The next step in blended finance: addressing the evidence gap in development performance and results

As part of the consultation on the OECD DAC Blended finance principles for unlocking commercial finance for the SDGs

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WORKSHOP REPORT

With the 2030 Agenda on sustainable development, the need for mobilizing private finance to achieve the Sustainable Development Goals (SDGs) are of outmost importance. Blending follows complex patterns involving many actors with different interests across long delivery chains. This affects the monitoring and evaluation function, which in the blended finance space is less mature than in other development cooperation activities. The 2018 OECD report "Making Blended Finance Work for the Sustainable Development Goals" stressed the lack of evidence on such mechanisms.

Hence, the development community will need to find new and innovative ways to tackle this challenge. The OECD workshop served as an opportunity for tripartite experience sharing and learning amongst:

- Donors: International Organisations, Ministries of Foreign Affairs and Finance,
- Development operators: multilateral and bilateral Development Finance Institutions (DFIs), Development Banks, Development Agencies,
- Private investors: fund managers, commercial banks, philanthropy, etc.

Participants agreed on the importance of (1) bridging the vocabulary and cultural differences between development cooperation and development finance, (2) mapping the existing evidence in development results achieved by blended instruments and gaps thereof, and (3) better understanding the specific methodological challenges faced when evaluating them.

What evidence on development results achieved by blended finance?

Leveraging additional finance is one legitimate use of Official Development Assistance (ODA). Blending should be resorted to, when it is recognized as the preferable way to solve a specific public problem. Development finance providers must ensure that allocating scarce concessional resources for blending is not drawing them away from other types of interventions that may be more effective in a given circumstance. In the public eye, this requires gathering more evidence on (1) if and how blending can address the needs the poorest and most vulnerable groups; (2) how it can be implemented alongside more systemic investments for enabling environments; and (3) how it can serve nationally identified sustainable development priorities, and national ownership more broadly. The latter entails, for instance, understanding the interplay with domestic private sector development and with domestic resource mobilisation.

Current studies provide indicative results, but more robust evidence is needed to establish blended finance as a tool in its own right within the portfolio of development cooperation. Indeed, **blending does not always lead to superior development results**. Partly, this can be justified by the fact that concessional blending is used for higher risk projects where success is, by design, harder to achieve. Based on the experience of the World Bank Independent Evaluation Group, alignment with the client's strategic interests and ex ante market assessments, both on the supply and demand side, are key to achieve development results from blended transactions; so is technical assistance to accompany the intended use of investments. Development finance providers must better understand the demand side, e.g. local financial intermediaries and investee companies, and their behaviour when implementing different instruments, before introducing a concessional element in their favour.

Based on the KfW Financial Cooperation portfolio, a preliminary analysis[1] of the correlation between evaluation results and the mode of finance suggests that **adapting financial structure to the type of development intervention could have positive effects on development success** (especially for income generating interventions like energy production being partly financed with market funds).

The level of risk investors are willing to take is intrinsically linked to the concessionality needed and, ultimately, to the volumes of additional finance they can mobilise. On guarantees and debt instruments, DFIs report rather low loss rates, raising questions as to their actual de-risking function. For instance, the 2016 evaluation of Sida's use of guarantees stressed the very limited number of defaults, none of them leading to an actual claim[2]. If increasing the development ambitions of blended mechanisms, for instance targeting those most in need (e.g. in least developed countries or fragile contexts), necessarily requires higher tolerance for failure, this may ultimately lead to increased concessional spending.

More transparency is needed to strengthen **public accountability, both on financial and development performance** (incl. risk profile of transactions, volumes of ODA spent, social and environmental outputs). Other questions scarcely tackled in the existing literature include the timing and conditions when it is worthwhile bringing in private capital, what unexpected outcomes and market externalities it may generate, and what are the preferable modalities for blending in a given context.

Methodological challenges in evaluating blended finance

In a blended finance setup, **the incentives of the different actors need to be better understood from the start**, as the motives of a financial intermediary might be very different from a donor's. Blended finance involves entities with more diverse legal settings than other financing instruments: public administration, public and commercial banks, pension funds, local financial institutions, multinational corporations, micro small and medium enterprises, individual borrowers, etc. Within the DFIs portfolio, often coexist

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[1] Thomas Gietzen, PhD - KfW Development Bank, Evaluation Department (forthcoming 2018) "Financing Instruments and Development Projects' Impact, an investigation into Blended Finance and its effect on development projects' success"

[2] Carnegie Consult for Sida Evaluation, Evaluation of Sida's use of guarantees for market development and poverty reduction (2016) https://www.sida.se/contentassets/a99e846c5eaf48268efb1f99a0de0edf/21668.pdf

opportunity-driven deals initiated by private partners and more public interest projects driven by policy objectives. Some even considered that such different intervention logics can and should not be reconciled in the same evaluation framework.

Different stakeholders also bring along different information needs, which evaluations should try to address. When documenting results, evaluators should thus not only consider upwards accountability, but also multi-polar accountability by engaging all partners involved.

Confidentiality represents an important obstacle to blended finance evaluation, as often data on the financial inputs (i.e. which public investors provided how much) is not accessible. To some extent, this might be a fake argument, which donors should invalidate: real trade secrets are not written in contractual agreements. In addition, donors manifest their difficulty in tracking financial flows from their replenishment of Collective Investment Vehicles (CIVs) to the reported cash outflows. Transparency on the use of public subsidies is highly demanded, to avoid risk of commercial capture, but the influence donors might exert decreases along the delivery chain.

Additionality is key to demonstrating the rationale for blending. Yet, donor governments, DFI and private fund managers all related their difficulties in this regard. In the absence of a 'control' situation to quantify what would have happened without the additional finance mobilised, development finance providers must resort to qualitative assessments, which may not be sufficient to meet their investors' expectations. Promising methods other than attribution are emerging (e.g. process tracing and probabilistic approaches), but there is no consensus yet on their application. Consequently, mobilisation is often assumed rather than observed. Moreover, blended instruments are, by definition, partnerships where each player wants/needs to claim their own additionality, thereby generating a fictitious competition and, possibly, duplication of efforts amongst partners. Additionality could thus be assessed jointly, looking at the blended mechanism as a whole, rather than for each investor.

In the **absence of an internationally agreed definition**, DFIs have defined their own approach to additionality. According to the EIB framework, an intervention is additional if it facilitates or enhances a project from the public development prospective in a way that the market alone would not allow. This implies (1) identifying a market failure problem before the investment decision, through interviews and desk research (2) qualifying the EIB's influence in the project design (3) verifying that private sector actors are not crowded out, both ex ante and ex post. At the IFC, the criterion is more used to ascertain whether the institution would do the activity anyway or if it is truly incentivized by the subsidy element. Besides leveraging ratios, evaluators should also consider the provider's qualitative contribution to improve the project design and/or implementation.

The evaluation framework must be tailored to the different types of investment instruments. Technical assistance is used to accompany a multiplicity of interventions with very different theories of change (e.g. debt versus equity instruments). A deal's financial structure will determine the sharing of risks (and returns) between partners, thereby shaping their incentives. The outputs, outcomes and impacts of a development intervention cannot be assessed independently of the inputs (time and money) deployed therein. For instance, early stage patient capital requires a longer timeframe to manifest its commercial sustainability, which in turn requires adapting the evaluation scope and judgement criteria. This highly rests on the evaluator's capacity to interpret the commercial and behavioural levers at play. However, evaluation have so far often dismissed or scarcely considered the financial structure of blended mechanisms.

Finally, but perhaps most importantly, most development finance providers are mandated to transform whole sectors, by promoting new business models in nascent or failed markets. When subsidizing a private actor, **donors and investors should primarily be concerned with the effects at system level**, rather than at the individual investee level. This creates a tension between statistical modelling versus observational data collection, where both methodologies have their value added, as long as the necessary transparency is provided on the nature of the evidence underlying the evaluative judgement. While the direct and unexpected impacts can only be ascertained on the lives of end beneficiaries, the importance of general equilibrium effects should not be overlooked in order to capture economic transformation. Governments and DFIs alike agree that impact evaluation should go beyond the firm level, as public intervention should ultimately contribute to public benefit.

The importance of RBM to increase the knowledge base

Public institutions have an obligation to ensure monitoring of development results by implementing partners, but also to harmonise in as far as possible their reporting demands, in an attempt to avoid unnecessary administrative burdens. Under the European Fund for Sustainable Development, the European Commission (EC) strives to provide a unique results-based framework which will enable the aggregation of project-level, to instrument-level and further to programme-level data. Being legally responsible for the use of funds up to the final intermediary, the EC also has to impose a quality assurance system. Donors should also thus play an active role in expectation setting, so that blending institutions prioritise development performance at par with the commercial one in end-of-year reporting.

Monitoring frameworks should rest on a theory of change validated through evaluations, where causality has been demonstrated. However, attention must be paid to agree on ex ante targets, which are both measurable and achievable. DFIs and private fund managers encounter difficulties to track project results after the end of their investment. This is particularly true for debt instruments, where they usually disengage once the loan is reimbursed.

Monitoring schemes should **capture information in a traceable, versatile and, where possible, quantifiable manner, while meeting the capabilities at the investee level**, if necessary through technical assistance. Concessional resources are crucial to ensure evaluability: even if donors bear the cost of the study, capacity building for small clients is often needed to produce baseline infomation. Declarations from implementing partners may raise trust issues but are still the preferred source, for efficiency concerns and as a way to stimulate ownership. Job creation is the most frequently used indicator, but even there a clear measurement methodology is still lacking. Moving beyond purely economic indicators, improvements in well-being can only be measured through individual perception. Ultimately, the quality of data available largely depends on the nature, capacity and commitment of the investees.

Analysis at an aggregated level (e.g. institutional or fund level) is crucial in proving effectiveness to public and private investors. However, asset managers face a recurring **trade-off between granularity and precision of RBM tools versus comparability of results at industry or sector level**.

Innovations discussed tackled the need to (1) embed the RBM approach more deeply into the organisational incentive structure and (2) promote continuous learning for both investors and investees. DFI and private fund managers are starting to better align their staff incentives (in terms of individual and team performance) with development objectives (even if only expected).

EBRD has adopted a new approach of **standardisation and automation** to ex-ante and ex-post impact assessment. The Transition Objective Measurement System determines a project's intrinsic value, including specific blending objectives, through an extensive list of questions to identify the expected market-level impact. The rating is adjusted by an appraisal of the project's contextual value, drawing on a compendium of standard and automatically attributed indicators. The former dimension translates the Bank's institutional mandate to project-level, whereas the latter links operational objectives to country and strategic priorities. This fully integrated Bank's results architecture incentivises the delivery of development results, remedial action, and feedback loops.

The development finance space is increasingly moving into **real-time tracking** of results. The Acumen LeanData initiative offers light and quick perception surveys that can assist client companies in assessing their business and social performance. The tool delivers fresh primary data at reduced costs for investees, allows constant learning and benchmarking, by ranking performance of similar client organisations across comparable indicators, for instance the poverty-probability index as a proxy for inclusivity.

For so-called impact investors, due diligence on environmental, social and governance (ESG) safeguards and bottom up impact analysis are progressively embedded throughout the investment life cycle, pre and post disbursement. Some asset managers, such as BlueOrchard, have established their own **proprietary tools** for tracking their social and environmental performance, for internal reporting and public communication purposes. This has become a key differentiating factor to crowd in public as well as private investors. More rigorous reporting on impact metrics by all players in this field would certainly support this objective.

Way forward: tackling learning constraints collectively

Blended finance evaluation requires more proactive and coordinated steering by policy makers

Contractual arrangements are instrumental to establishing a joint evaluation strategy between donor governments and their blending arms. In the UK, DFID and CDC have committed to a joint Evaluation & Learning Programme, which quantitative impact evaluations on large programmes for accountability to Parliament, accompanied by qualitative project performance reviews for formative purposes. In the Netherlands, since 2011, the Ministry of Foreign Affairs has signed a memorandum with FMO and other implementing agencies, establishing a multiannual plan for rigorous evaluation of government funds. Such agreements must imperatively foresee the allocation of sufficient resources. Other good practices include stakeholders involvement, providing management responses, better timing to align with the decision making process.

The issue of commercial confidentiality reflects in the **scarce publicity of evaluation findings**: most evaluation reports produced by DFI or CIVs are only shared with their Governing Board. Indeed, evaluation owners must apply caution in what they publish, to avoid the danger of self-fulfilling prophecies: for instance, a negative opinion on the financial sustainability of a given company might easily induce other investors to pull out. These concerns greatly limit the public availability of evaluative evidence for collective learning in the blended finance space.

Moreover, the Ministry of Finance usually seats at the DFI Governing Boards (IFC, EBRD, EIB, etc.), although development cooperation falls under the competency of the Ministry of Foreign Affairs. Compared to other aid modalities, blended finance thus calls for **enhanced coordination at the central government level to share and mainstream evaluation learnings**, at least within the public apparatus. If blending is to be become a tool for development cooperation in its own right, the policy design and steering must be reconciled into one unique learning cycle between the two arms of the executive.

Evaluation capacity and independence of development finance actors must be reinforced

Bilateral DFIs, such as the Danish IFU, are progressively gearing up their results measurement capacity, but **resources for in-depth evaluations are not yet a natural part of the investment cycle** in the same way as financial audits. Still, DFI representatives agreed that they should be, at least for larger investments above a certain threshold. Private players committed to impact investing may offer some good practices in this regard. The Children's Investment Fund Foundation, for instance, reserves 5% of the programme budget to assess results down to the beneficiary level. The proportion is staggeringly high compared to some bilateral DFIs, even those with well-established evaluation functions.

Concessional resources are crucial to **ensure evaluability**: even if donors bear the cost of the ex-post study, capacity building for smaller organisations is needed to produce baseline data throughout implementation.

Because evaluating blended finance is technically demanding, development finance providers may choose to externalize to third parties, but the skills are not always available. Research institutions and consultants often cannot provide both the financial and the social/environmental sustainability expertise necessary to evaluate blended projects. **The evaluation profession must improve their financial literacy**.

Especially where evaluation is not hierarchically independent, it is important to **test whether the M&E system is fit for purpose**, for instance by conducting cost-benefit analysis. At the Private Infrastructure Development Group (PIDG), an independent review of the Results Monitoring System and associated processes is carried out every 2-3 years. Moreover, an independent panel reviews the work of PIDG's internal development impact team, reporting directly to the Board (with an option to go directly to the Owners).

Synergies between monitoring, evaluation but also audit can be improved. At times, evaluators may choose not to use the national monitoring mechanism to avoid conflicts of interest. More and better information sharing information amongst the three would facilitate organisational learning. Still, clear value added in ex post independent and systematic assessments, as only evaluation can question the rationale of an intervention.

Global multistakeholder concertation is needed for the emergence of a shared evaluation culture

Development cooperation and development finance actors must converge towards a common understanding on development effectiveness and additionality. Discussions proved the heterogeneity in definitions of development results, as well as in the criteria applied for addressing effectiveness, efficiency and additionality. More clarity would also be beneficial on the respective roles of (ex-ante) impact assessment, ESG due diligence, monitoring and (ex-post) evaluations.

The 2030 Agenda has greatly expanded the number and diversity of financial actors called upon to play their part for global sustainable development and blended finance embodies this fundamental transition in our approach to development cooperation. DFIs and private investors, particularly in the impact investing community, have already taken important strides to improve their public accountability, but the evaluation profession still faces significant challenges in operationalising the collective vision of the SDGs. **Alignment on language and standards is a prerequisite for dialogue, partnership and learning.**

This will require building consensus across a diverse and multilayered set of stakeholders comprising representatives from OECD members and partner countries; different branches of government therein; central policy makers and delegated operators; public and private law entities; actors stemming from bilateral development assistance and international market finance; the intrinsically linked but functionally separate monitoring and evaluation functions. As a neutral intergovernmental organisation, not involved in service delivery, the OECD is uniquely placed to convene such a diverse group and broker negotiations. Historically, the OECD Development Assistance Committee (DAC) has played an important role in promoting the quality of the evaluation practice in development assistance. The same must now happen in the development finance field. **The OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs offer a unique opportunity to take a first concrete step in this direction**.