EUROPEAN EVALUATION SOCIETY

GUIDANCE NOTE FOR THE SUB-GROUPS OF THE THEMATIC WORKING GROUP (TWG) ON PRIVATE SECTOR EVALUATION

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INTRODUCTION

As presented in the July Progress Report of the Thematic Working Group on Private Sector Evaluation, Sub-groups have been established to enhance the discussion of the Group on key topics and subject of relevance to the evaluation community. The Sub-group for **Evaluation of Financial Intermediaries**, including SMEs has been established in view of the crucial role financial institutions play, also in development cooperation. Vast amounts of donor money public as well as private sources, including social investments are supporting and strengthening the financial sector in the third world. The Sub-group for the Evaluation of Public-Private Partnerships (PPPs) was created in view of specific interest from within the EES, but also bilateral donors see PPPs as an area where evaluation is required, as it is an important sector in developing and transition countries where the private sector meets public interest. The Sub-group on Corporate Self-Evaluation has been established to find out more about evaluation-related activities of the private sector, such as: corporate responsibility programmes, mostly incorporating social and environmental responsibility activities, anti-corruption measures and promoting business ethics and transparency. In view of a growing debate in the evaluation community on what makes private sector evaluation so specific compared with public sector evaluation the Sub-group on the Specificity and Dynamics of Private Sector Evaluation has been established.

The present note is to suggest themes of discussion as starting points for the Sub-groups.

EVALUATION OF FINANCIAL INTERMEDIARIES.

One topic would be to deepen our understanding on how to evaluate Multilateral Development Bank (MDB) lending to financial intermediaries. Over the years lending activity in this area has continuously oscillated between objectives of directly strengthening financial intermediation (banks and financial sector) and indirectly improving the conditions of the beneficiaries, with the danger that neither of the two goals would be achieved in a fully satisfactory manner. This is a project design and implementation issue, as well as a business environment issue.

In many cases, considerations of disbursement and financial performance of the intermediary was predominant. The impact on the beneficiaries was often overlooked. MDBs tended to rely upon commercial banks reporting on beneficiaries and field visits of the best subproject cases. For micro-finance projects outreach benefits were measured through number of loans granted and repeat financings, rather than focusing on the use of funds and the move of loan recipients from the informal sector to a micro- or small business. When subsidies were provided in one form or another, the impact and the issue of phasing them out was often lightly investigated. Occasionally ex post surveys of enterprises were made.

In recent years, however, attempts were made to better asses the impact on ultimate beneficiaries though “impact evaluations” (IEs), including a number of random control trials (RCT) evaluations, but a full assessment of the relevance and usefulness of these evaluations is yet to be done, as far as they intend to be applied in the private sector.

On the side of the financial intermediaries, which over the years have been the recipient of many different MDB products, a set of conditions regarding corporate governance of the financial intermediary had to be complied with, especially in repeat financing. Credit-related and conditions related to development or transition objectives were an essential part of these financial products. However, there was often little consistency in the conditionality for all these products, which prevented a continuous improvement of corporate governance. It might be the case that a bank agreed to a set of conditions on a certain loan from an MDB when on-lending the funds to corporations, but accepted a much weaker set of conditions when using their own funding. Also prepayments on an MDB loan resulted in repeat financing with reduced conditionality to ensure proper disbursement, thereby diminishing the MDB's leverage in fostering corporate governance. In times of crisis in particular, the level and intensity of MDB conditionality, was also diminished in the financial sector.

EVALUATION OF PUBLIC-PRIVATE PARTNERSHIPS

Whatever form they took, a major issue facing public-private partnerships (PPPs) has been the sustainability of the partnership. The past and current instability of PPPs can be addressed in various ways. Each one of them would need further evaluation analysis:

- **Assessing and mitigating risk is essential for both public and private parties.** Public authorities often sought to mobilize private capital, where the magnitude of the capital investment required, compared with a public authority, rendered projects unfeasible. On the other hand public authorities were often able to borrow at lower cost than private entities. It was assumed the higher private costs might be offset by the increased efficiency of private firms. But when this was not the case, the private company went bankrupt and the public sector, which had to maintain the delivery of the service, was left to remedy to the situation.

- **The importance of open competition.** When there was market competition, the market could ensure that the public authority was achieving a fair deal for the risk allocation proposed. If the project was not attractive, substantial negotiations with one bidder could generate outcome that had not been tested by the market. The risk of accepting an unfair commercial offer could then materialize, especially in the absence of assistance from competent and expert advisers.

- **Fair labour contract are crucial.** Trade unions might have feared that working conditions would become worse under a controversial PPP and were more inclined to strike at early signals of deterioration during PPP implementation.

- **Good legal frameworks are the basis for success.** It remains to be seen if legal frameworks were adequate to lead to sustainable contractual relationships. To help prevent unfair deals and to contribute to a smooth running of the concession, there is a need for a legal framework that supports good drafting of tender documentation. In addition legal frameworks may or may not have included effective provisions for resolution of disputes to help avoid adversarial positions to go to court, when the dispute could be resolved by mediation or arbitration.

CORPORATE SELF-EVALUATION

Another subject of discussion in the context of private sector evaluation is answering the question of what really corporate self-evaluation is about, and how it could complement other evaluations made by MDBs and NGOs. This may be done in the context of the new trends of corporation activities branching out from corporate score card type of performance evaluation to some form of self evaluation through all kinds of new social responsibilities activities such as more transparency in the publication of Board and CEO remunerations in annual reports. Corporate willingness to reach quality labels for a range of products and processes should be included.

Large corporations, which are listed on stock exchanges, have become aware that striving towards social responsibility and environmental sustainability is of the essence in order to satisfy their shareholders and also their Board of Directors. Corporate responsibility (CR) departments have a key role to play in these corporations' compliance with codes of conduct in these areas. IFC has been involved with an initiative "the Equator Principles" whereby financial institutions would apply minimum standards of environmental sustainability.

Staff of CR departments of larger corporations is engaged in control activities for the application of health and safety standards and local investment standards. The engagement also includes fighting corruption at local levels and being an example in their sectors for business ethics and transparency. The link of these efforts to evaluation of investment operations, as pursued in the MDBs would be interesting to analyse. One could think about a one-day workshop with large companies where the above issues would be discussed with several heads of CR departments.

SPECIFICITY AND DYNAMICS OF PRIVATE SECTOR EVALUATION.

A fourth Sub-group to discuss (a) the extent to which private sector project evaluation has in common with public sector project evaluation and (b) the extent to which evaluating projects in the private sector is - or should be - different from evaluation of projects in the public sector. This discussion can take place in the context of MDB Management and Board members attempting to support more and more projects "at a higher level outcome and impact", i.e. outcome and impact beyond the immediate surrounding of the project. At a first glance and as a starting point, we could discuss the proposition that there are commonalities between public and private sector evaluation, but they tend to differ as projects attempt to reach a higher level of outcome and impact, simply because the context in which they are operating are so different. Some clarifications for the purpose of a discussion are given below.

A) Project level

Both public and private project evaluations have been following the DAC principles regarding relevance, effectiveness, efficiency, outcome and impact. They also both tend to rely upon the same evaluation process theories and practices: theory of change, theory based evaluation and impact evaluation (IE) techniques. In addition, while there are significant presentation differences, the MDBs Good Practice Standards (GPS) for the public sector might end up to be quite close in substance to the GPS of the private sector (excluding of course structural adjustment lending in the public sector).

In comparing public and private sector evaluation approaches, however, one must be sure what the unit of account would be. If there is an investment in a public sector utility (water and sanitation, power and energy or telecommunications) this can be compared with a private sector investment in these areas or with a public-private partnership investment. The way to evaluate has many similarities; although there might be a different approach in tariff setting in case of a sovereign operation relative to tariff setting in the context of a concession with a strong overseeing regulator. While the corporate principles are by and large the same to judge, some mandate-related (transition and/or development) or social conditionality in the public sector might differ from a private sector operation.

In case of a public project in social sectors such as education and health, the comparison with private sector evaluation is more challenging. When evaluating private sector operations, whereby the investment of the MDB is at risk such as with EBRD and IFC there is also an important institutional dimension when conducting private sector evaluation. The aspects of accountability and learning, which MDB Board of Directors request from Management, need to be assessed when conducting project evaluation. Appropriate evaluation procedures and practices need to be in place to make sure that lessons learned are applied and that conclusions and recommendations in past projects will be used to select and formulate new projects. A good management commenting system is of the very important and maintaining a high quality tracking system to follow-up evaluation recommendations by Management is essential. The learning cycle is usually short for private sector projects and what has been learned must be applied immediately in new projects. This learning cycle is much longer in public sector activities and the learning by project teams is more challenging as by the time an evaluation takes place, some of the institutional memory on the management and project team side may have been lost on the way.

B) Higher level of outcome and impact

When it comes to compare public and private sector evaluation, a serious problem begins to appear if the project is requested by MDB Management and Board members to contribute to sector and even national reforms, because its leverage as a stand alone project could be not be enough to trigger the changes. The MDBs solved this problem for the public sector by disbursing against reform achievements to be undertaken by policy makers and then eventually making investment projects under the new policy umbrella. However, when it came the private sector, which does deal directly with policy reforms, private sector loans similar to public sector loans could not be made. Then concepts came up like "transition impact" or "development impact". The aim was to show the extent to which a project in the private sector could achieve an impact beyond the immediate surroundings of the project itself. It happened though that in many cases single projects could not significantly reach this goal and therefore a more influential critical mass of projects was needed.

Over time, it even appeared that this critical mass was hard to achieve, and, when achieved, might have left a number of structural deficiencies almost intact within the private sector. More recently attempts have been made to combine policy dialogue and technical assistance with private sector development together with identifying a critical mass of projects for both leverage and support for reforms. This is a form of programmatic lending, i.e. lending attached to an agreed sector reform program. The risk attached to this approach is that, depending on how the entire scheme is designed; it may neither produce solid and sustainable private sector reform, nor good projects, if goals and strategies remain diffuse and not mutually supporting. In that case the MDB might be left with both weak reforms and weaker projects. However, if the trend in MDBs is to keep moving projects to a higher-level plane, the issue must be discussed. The above mentioned downside risk might be avoided by further refining this sector reform support perhaps through a multiple path system of lending/TA/policy dialogue towards the common goals and adjusting the reform program on the way, depending on the speed and the kind of reforms implemented. In addition, self-evaluation of the corporation may provide complements to MDB evaluations of what has happened beyond the immediate surroundings of the project.

In a nutshell, the project and its higher plain objectives might suffer, or at least the challenges are considerable, for MDB staff to follow this new trend. In attempting to respond to the challenges that matter to today's world, "real time evaluation" approaches could help Management and the Board in identifying on time the higher level issues that surround project performance. This applies especially to the evaluation of the responses of governments, private sector and MDBs to financial crises. In addition, there are cases where combinations of investments with technical assistance grants have provided opportunities to promote institutional strengthening and outreach in areas where the market was not yet fully performing, especially in the banking sector. In principle a market-oriented private sector should operate free from subsidies or grants, but when they are provided, evaluation should fully review the accountability for their use and derive lessons learned towards the creation of positive higher-level outcome and impact.

CONCLUDING REMARKS

The above suggestions of topics for discussion will need further thinking and refinement in their content and presentation within the Sub-groups, in particular when all Leaders and/or Co-leaders of the Sub-groups are known. They can be used to prepare a Work Programme (WP) for each Sub-group. This note is only to summarize at first understanding of the evaluation challenges and does not intend to be complete or exhaustive. These challenges could be used as a starting point for the Sub-groups to review, modify, extend and add new WP considerations. Throughout the future debates, it matters very much to clarify the objectives of the debate and the process that will lead to new findings.