From: Pierre Harkay & Luuk Zonneveld
To: BIO Board of Directors, for its meeting on April 30, 2019
Date: April 24th, 2019
For: approval

A case study evaluation of five BIO financial sector investments in Ecuador and Peru: Management Response to the evaluation's conclusions and recommendations

BIO's management contract with the Belgian State foresees that BIO commissions an annual evaluation on its ongoing and/or exited interventions. For this year's evaluation, it was decided to focus on [five BIO financial sector investments in Ecuador and Peru. The evaluation assessed:

- What are the development outcomes of the activities of the institutions, including economic, social and environmental outcomes as well as in the broader framework of the Sustainable Development Goals?
- What has been BIO's additionality and added value to the development outcomes?

On the basis of a Terms of Reference, which was approved by the Steering Committee, the consortium Carnegie/Timpoc was selected.

The following investments in Peru & Ecuador were evaluated:

	Type	Client name	About the client	BIO's investment	Business Development Support Fund offered?
1	NBFI[1]	Acceso Crediticio - Peru	Acceso Crediticio finances, through leasing, natural gas vehicles (NGV) and liquefied petroleum gas (LPG) powered vehicles.	BIO approved a senior loan of 10 million$ in October 2016	No
2	MFI	Cooperativa Pacífico - Peru	Cooperativa Pacífico, via a membership structure, finances SMEs members in urban areas	BIO approved a senior loan of 10 million$ in October 2017	No
3	MFI	Vision Fund - Ecuador	Vision Fund focuses on providing micro-finance to microenterprises in rural and partly urban areas. The target clients are mainly women	BIO approved a senior loan of 2 million$ in June 2015	Yes
4	FI	Banco D-Miro - Ecuador	Banco D-Miro provides micro-credit with a strong social focus on underserved groups in vulnerable peri-urban areas in the coastal region.	BIO approved an unsecured loan of 5 million$ in October 2015	No
5	FI	Banco Pichincha - Ecuador	Banco Pichincha is the leading general bank in Ecuador with the country's largest branch network. It finances MSMEs throughout the country.	BIO approved a subordinated loan of 15 million$ in June 2016	No

Main Findings

Overall the consultants found that "*BIO operates as very prudent investor; it is a relatively small investor compared to other DFIs and can choose specific niches in the market, which in turn is appreciated as well*

[1] . NBFI = Non-Banking Financial Institution

by the – potential – clients. Its lean organisational set up allows for relatively fast decision making and less bureaucracy in the assessment and appraisal process. Staff of BIO is aware of this comparative advantage and explored well investment opportunities that other, larger DFIs would consider not yet attractive".

Regarding the development objectives and additionality, the consultants mentions that "*BIO's financing has been **effective to attain the initially set development objectives,** and at the moment of the investment decision these investments were relevant albeit for varying reasons. **In all five investments one may speak of additionality of BIO as financier**. **BIO's financing had catalytic effects** (mainly in terms of attracting and/ or convincing other financiers to join). In the two cases in Peru, BIO was an investor with demonstrating effect as early financier with a relatively high funding amount compared to other external international financiers. In the three cases in Ecuador, the financial institutions were facing serious liquidity problems due to the political and economic uncertainties at that time.*"

With respect to financial inclusion objective, the report notes that "*all five investments are expected to contribute to the objective to promote financial inclusion by promoting access to financial services, in particular with respect to credit, and in two cases (Banco D-Miro and Cooperativa Pacífico) increased savings are explicitly mentioned as expected additional outcomes. This is both to improve the funding base of the respective financial institutions and seen as service for the intended clients/ target group*".

The consultants issued 8 *lessons learnt* and follow-up <u>recommendations</u> (see action plan below for our response and comments):

- *Careful selection of financial institutions reduces the need to invest in bringing about structural changes in the financial institutions*.
    - <u>Recommendation 1</u>: Continue to select financial institutions carefully to ensure development effects
- *Development Finance Institutions (DFIs) as BIO play a catalysing role with investments in niche financial sector markets*.
    - <u>Recommendation 2</u>: Enhance the catalysing role with investments in niche markets
- *Realistic monitoring and evaluation comprise more than just financial data*
    - <u>Recommendation 3:</u> Enhance the use of reporting
- *Realistic monitoring and evaluation comprise more than just financial data*
    - <u>Recommendation 4:</u> Improve development results monitoring on target groups
- *Defining the purpose of subordination strengthens the effectiveness of the instrument*.
    - <u>Recommendation 5</u>: Define and adhere to conditions for subordination of loans
- *Setting explicit development objectives avoids automatic renewal of financing*
    - <u>Recommendation 6</u>: Set explicit development objectives in renewal of financing
- *It pays off to synchronise financing with technical assistance*
    - <u>Recommendation 7:</u> Improve complementary effect of technical assistance
- *Cooperation with non-financing development actors enhances the effectiveness of financing*
    - <u>Recommendation 8</u>: Boost cooperation and communication with other (Belgian) development actors

Overall, we found the lessons learnt and the recommendations very broad and addressing issues that BIO is either already doing or improving. For two recommendations, we disagree with the evaluators' conclusion, namely on the subordinated debt conditions and the automatic renewal of our loans in case of (potential) follow-on investments. Finally, the length of the report (the evaluation's terms stipulated max. 50 pages for the report itself) makes it difficult to read (142 pages), with a quite descriptive toneand quite some repetition across the chapters.

However, there are some interesting points which merit to be reflected upon (use of TA, cooperation with other actors, improve reporting of development reporting, catalysing role of BIO). Also, the digital survey done at the end-clients level is quite interesting as an innovative approach to assess how effective the financial institutions we finance are perceived. It is the first time such a client survey was done as part of one of our evaluations, and we will share the results of the survey with our FI clients for discussion and feedback.

Finally, it is worth to mention the very good presentation by the consultants at the feedback workshop with BIO staff, which they successfully made interactive and participative. The consultants were able to present the outcome of the study with an innovative methodology, raising a good discussion and reflection among BIO staff. We will keep this way in mind for the next annual evaluation presentation.

Action plan

	Recommendation	Acceptance by BIO mgt?	Strategy of implementation: Consultant / BIO Mgt response	Responsible	Actions	Timing	Status
1	Continue to select financial institutions carefully to ensure development effects: Define clearly the development objectives and be specific about target groups to be reached (more than just micro, small and medium-sized enterprises (MSMEs)).	Yes	The consultant writes that "the present pre-selection mechanisms of BIO and its monitoring and evaluation system are in line with this approach". There is this no need for change in the current way to select FIs. Selecting the right FIs that BIO wishes to work with is part of our DNA, as we carefully select financial institutions that have development objectives similar to or are in line with ours.	Investment Department Carole Maman CIO	None additional to current practice	Ongoing	CIO and Investment Team are responsible for the selection of projects. Discussion with Development Officer already takes place pre-Screening Committee if needed (e.g. in case development objective are unclear).
2	Enhance the catalysing role with investments in niche markets	The recommendation is split into two parts (see right column). We do not agree with the first one, but accept the second part of the recom-mendation.	1) "Once other DFIs followed BIO and provided (additional) financing to the financial institution first supported by BIO, the latter might consider its role as played and seek new investment opportunities". The assumption that if other DFIs follow BIO's investment, we have no longer a role to play is not true. Even if bigger DFIs come after BIO, we could still be additional and support again our clients. 2) "In niche markets DFIs as BIO can effectively operate as one of the first investors and play a catalysing role by making the financial institution more attractive for fellow investors". We fully agree, and this is an approach we'll continue to take, given our smaller ticket size and capacity to catalyse other investors. Providing a "stamp of	Investment Department Carole Maman CIO Pierre Harkay, D&S Unit Manager	None additional to current practice	Ongoing and to be reinforced	BIO seeks (and will continue) to be additional to private investors, especially given our smaller entry ticket size for smaller FIs. Even if "our role is played", it does not mean that we would no longer be additional. Throughout the Development Assessment framework, the DO always check BIO's additionality, both financially and non-financially.

			approval" to the market is and will remain one of our priorities.				
3	Enhance the use of reporting: • Accept standard/ uniform (general) reporting formats from financial institutions on financial performance and related risk appraisal that they use for various DFIs/ private investors • Continue further alignment to other DFIs' reporting and investment appraisal process could lower the burden on financial institutions in the process while improving the means available for improvements in development result monitoring • Require financial institutions to report explicitly on the degree to which predefined development objectives are attained ▪ Include research and data collection and analysis at end-client level to the general reporting. ▪ Next to requiring financial institutions to report on E&S, offer assistance to support the internalisation of E&S (e.g. in the form of advice and support to initiate related institutional actions).	Yes	Most of the points mentioned in this recommendation have already been operationalised since 2015 when we adopted our new development assessment framework: • We try as much as possible to align with other EDFIs reporting standards (E&S, development, financial data) • Specifically, on development reporting, we provide (when appropriate) a tailor-made reporting template to the institutions to ensure they are capable to report on the indicators we request, in line with BIO Development Goals. As mentioned above, we also aim at harmonising with other EDFIs/investors. • "Include research and data collection and analysis at end-client level to the general reporting" is not realistic to ask to our clients, especially smaller FIs. However, we could support our FIs willing to do so, for instance with TA support • We already offer TA to our clients to support them with E&S requirements/procedure internalisation and this is a priority in the next years We will also better communicate to our clients how our investment is expected to contribute to the SDGs.	Portfolio Department, Denis Pomikala and D&S Unit, Pierre Harkay	None additional to current practice	Ongoing	By recruiting a Sr Development Officer (starting in June 2019) we'll reinforce our capacity to ensure an efficient use of reporting. On reporting at end-client, BIO will check with current FIs clients and future investees, whether they would be interested to do so, for internal learning, on a voluntary basis. BIO will continue to provide TA and be proactive with clients. Regarding SDGs, we'll map our current development assessment framework to the SDGs, and will also communicate to our clients, to raise awareness and ensure commitment with our mission. Nota bene that we have hired a temporary Junior Development Officer (Oct. 2018-June 2019) to strengthen our indicators database and better assess our impact. This will also support our efforts to better make use of reporting and draft development impact analysis, for both internal learnings and external communication.

4	Improve development results monitoring on target groups: ▪ Define more explicitly and precisely which target groups BIO would prefer financial institutions to serve. ▪ Work with clear descriptions and definitions of intended target groups.	Yes	Since the new development assessment framework implementation in 2015, we have been trying to be more specific in our loan agreement, specifying what we aim at financing (Development Objectives) and how we intend to monitor our impact (through development reporting sheet). However, depending of the funding we provide (senior loan, subordinated debt or equity) and the type of Bank (FI, MFI, NBFI), it's not always possible to set a target group other than MSMEs. Proposed improvement is to always check with our client to enhance reporting granularity.	Pierre Harkay D&S Unit	None additional to current practice	Ongoing and to be further streamlined in our contracts when possible	To be checked on a case-by case basis with our client if possible to include clearer target groups for FIs, but in subordinated debt project this is unlikely (as we cannot earmark the use of funds, as they are used to leverage more debt in the market). And in equity there is no clear way to inset it in shareholder agreements (however our role is at the level of the BoD, so we have an influence).
5	Define and adhere to conditions for subordination of loans: ▪ For subordinated loans to have added value, both partners must define clearly the reason for subordination and define related repayment schedules or rescheduling conditions. ▪ Once the subordination cannot be justified anymore the loans can best be converted into senior debt.	No	Subordination is subject to central bank/financial regulator regulations. The subordination terms cannot be changed simply because "it would have lost some added value" over time (see page 7 of the executive summary for more detail). The terms are set at the beginning of the contract and cannot be adapted as suggested.	Carole Maman - CIO	None	/	/

6	Set explicit development objectives in renewal of financing: -Explicitly set the purpose and development objectives of financing offered and request on related well focused reporting specifying the degree to which these objectives are attained. - In working with financial institutions that seek follow-up financing, BIO needs to communicate clearly the reasons why it would renew its financing and under which conditions. Renewal only ought to take place if actions are warranted to attain the original or adjusted development objectives and have been agreed upon. - During monitoring and evaluation visits to the financial institutions stress (in addition on monitoring the financial performance) the importance of the development objectives initially identified and considered as justification for the financing by BIO.	No	There is never an automatic renewal of a loan. A FOI always follows the same process and procedure as a new investment project. Development and financial rationales are duly investigated. We also never commit to renew a loan automatically to our clients.	Carole Maman CIO		/	/

7	Improve complementary effect of technical assistance: - Make a distinction between technical assistance expected to enhance the effectiveness of the financing operations made possible by the investments and additional technical assistance. - Interlock the directly related technical assistance with financing and discuss technical assistance in earlier stages. - Continue to take a proactive role in the technical assistance process by clarifying the benefits the financial institution might have while safeguarding the demand-driven approach. - Actively support the financial institution to use technical assistance when this will contribute to mutually desired product / service innovations or organisational changes (leading e.g. to starting operations in a new sector or for a new target group or offering new product under new terms). - Explore joint opportunities of co-financing technical assistance with other DFIs technical assistance programmes.	Yes	Technical Assistance is usually demand-driven, i.e. our clients make a formal request to benefit from a grant. However, BIO will continue (and reinforce) to be proactive in identifying gaps and opportunities for potential TA in view for reinforcing sustainable business practices. New leaflets have been developed in Q1 2019 and meetings per sector have been organised to explain the new possibilities for TA following the change of Law of BIO in 2018. Next steps are: discuss TA as soon as possible and preferably directly with the potential clients and not the IO, better follow-up by the TA Officer when a project is approved by the IC/CC. More awareness on TA internally will also be organised regularly (TA Officer joining team meetings of Investment and Portfolio Departments, presentation to BIO all staff,…)	Pierre Harkay D&S Unit	Process to better source BDSF projects (with strong value-added from a development perceptive) will reviewed	By end of 2019	Moving from a demand-driven to a more proactive use of the BDSF is already ongoing, but should be reinforced, especially for priority thematics: climate, digital and gender.

	- Explore possibilities with financial institutions to use technical assistance in support financing offered to their end-clients (e.g. financial education).						
8	Boost cooperation and communication with other (Belgian) development actors:	Yes	BIO is already engaged in boosting communication and cooperating with other actors.: • We ask a feedback from Embassies for each new project and visit (as far as possible) them when going on due diligence mission • BIO's External Relations Manager is the point of contact for DGD, but also for other stakeholders • BIO is part of the working group set up and chaired by the DGD (since mid-2018) • BIO works closely with Enabel and DGD on the new bilateral programmes with Partner Countries wrt Private Sector Development – PSD (organisations of workshops, studies, member of a Ministerial Task Force on PSD,…) • BIO stories are sent to the embassies network, DGD and stakeholders To be further developed: • Further build up relationship with (Belgian) development actors on the ground and better communicate on our investment strategy and criteria • Strengthen communication with stakeholders	CEO Luuk Zonneveld Pierre Harkay D&S Unit Manager Ben Jehaes, External Relation Manager		Ongoing and to be further developed	D&S Unit Manager is strongly involved with DGD and Enabel on the PSD thematic. Further involvement from External Relations manager planned

	- Communicate strategy, proposition, activities (ex-ante and post) and results towards other Belgian development actors. - Communicate technical and quality requirements expected to be delivered by other Belgian development actors to make related financing feasible and effective. - Consider appointing a single point of contact within BIO for the Belgian government agencies to streamline the communication processes from both ways and in this way improve visibility and the identification of future opportunities. - Build on the knowledge and local presence of other (Belgian) development actors and seek collaboration with external parties with market knowledge and local presence could assist to attain the development results either through being a pipeline generator or providing first-hand market knowledge in the investment appraisal process.						