or supports a mediation according with ICM policy.

Complaints are filed by communities or individuals through an email address which can be found on FMO's website. International NGOs help individuals, groups or communities file the complaints. Complaints can be filed in any language.

We understand from having interviewed a senior member of the Independent Complaints Mechanism that FMO received six complaints in the period between 2014 and 2018, and two additional complaints between 2019 and 2020. Up until 2018, only four complaints were deemed to be admissible for review and they relate to issues on land rights, as well as negative environmental and social impacts. The complaints are handled by the DFIs' complaints offices and the IEP. Complaints are first received by the Complaint Departments, which handle all types of grievances. Due to the limited caseload, there is not a separate department that deals with this type of grievance. The complaints are then forwarded to the IEP, which assesses the admissibility of the complaint before starting a review. This assessment has to be done within 25 working days of receipt of the complaint, and it involves criteria such as: FMO's active relationship with the client, presence of detrimental effects of investment in communities/environment.

Some complaints are not deemed admissible for further review and investigation because they relate to financial misconduct, rather than issues related to ESG and human rights. These types of complaints are passed on to the compliance department instead. In other cases, the complainant ceases to respond to FMO's requests for additional information, or the complaint refers to an investment where FMO is not in the lead.

All the complaints received by FMO to date are related to FMO's non-compliance to its internal policies. If a complaint is deemed admissible, the panel conducts a thorough review of all the available documents for the client, involving FMO Investment Officers, as well as complainants. The panel then conducts a field visit to interview a variety of stakeholders, including client's local management, ESG specialists, local communities, and other relevant stakeholders. At the end of this investigation, the IEP publishes a report focusing on the potential non-compliance of FMO. After the publication, the independent panel conducts monitoring of activities one year later, which may include a review of documentation, further desk research and in some exceptional cases additional field visits.

For example, in 2016 the ICM received two complaints for Sendou I, a coal-fired plant project in Senegal, related to alleged issues on relocation and resettlement, environmental impacts such as air pollution, health impacts and lack of compensation for loss of land. The complainants asked the ICM to undertake a compliance review and a mediation process. The following year, the IEP produced a compliance review report highlighting where FMO's environmental and social policies had not been applied and issued a monitoring report assessing the actions needed to bring the project into compliance.287 A 2020 update288 on the monitoring of FMO's non-compliances (related to this project) highlights that limited progress has been made and further monitoring is needed to assess FMO's compliance on issues related to access to drinking water, marine impacts, coal transport, air quality, land rights issues and the impact of economic displacement on fish-drying women.

Of the other two complaints submitted to FMO, the complaint in relation to Lome Container Terminal submitted in 2018 does not have monitoring reports available on the website. The complaint related to the Barro Blanco Hydroelectric Project in Panama was monitored from 2014 to 2017 (in line with the policy to follow-up for three years). The 2017 monitoring report of this complaint mentions developments related to better engagement and communication between FMO, the co-investor (DEG), affected communities and their representatives. However, the report also expressed outstanding concerns around the impact of the test flooding on local communities, shoreline and gallery forest. The report notes that although FMO and DEG made an ex-post plan to mitigate the impact of the flooding, the plan came a significant time after the flood and its effects had already impacted communities and nature irreversibly. The report concludes that given the seriousness of the concerns, the IEP intended to continue the monitoring of this project. However, to date there are no updates available publicly.

In conclusion, for each of the four admissible complaints, there is either insufficient progress or insufficient documentation of progress made since the complaint has been made.

The ICM is a relatively new complaint mechanism and it has evolved over time to adapt to some of the challenges that it was facing. For example, in 2017 the ICM revised their policy, establishing clear timelines for the admissibility assessment (25 working days), lowering barriers to file complaints (any language is admitted) and outlining further the monitoring mechanisms. It was established that monitoring by the IEP should only last for a period of three years and should focus on instances of non-compliance, developing actions to address potential gaps.

It was reported that other European DFIs do not have a similar complaint mechanism which includes an independent panel in charge of assessing the complaints. Other DFIs normally have complaints departments that deal with these types of complaints without the specific expertise needed to assess the complaint, brought to the ICM by the independent panel.

However, we understand from a series of interviews with NGOs, that despite FMO's efforts to lower the thresholds for submitting complaints, there are still significant improvements needed to communicate the existence of this mechanism to affected communities and/or individuals. For example, clients are currently not required to disclose the existence of the mechanism when a project is open. Ensuring that

[287] ICM (2020) Annual Report, DEG/FMO/Proparco Independent Complaints Mechanism, July 2018 – December 2019

[288] FMO, Independent complaints mechanism https://www.fmo.nl/independent-complaints-mechanism

there is clear communication about the availability of the complaint mechanism would increase transparency and guarantee access to grievance mechanisms for affected communities and individuals.

Annex D: FMO Interviewees for the Process Review

Name	Role (held at the time of interview)
Pieter van Mierlo	CEO
Linda Broekhuizen	CIO
Huub Cornelissen	Director, Credit, Legal and Special Operations
Tony Bakels	Manager, Credit
David Kuijper	Manager, Public Investment Management
Yvonne Bakkum	Director, FMO Investment Management (FIM)
Jorim Schraven	Director, IESG
Huib-Jan de Ruijter	Director, FI Department
Frederik van Pallandt	Director
Pieternel Boogaard	Director, AFW
Jaap Reinking	Director, Private Equity
Jacco Knotnerus	Former Strategy Director
Chantal Korteweg	Strategy Director
Erin Court	Senior E&S Adviser, Credit
Jeroen Horsten	Financial Risk Manager

Annex E: Evaluation Matrix

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
Portfolio statistics: EQ1. How has FMO's Portfolio Developed?							
A. How has FMO-A's portfolio developed between 2013 - 2018 in terms of size and sector of businesses, countries and regions, client type, product type, financing of technical assistance?	X	X			Portfolio characteristics: trends in the development of the portfolio by key investment characteristics.	Portfolio typology indicators.	FMO investment data. Previous evaluations of agreement between FMO and the State Sector evaluations. Interviews with FMO employees.
B. What is the composition of the financial return in terms of size of investment, countries and regions, product type, and distribution over the investments?	X				Descriptive trends in the development of the portfolio by key investment characteristics.	Financial return indicators; portfolio typology indicators.	FMO investment data. FMO annual reports Interviews with FMO employees.

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
C. What is the relation between development impact and financial return, and how does this vary by context? How does this vary when definition of impact is broadened and time horizons are lengthened?	X				Descriptive analysis of financial returns measured against development impact ratings, mapped onto 'impact/financial return' matrix, with further segmentation by risk profile, size, region, product type etc.	Development Impact metrics (whole portfolio); Financial return indicators; broadened impact metrics; lengthened return estimates; Portfolio typology indicators.	FMO investment data. FMO annual reports. Interviews with FMO staff. Interviews with Steward Redqueen.
Effectiveness, relevance and impact: EQ2. To what extent has FMO contributed to the advancement of productive enterprises in developing countries and to inclusive development?							
A. What have been the direct and indirect effects on sustainable development?	X		X	X	Investment types with high and low levels of impact (in terms of jobs supported, implementation of ESG principles, and greenhouse gas reduction).	Total portfolio-wide impact and impact by investment types.	FMO investment data. Interviews with FMO employees. Sector evaluations Field visits to investee firms.

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
B. Does FMO maximize development impact per invested euro, given the required financial return? How does FMO operationalize this?	X	X		X	1. Value for money offered by FMO portfolio, benchmarked against other DFIs. 2. FMO's policies and procedures to maximise value for money.	1. Ratio of impact to invested amount, in total and divided by investment types. 2. Relevance and effectiveness of FMO policies and decision-making processes to maximise impact per invested euros.	FMO investment data. Interviews with FMO employees. Field visits to investee firms Investment case templates / Impact cards.
C. Is FMO's development impact management fit for purpose?		X	X	X	1. FMO's approach to setting development targets. 2.FMO's engagement with stakeholders 3.FMO's approach to continuously learn	1. Quality of FMO's policies and processes to set targets. 2. Quality of FMO's engagement strategy. 3. Quality of FMO's policies and processes to	Investment case templates /Impact cards. Interviews with FMO ESG team. Interviews with FMO employees. Interviews with government and other stakeholders,

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
						continuously learn.	including private investors. Review of previous evaluations as well as annual reviews from Govt.
D. How does FMO ensure that benefits accrue to underserved sections of a society?		X	X	X	FMO's policies, procedures and due diligence to achieve equity.	Quality of FMO's policies and due diligence/documentation in awarding investments.	Investment case templates / Impact cards. Interviews with FMO employees. Field interviews.
E. What is the quality of FMO's indicators and impact data, how did the quality develop during the evaluation period, how can they be used to measure effectiveness and impact?		X	X	X	FMO's ability to capture and communicate the impact of its work; peer analysis against other DFIs, as well as against the standard of measurement among impact investors (i.e. the GIIN), trade-offs associated with capturing	Quality of FMO's policies and processes to capture impact and completeness of data at portfolio level.	FMO investment data. Investment case templates/Impact cards. Interviews with FMO employees.

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
					more detailed impact data.		Interviews with other stakeholders.
F. What has been the role of the Dutch State in ensuring that FMO maintains a good balance between risk, development results and financial targets?		X			Strategic guidance and oversight provided by MoFA and other organisations.	Quality of Dutch State's policies and processes to balance risk, development results and financial returns.	
G. How does FMO's banking license contribute to its mandate? Is FMO's current set-up the correct form to execute its mandate?		X			1. SWOT analysis of FMOs banking licence against Basel Principles. 2. Mapping of banking licence requirements to FMO activities.	Determination of the pros and cons of FMO's banking license on the types of financing that FMO is able to provide, and the implications for the overall portfolio.	Review of FMO documents. Review of Basel documents. Interviews with FMO employees. Interviews with MoFA employees.
Additionality: EQ3. To what extent would other commercial or private investors be available for FMO-investments?							

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
A. Are investments in line with the policy principle of additionality and how has FMO operationalised this? i. What are FMO's incentives to be additional and innovative? ii. How does FMO determine minimum levels of additionality? iii. Which type of investments had high/low levels of financial additionality (in terms of sectors, currency, product type, client type, countries and regions, etc.)? What is the relationship between high/low levels of additionality, risk and financial return?	X	X	X	X	Investment types with high and low levels of additionality.	% investments with additionality cases by investment type (further explored in case studies).	FMO impact card data. Investment committee documentation (to fill gaps).
					Relationship between additionality, risk and return.	Additionality rating by level of risk and return (organised by investment 'categories').	FMO investment data. Interviews with FMO employees.
					Benchmarking of FMO investments against others.	Number/value of investments per sector (by FMO, other DFI and private).	FMO investment data. Data from other DFIs.
					Incentives for FMO to be additional and innovative.	Quality assessment of FMO's incentives of being additional within investments.	FMO investment data.

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
					FMO’s policies and processes to ensure minimum levels of additionality.	Number/quality of use of additionality scores in Investment Committee Templates.	Investment case templates / Impact cards. Interviews with FMO employees.
					Could investee firms have accessed finance from other sources?	Ability to access private finance at (i) sufficient scale and (ii) acceptable terms.	Interviews with FMO/MoFA employees. Field visits to investee firms.
					Triangulating FMO investments with commercial viability of other investments.	Average length of FMO loan terms vs. others.	Document review of Investment Committee Documentation Secondary data on market (terms, rates etc.)
B. How does FMO ensure its additionality in a rapidly changing market environment with more private players entering the market?	X	X	X	X	FMO’s strategy to maintain its additionality in a rapidly evolving market place for investment finance.	Quality assessment of FMOs additionality relative to other market actors.	Data review of additionality within the investment portfolio. Document review of Investment

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
							Committee Documentation Secondary data on market (terms, rates etc.) to determine form of additionality Interviews with FMO and External Stakeholders.
C. Does FMO benchmark its additionality versus other DFIs and does it seek to be an innovator in the field of additionality within this group?		X			FMO's policies and processes to benchmark additionality vs. other DFIs.	Quality of FMO benchmarking and additionality strategy vs. others.	
D. What is FMO's non-financial additionality and its value-added to FMO clients compared to other DFI's and market parties?		X	X	X	Non-financial advisory services provided by FMO.	Quality/type of FMO services vs. others.	Interviews with FMO employees. Interviews with employees of other DFIs. Field visits to investee firms.
Catalysing role: EQ4. To what extent do FMO's investments catalyse additional (private) resources?							

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
A. What kind of blended-finance structures does FMO engage in and how has this developed?			X	X	Longitudinal review of portfolio in looking at blended finance instrument growth between periods.	Assessment of: 1. The changing composition of blended finance in the portfolio. 2. A separation out of the types of blended-finance structures by typology. 3. Assessment of the quality of those blended finance instruments through interviews and review of process and policy documentation.	FMO investment data /impact card data.

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
B. To what extent do FMO's investments catalyse additional (private) resources? i. To what degree does FMO attract co-financing on project level?	X		X	X	Degree to which FMO attracts co-financing at the project level.	Ratio and quantum of co-financing by investment recipients (by investment characteristic).	FMO investment data (OECD/MDB reporting on mobilisation)/ impact card data. Field interviews Co-investor interviews (where possible).
ii. Which type of investments work best in catalysing resources from third party financiers (other DFI's and private financiers)?	X		X	X	Types of investment which are most effective in catalysing resources from third party financiers (other DFI's and private financiers).	Ratio and quantum of co-financing by third parties (by investment characteristic).	FMO investment data. (OECD/MDB mobilisation reporting, separated out by deal and actors involved)/ impact card data. Field interviews Co-investor interviews (where possible).

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
iii. What are the consequences of catalysing on the additionality and risk-profile of FMO clients?		X	X	X	Potential consequences for the additionality and risk-profile of FMO clients.	FMO investment data. (OECD/MDB reporting on mobilisation, separated out by deal & actors involved)/impact card data. Review of policies regarding third-party capital mobilisation, and counter-party risk; assessment of whether third-parties are also engaging in ’additionality’ behaviour (i.e. other DFIs/impact investors).	FMO investment data/impact card data. Field interviews.

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
FMO's role as fund manager: EQ5. How do the State funds influence FMO’s own portfolio FMO-A?							
A. How do the State funds influence FMO’s own portfolio FMO-A?		X			Influence of state funds in investment decision-making. Purchase of state fund assets by FMO-A portfolio. Influence on FMO-A portfolio decision-making of existence of state funds.	Number and distribution of state fund exits facilitated by FMO-A investments.	FMO investment data. Interviews with FMO staff.
EQ6. How should FMO position itself in the evolving development finance landscape to maximise synergies between the goals of additionality, mobilisation and impact?							
A. How should FMO position itself in the evolving development finance landscape to maximise synergies between the goals of additionality, mobilisation and impact?	X	X	X	X	Given landscape and FMO CA - to: 1. Maximise development impact (holistically defined). 2. Optimise financial returns (over appropriate time frame).	1. Impact data (narrow and broad). 2. Returns data (normal and long). 3. Quadrant analysis of role of context.	Evidence from EQs 1-5 Review of global finance landscape. Key informant interviews. Knowledge of research team.

Evaluation question	Portfolio Analysis	Process Review	Desk Review	Case Studies	Criteria	Indicators	Data Sources
					3. Minimise trade-offs between impacts and returns. 4. Optimise mobilisation, given context and time horizons. 5. Maximise additionality.	4. Mobilisation data. 5. Characteristics of the global development finance landscape.	

Annex F: Terms of Reference

ToR Evaluation
agreement State-FMC

Itad is a global organisation. Our strategy, monitoring, evaluation and learning services work to make international development more effective. We generate evidence on important issues – from malnutrition to migration – to support our partners to make informed decisions and improve lives.

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