Evaluation of the FMO-MASSIF Fund (2015-2019)

seo amsterdam economics

Amsterdam, 19 November 2020
Commissioned by the Dutch Ministry of Foreign Affairs

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Final Report

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SEO-report nr. 2020-83

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Abbreviations

BoP	Bottom of the Pyramid
CCR	Client Credit Review
CD	Capacity Development
CG	Corporate Governance
CPP	Client Protection Principles
DD	Due Diligence
(E)DFI	(European) Development Finance Institution
E&S	Environmental and social
ESG	Environmental, social and governmental
FI	Financial Institution
FMO	Dutch development bank (in Dutch: "Nederlandse Financierings-maatschappij voor Ontwikkelingslanden")
FP	Financial Proposal
LIC	Low Income Country
MSME	Micro, small and medium size enterprise
PE	Private Equity
SIS	Sustainability Information System
ToC	Theory of Change
ToR	Terms of Reference
WMSME	Women-owned micro- and small enterprise

Executive summary

In 2006, the MASSIF fund was created at the Dutch development bank FMO. FMO is 51 percent owned by the Dutch Government, 49 percent by Dutch commercial banks and is one of the largest bilateral private development banks in the world that provides clients in developing countries and emerging markets with loans, equity and Capacity Development (CD) support. Over the period 2006-2019, the Dutch Ministry of Foreign Affairs (MFA) contributed in total EUR 351 million to the MASSIF fund.

The main aim of MASSIF is to strengthen financial sectors and promote micro, small and medium sized enterprises (MSMEs) in developing countries. Since 2017, all MASSIF investments should fall under at least one of four investment themes or 'target groups' described in its new 'Next Frontier' strategy.

1. 'The Unbanked'
2. 'Agri/Rural'
3. 'Women-owned micro and small enterprises' (W(M)SMEs);
4. 'Innovations in Inclusive Business'.

The evaluation of the MASSIF fund is required by the Dutch government under its general policies on evaluation, and is aimed at both accountability and learning. Following a competitive tender procedure, SEO Amsterdam Economics (SEO) was commissioned by MFA to conduct the evaluation of MASSIF. This has included 20 case studies that SEO conducted jointly with Oxford Policy Management (OPM) and the results of which are summarised in this report. In parallel, SEO has evaluated the B-CD grant provided by MFA to support FMO's Capacity Development programme, which will be published as a separate report. Both evaluations analyse the efficiency, additionality, and effectiveness of the two instruments.

This evaluation's methodology includes a mix of qualitative and quantitative methods. Starting with reconstructing the MASSIF 'Theory of Change', the main qualitative methods are desk review of programme and project documents and other relevant literature, and semi-structured interviews with a large number of stakeholders. At FMO, these consisted of interviews with member of the FMO evaluation team, MASSIF management, relevant Investment Officers (IO) from Equity and FI departments, E&S officers, Corporate Governance officers, members of the impact team, and other relevant FMO staff. In addition, case study experts from SEO and Oxford Policy Management conducted interviews with MASSIF clients, co-investors in those clients, Board or AC members, MFA staff, and other relevant local and international stakeholders. Quantitative evaluation methods include statistical analysis of MASSIF's portfolio and impact data as well as secondary data sources. Using multiple sources minimised bias and ensured that our conclusions would not depend on a particular selection of case studies or interviewees.

Conclusions on efficiency and financial performance

- MASSIF is generally run efficiently and its operating costs are broadly in line with its peers.
- MASSIF operates largely in line with its mandate. The MASSIF investment criteria are generally correctly implemented, and are sufficiently different from the FMO-A investment criteria.
- MASSIF investments between 2017-2019 are in line with its new strategy in terms of the four groups targeted, although it is difficult to assess whether this is also the case in terms of target groups reached (see conclusions on impact measurement).
- MASSIF performed well on its geographic targets, with around 40 percent of investments taking place in Africa and 25 percent in Asia.
- MASSIF funds more risky investments than FMO-A, mostly reflecting higher client risk rather than higher country risk. As a result, MASSIF's financial performance is more volatile than FMO-A
- Over the period 2006-2019, MASSIF's revolvability was 141 percent: at end-2019, total fund capital was EUR 495 million while MFA had contributed EUR 351 million. This high level of revolvability remained broadly constant during 2015-2019, implying that MASSIFs revolvability was close to 100 percent during the evaluation period.
- It could be inefficient for the Dutch government to have two of its Official Development Assistance (ODA) funded instruments, MASSIF and the Dutch Good Growth Fund (DGGF), invest in the same clients, as happened quite often until recently.

Recommendations to improve efficiency and financial performance

- MFA should maintain MASSIF's overall revolvability requirement of 100 percent. If it were higher, then MASSIF would have less incentive to take risks. If it were lower, the implicit subsidy could be market distorting. However, a subsidy element may well be justified for specific types of investments with high expected development impact, low risk of market distortion and high potential catalytic effects. To stimulate these types of investments, it would be preferable to set up a special sub-fund under MASSIF that is subject to lower revolvability requirements, rather than lowering the revolvability target for MASSIF across the board.
- MFA should engage with both MASSIF and DGGF (track 2) managers to discuss how to define and demarcate their respective target markets better, avoid overlap, improve complementarities and cooperate on due diligence and monitoring processes in cases where they invest jointly.

Conclusions on financial additionality

- MASSIF was explicitly designed to be financially additional to commercial investors, to other development finance institutions (DFIs), and to FMO-A.
- FMO's own analysis of additionality in Financial Proposals (FPs) is limited and should be improved.
- In nearly all 20 case studies, MASSIF investments were fully or moderately financially additional to the commercial market, as well as to FMO-A and other DFIs.
- In cases where financial additionality was low, MASSIF clients often still valued MASSIF because of its non-financial additionality or expected catalytic effects (see below).

Recommendations to improve financial additionality

- Instructions for the new FP template should require a deeper analysis of financial additionality relative to commercial investors, DFIs, and FMO-A.
- ODA funds like MASSIF should be additional to non-ODA funding, but do not need to be additional to other ODA funding. The FP template for MASSIF investments should therefore

distinguish between ODA and non-ODA DFI funds, to the extent possible, when assessing the additionality of MASSIF investments to other DFIs.
- Clearer guidelines should be developed on how to handle and assess MASSIF's additionality relative to private impact investors, which sometimes have similar risk profiles to ODA funds.

Conclusions on catalytic and demonstration effects
- In the majority of case studies, MASSIF had catalytic effects in that it helped to mobilise other investors *ex post*, by reducing investees' perceived or actual risks.
- In some cases, MASSIF also had catalytic effects related to *ex-ante* mobilisation. particularly in the case of private equity funds, when MASSIF often helped a fund reach fist close.
- In 4 out of 20 case studies, MASSIF was successful in catalysing follow-up investments from FMO-A.
- FMO does not systematically analyse demonstration effects, whereas some other DFIs do. MFA does not require demonstration effect analysis, however our case studies and some in-depth evaluations commissioned by FMO suggest that such demonstration effects often exist.

Recommendations to improve catalytic and demonstration effects
- MASSIF investments with low financial additionality may still be warranted in cases of high potential catalytic effects.
- Demonstration effects of MASSIF investments and capacity development (CD) could be measured and reported more systematically. In particular, when MASSIF or its clients introduce new financial instruments, innovative products or standards that have the potential to be replicated, they offer a more systemic indirect impact at the level of the investment community, the financial sector, or other sectors in target countries.

Conclusions on ESG and nonfinancial additionality
- The CD offered by MASSIF appears to add significant nonfinancial value, but its impact is not systematically measured and reported, in part due to the limited human resource capacity of the CD team.
- MASSIF's risk rating methodology for Environment, Social and Governance (ESG) risks is generally sound, but at the time of evaluation FMO did not directly link identified ESG risks with CD projects. In some cases, CD was not provided despite an identified need.
- CD on improving the implementation of Client Protection Principles (CPP) was sometimes highly beneficial, but clients with existing strong CPP standards felt that the benefits of obtaining CPP Smart Campaign certification did not outweigh the costs.
- With respect to MASSIF equity investments, FMO-nominated Board or AC members were able to have a positive impact on clients' ESG policies and procedures, but this impact channel could be used more effectively.

Recommendations to improve ESG and non-financial additionality
- Measuring and monitoring the impact of CD should be done more systematically and may require a larger CD budget. For example, one could measure the short-term impact of CD on improving knowledge and skills using simple pre-CD and post-CD evaluation forms; the medium-term impact of CD with a short CD beneficiary survey after 1 year; and the 'catalytic effects' of CD with a short impact report 1 year after the CD has been completed.

- FMO's initiative to further improve the linkages between CD and ESG teams is welcome, and should be used to strengthen (a) identification of CD needs aimed at reducing ESG risks; (b) measurement of CD impact on reducing ESG risks.
- MASSIF's indirect clients should be encouraged or required to assess potential E&S risks seriously.
- FMO may wish to review and improve its procedures for identifying and selecting effective Supervisory Board or AC members of its equity investees, as well as their implementation.

Conclusions on impact measurement

- MFA requires MASSIF to report on a limited number of impact indicators.
- Knowledge relevant to impact measurement is quite fragmented at FMO; tools are not centrally integrated.
- While some relevant impact indicators are already being collected at the level of target groups (e.g., the number and volume of loans by type of client; direct jobs supported by gender), this is not yet systematically reported. Moreover, only limited information is available at higher impact levels.
- At the time of evaluation, data quality and coverage of datasets used for FI Impact Cards was suboptimal, while that for equity fund Impact Cards was unusable.

Conclusions on end-beneficiary access to finance

- Financial Proposals and impact data at the portfolio level thus far contained limited analysis on the expected and actual impact of potential MASSIF clients to improve financial access for specific target groups.
- The available portfolio data suggest that the share of loans provided to MSMEs and rural micro-entrepreneurs increased since 2017, but MASSIF's impact on improving access to finance for women was difficult to assess given limited data coverage and absence of a benchmark.
- Case studies suggest that MASSIF was generally successful in improving access to finance: in 12 out of 20 case studies, we rated this impact as high, and in the other 8 cases as moderate.

Conclusions on end-beneficiary outcomes

- While the FP template has recently been improved, the FPs reviewed for our case studies contained limited analysis on the expected impact of MASSIF investments.
- The available impact data show that direct employment at the client level (in operations or maintenance) typically increases rapidly in the years following a MASSIF investment.
- MASSIF clients on average have a larger share of female employees than an ILO benchmark for the share of women in the workforce.
- Data on indirect employment at the end-beneficiary level is too limited for drawing conclusions.
- Impact on end-beneficiaries' access to (new) goods and services is not measured systematically.
- With regard to improvements in income, 8 out of the 20 case studies found a positive quantitative estimate on revenue, profits or income. In most other case studies this was not possible to estimate.

Recommendations to improve impact measurement

- Further improve the MASSIF Theory of Change and results framework.
- Further improve the measurement of expected impact (in the FP template) and actual impact by developing a database of country-level benchmarks, at least for access to finance and employment, preferably by target group.

- Further improve output and outcome measurements in Impact Cards.
- Further improve the measurement of (expected) inclusion impact by developing a full database of ‘inclusion gaps’, similarly to EBRD.
- Continue the good practice of (externally) evaluating individual investments, and do so over a longer time period.

Recommendations to improve impact

- Use MASSIF’s successful track record and high revolvability as a comfortable buffer for mitigating the impact of COVID-19 on MASSIF clients.
- Further improve the inclusion impact of MASSIF by linking the improved measurement of inclusion gaps to business development and approval processes for MASSIF investments and CD.
- Expand the capacity of the CD team to use CD more often as a channel to improve impact.
- Consider setting up a special fund or using separate investment criteria for specific types of MASSIF investments that have a high potential development impact, low risk of market distortion, and high potential catalytic effects, because MASSIF investments and CD could over time make the client commercially viable. Examples could be investments in high-risk, high-impact countries (e.g. fragile states, Sahel region, countries worse hit by COVID-19) or investments aimed at specific target groups (e.g., women-led SMEs, refugees). Similarly, a local currency fund could be set up to encourage local currency investments in countries where the FX hedging cost is currently prohibitive.
- Improving impact measurement in the medium term will allow for better decisions in the long term on how to further improve MASSIF’s design to maximise its impact.

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1 Introduction

Commissioned by the Dutch Ministry of Foreign Affairs, SEO Amsterdam Economics has evaluated the MASSIF fund, covering the period 2015-2019.

Background MASSIF fund

The Dutch entrepreneurial development bank FMO pursues sustainable development goals through both investments and Capacity Development (CD). As one of the largest bilateral private development banks in the world, FMO invests in more than 85 developing countries and emerging markets. By helping private companies in these countries to operate and grow in an environmentally and socially responsible manner, FMO aims to support jobs and income generation and "improve people's lives in those parts of the world where this makes the biggest difference."[1] In addition to providing loans and equity investments to its clients, FMO has a Capacity Development (CD) programme to facilitate the transfer of knowledge and the provision of technical expertise.[2]

In 2006, the FMO-MASSIF fund was created as a revolving fund to build and strengthen financial sectors and promote micro, small and medium-sized enterprises (MSMEs) in developing countries. Microfinance, SME finance and agri-finance were the initial primary target sectors. Over the period 2006–2019, MFA contributed in total EUR 351 million to the MASSIF fund. As of December 2019, MASSIF had a total fund capital of EUR 495 million (implying 141 percent 'revolvability') and a committed portfolio of almost EUR 545 million.

Since the adoption of MASSIF's new 'Next Frontier' strategy, effective 2017, the MASSIF budget has been allocated across four investment themes: (1) 'The Unbanked', (2) 'Agri/Rural', (3) 'Women-owned micro- and small enterprises' (W(M)SMEs), and (4) 'Innovations in Inclusive Business'. Since 2017, all MASSIF investments should fall under at least one of these four themes, in line with the Investment Criteria and Guidelines.

MASSIF can invest using a wide range of products. These include, but are not limited to, direct equity investments, private equity fund investments, guarantees, mezzanine products, loans, convertible loans and convertible grants. In addition, funding for capacity development (CD) projects is available to MASSIF clients from the MASSIF CD budget, which is used to improve MASSIF's non-financial additionality, also called ESG additionality, or perhaps better termed, 'potential development impact' in the broadest sense.

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1 https://www.fmo.nl/

2 https://www.fmo.nl/partner-with-us/capacity-development

Purpose of the assignment

The evaluation of the MASSIF fund is required by the Dutch government under its general policies on evaluation. Since 2001, regular, independent evaluations of Dutch government policy have been mandatory. Development cooperation programmes were already subject to close evaluations for much longer. Following a competitive tender procedure as part of MFA's evaluation framework, SEO Amsterdam Economics was commissioned by MFA to conduct the evaluation of the MASSIF fund (as well as the evaluation of the B-CD grant, which has been carried out in parallel).

Evaluations of Dutch development cooperation programmes generally have two objectives: accountability and learning.[3] The accountability objective is to determine whether policies and programmes have been efficient and effective, so as to account for the use of public funds. The learning objective is to offer insights into why results were (or were not) achieved, and to draw on these lessons to improve policies and programmes.

Similarly, the MASSIF evaluation aims to increase accountability and provide lessons learned. The MASSIF evaluation analyses the efficiency, effectiveness and (financial) sustainability of the fund. Furthermore, the evaluation aims to create insights into the role that MASSIF plays in a changing investment climate. This evaluation will also serve as input for the decision about the future of MASSIF.

[3] https://www.government.nl/ministries/ministry-of-foreign-affairs/organisational-structure/ministry-of-foreign-affairs-evaluations

Evaluation questions

This evaluation addresses the following evaluation questions:

#	Evaluation question
1	How has MASSIF's portfolio developed between 2015 - 2019 in terms of size and sector of businesses, countries and regions, client type, product type and technical assistance provided?
2.1	Outputs: What are the direct and indirect outputs of MASSIF in terms of funding for target groups (innovations in goods and services, the unbanked, women-owned (M)SMEs, rural/agri finance), and technical assistance?
2.2	Outputs: To what extent were the outputs of MASSIF additional?
3	Outcomes: What are the direct and indirect outcomes of MASSIF in terms of e.g. jobs supported, growth in production and services, access to goods and services, application of client protection principles and economic, social and governance (ESG) principles?
4	Outcomes: Did MASSIF investments have any demonstration effects in the market?
5	Impact: How have MASSIF investments impacted the local financial sector and investments of local businesses in terms of e.g. institutional strengthening and a stronger sector?
6	How does MASSIF's Capacity Development budget contribute to MASSIF's outputs and outcomes?
7-8	Has the MASSIF fund been managed efficiently?
9	How has MASSIF's requirement of being 100% revolving affected its developmental outcomes, for example through determining the risk profile of its investments?
9.1	What would be the effect of changing the revolvability requirement on the developmental outcomes?
9.2	What are the developmental effects of MASSIF's relatively high revolvability (138%) in relation to its required revolvability of 100%?
10	How does FMO assess, monitor and manage the social and environmental risks of MASSIF investments?
10.1	How does FMO ensure it learns from its past (successful and unsuccessful) investments?
11	What social, environmental and economic impact did MASSIF investments have on the local communities?
12	How does FMO ensure that MASSIF investments remain additional to the commercial market with a rapidly changing market environment with more and more private and DFI players entering the market?
12.1	To what extent are MASSIF investments additional financially for its clients to the commercial market, other DFIs and FMO-A? How do MASSIF's local currency loans, financing conditions, tenor of the loan and technical assistance influence MASSIF's additionality?
12.2	To what extent are MASSIF investments additional non-financially for its clients to the commercial market, other DFIs and FMO-A?
13	To what extent does MASSIF catalyse resources from FMO-A, DFIs, commercial investors or other (local) investors?
14	To what extent and how do clients 'graduate' from MASSIF and transfer to FMO-A or other investors?
15	What learnings can be identified for MASSIF in order to improve the effectiveness, efficiency, sustainability, additionality or catalytic effects of the MASSIF fund?

2 Methodology

2.1 General methodology

The basic framework for this evaluation is a reconstructed version of MASSSIF's Theory of Change (ToC). Appendix A presents the ToC that was reconstructed by the evaluation team for this evaluation. Based on MASSIF's 2017 ToC, this reconstructed version (a) adds arrows to clarify the underlying 'theory' (where each arrow is a hypothesis), and (b) more clearly distinguishes three[4] main "impact pathways":

1. **Client pathway**: Impact at the level of MASSIF clients (typically financial institutions);
2. **Investor pathway**: Impact at the level of other investors in the market (catalytic effects);
3. **Beneficiaries pathway**: Impact at the level of end-beneficiaries (clients of FMO clients, and other beneficiaries affected indirectly).

Based on this reconstructed ToC, we can derive the following key hypotheses to be tested:[5]

1. **Client pathway:**
   a. MASSIF has (financial or non-financial) ***additionality*** for its clients;
   b. MASSIF investments contribute to improved ***client performanc***e;
   c. By demonstrating that a certain business model can be successful, MASSIF investees can serve as a "showcase" and encourage others to do the same (***demonstration effects at the MASSIF client level***).
2. **Investor pathway:**
   a. MASSIF investments can mobilise investments by other investors in the same client, either *ex ante* (being a 'cornerstone investor'), or by attracting other investors *ex post*, following improved client performance (***catalytic effects***)
   b. MASSIF investments can mobilise investments by other investors in similar clients, by demonstrating that investments in certain types of FIs or funds can be successful (***demonstration effects at the investor level***)
3. **Beneficiary pathway:**
   a. MASSIF clients are additional for their clients, i.e., they improve ***inclusive access to finance*** for specific target groups (e.g., women-owned or rural MSMEs).
   b. Improvements in access to finance in turn contribute to improvements in ***end-beneficiary outcomes***: employment, income, access to goods and services, gender equality, and sustainable livelihoods.

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[4] The reconstructed ToC diagram in Appendix A also contains a (less visible) fourth pathway, namely the financial sector policy pathway. The financial sector policy pathway denotes the impact FMO can have at the level of financial sector development through policy discussions with financial sector regulators. This fourth pathway is not part of the general methodology, given that it is not part of the mandate of MASSIF and according to FMO is used as a channel of impact only in rare cases. Nevertheless, we report impact at this level for case studies where FMO appeared to have had an impact on financial sector policy.

[5] Note that these three types of demonstration effects are not in the original MASSIF ToC, and were not a major component of this evaluation, but they are important channels to achieve sustainable, systemic impact.

c. By demonstrating that a certain MSME business model is successful, the MSME clients (end-beneficiaries) of MASSIF's clients can serve as a "showcase" and can encourage other MSMEs to do the same.[6] (***demonstration effects at the MSME level***).

2.2 Definitions

Efficiency

The OECD-DAC Network on Development Evaluation defines efficiency as "The extent to which the intervention delivers, or is likely to deliver, results in an economic and timely way." The term 'economic' refers to "the conversion of inputs (funds, expertise, natural resources, time, etc.) into outputs, outcomes and impacts, in the most cost-effective way possible, as compared to feasible alternatives. This may include assessing operational efficiency (how well the intervention was managed)."[7]

Following this definition, we interpret efficiency as the relationship between the costs of MASSIF's inputs and the results (outputs, outcomes and impact) generated by MASSIF. Given the nature of MASSIF as a revolving fund, the actual costs are mostly operational (management fees). In Section 3.3, we therefore benchmark these fees against 'feasible alternatives,' which in this case are other DFI funds aimed at similar outputs, outcomes and impacts.

Effectiveness

The OECD-DAC Network on Development Evaluation defines effectiveness as "The extent to which the intervention achieved, or is expected to achieve, its objectives, and its results, including any differential results across groups." In this evaluation, we treat both effectiveness and impact under the heading of "impact", where the latter is defined by OECD-DAC as "higher-order effects and broader changes to which an intervention may be contributing."[8]

When analysing effectiveness, one should also take the relative importance of the objectives or results into account. As such, effectiveness should be interpreted as the extent to which the intervention achieved, or is expected to achieve, its outputs and outcomes on the condition that the intervention and the predetermined objectives are also important/relevant for the target group. We therefore assess the reported outputs and outcomes in relation to the predetermined objectives. Moreover, we critically assess the importance/relevance of the achieved outputs and outcomes to the target group (for example, we assess not just whether MASSIF clients improved access to finance in general, but specifically whether they improved access to finance for target groups such as rural borrowers or female entrepreneurs).

[6] Assessing this type of demonstration effect was beyond the scope of this evaluation, given the inability to conduct field visits.
[7] https://www.oecd.org/dac/evaluation/daccriteriaforevaluatingdevelopmentassistance.htm
[8] Ibid.

Financial additionality

The general FMO investment criteria define financial additionality as "only providing financial services which the market does not provide, or does not provide on an adequate scale or on reasonable terms." This is similar to the definition used by the Donor Committee for Enterprise Development (DCED 2014), which sees financial additionality as a subset of 'input additionality'. This in turn is defined as the extent to which "the public input resources are additional to what might anyway be invested or done by the applicant/partner company and other parties, as well as the timing of it".[9]

MASSIF investments can be financially additional in quantitative or qualitative terms:

- When there is a funding gap, MASSIF investments can be additional purely in terms of the ***quantity of funding*** offered.
- In addition, and even when there is no funding gap, MASSIF can be additional in terms of the ***quality of funding*** offered. For example, it may offer equity funding while others offer only debt funding; it may provide local currency debt when others provide foreign currency debt; or it could offer loans at longer tenors than those currently offered by the market.

MASSIF was explicitly designed to be additional to both commercial investors and to other development finance institutions (DFIs). The MASSIF investment criteria explicitly state that, "[i]n case an intermediary already receives DFI or (commercial) funding then MASSIF investments [are] to have an additional character." As agreed with MFA, we interpret "DFIs" here to mean the core (non-ODA) capital of DFIs (i.e., DFI funds similar to FMO-A), since MASSIF is not expected to be additional relative to other similar ODA funds.

The timing of the MASSIF investment is also crucial for the assessment of financial additionality. We therefore assess the financial additionality of MASSIF only at the time the MASSIF investment was made, against the alternative funding that was available at that time. Sometimes events take place post-investment that make future MASSIF investments less additional, which could lead MASSIF to revise its appreciation of the additionality of its investment and may even lead to early exit. This however would not alter our assessment of financial additionality, which is assessed only in the *ex-ante* situation.

Catalytic effects and demonstration effects

As indicated in our reconstructed ToC, we can classify catalytic effects into two categories:

1. **Ex-ante mobilisation of other investors in the same FI**: through its role in identifying and developing an investment project, MASSIF can mobilise other investors from the very start, e.g. via syndicated loans, shared equity, or other forms of co-financing.
2. **Ex-post mobilisation of other investors in the same FI:** by successfully investing in a particular type of FI client (possibly combined with capacity development and policy dialogue), MASSIF makes these FI clients more attractive for further financing by other investors. This can occur because of:
    - reducing perceived risks, through a 'stamp of approval';
    - reducing actual risks, by improving fundamentals.

[9] Donor Committee for Enterprise Development (DCED 2014), "Demonstrating Additionality in Private Sector Development Initiatives". Available at: www.enterprise-development.org

In addition to these two types of catalytic effects, MASSIF can also have 'demonstration effects.' MFA considers demonstration effects as 'positive side effects' that MASSIF should strive for, but should be held accountable for. In line with the TOC's three impact pathways, demonstration effects can occur at three different levels:

1. **Demonstration effects at the investor level:** by demonstrating that investments in certain types of FIs or funds can be profitable or impactful, MASSIF investments can serve as a "showcase" and influence investments by other investors in other similar FIs (e.g. investors becoming more interested in fintech funds)
2. **Demonstration effects at the FI level:** by demonstrating that a certain FI business model (e.g., offering a new financial product or service, or serving certain underserved segments) can be profitable, the MASSIF investees can serve as a "showcase" and encourage other FIs to do the same.
3. **Demonstration effects at the MSME level**: by demonstrating that a certain MSME business model (e.g., producing new goods or services) can be profitable, the MSME clients of MASSIF's clients can serve as a "showcase" and can encourage other MSMEs to do the same.[10]

Non-financial additionality

Non-financial additionality is similar to the concept of 'development additionality' which is defined by DCED (2014) as "the extent to which the public resources contribute to changes in development-relevant results that would not have materialised without it." Development-relevant results in turn are defined as the net results "(outputs, outcomes and impacts, e.g. related to the scale, scope, quality, target group or location of the project or partner activities) that are expected to be achieved as a result of 'additional' public inputs." (p.4). In other words, MASSIF can be said to have 'non-financial additionality' if it contributes to changes in outputs, outcomes, or impacts in ways other than through its funding (e.g., via Capacity Development).

In its Investment Criteria of November 2019, FMO used the related concept of 'ESG additionality'. This is defined as "value addition in the field of Environmental, Social and Governance standards. Hereby, ensuring that outcome / returns to society will be higher than would otherwise be the case with other parties. ESG additionality is considered an element in a financing package that cannot be easily obtained from other market parties." FMO further specified the definition as "offers unique value-adding services or provides unique expertise in ESG standard setting or in enhancing green and inclusive outcomes, of value to the client."

2.3 Next Frontier strategy

This evaluation covers the full period 2015-2019, but pays particular attention to the 2017-2019 period when MASSIF operated under its new 'Next Frontier' strategy. Since the change in strategy occurred midway through the evaluation period, this is an opportunity to assess whether the new strategy has improved MASSIF's additionality, efficiency, or effectiveness.

10 Assessing this type of demonstration effect was beyond the scope of this evaluation.

From 2006, MASSIF initially focused on poverty reduction by encouraging employment and inclusive business, financial sector development and good corporate governance.[11] Microfinance, SME finance and agri-finance were its primary target sectors. Effective 2017, MASSIF adopted its new 'Next Frontier' strategy focusing on 12 out of the 17 SDGs. While financial inclusion is not an explicit target of the SDGs, access to finance is seen as a crucial enabler for realising many of them (CGAP, 2016).

MASSIF's 'Next Frontier' strategy increased focused on responding to the unmet demand for financial services in specific segments or markets. MFA agreed on focus segments including:[12] (1) The 'unbanked', (2) MSMEs supporting Agriculture and Rural livelihoods, (3) Women-owned (M)SMEs, and (4) Innovations in Inclusive Business. For each investment theme, MASSIF was to select the most appropriate distribution channels and partnerships to provide tailored financing and capacity development benefitting these end-beneficiaries.[13]

1. **The Unbanked**[14]
   This theme focuses exclusively on the World Bank-designated Low-Income Countries ('LIC') and fragile and conflict-affected states. It was agreed that MASSIF investments need to be targeted towards institutions that can provide and scale MSME access to finance in these countries. These intermediaries can offer a wider range of stable finance and other financial services to MSMEs and lower-income households.
   - Investments are encouraged to these intermediaries that do not (yet) receive DFI, impact investor or commercial funding;
   - If an intermediary already receives DFI or (commercial) funding, then MASSIF investments need to have an additional character,[15] which may be financial (local currency, longer tenor, mezzanine or growth equity) and/or supporting a specific (higher risk) client segment of the intermediary.

2. **MSMEs supporting Agriculture and Rural livelihoods**[16]
   This theme focuses on creating viable livelihoods for small-scale farmers and rural communities requiring access to finance, markets, and employment. FMO has identified important financing bottlenecks for small agricultural production and different segments of the agribusiness value chain. Depending on the country context and crop/product, MASSIF can support improved yields and decreased post-harvest losses in a number of different agribusiness client segments, in support of rural livelihoods. These include the following types of intermediaries that not only provide access to finance, but often also access to markets, inputs and employment:
   - Rurally-based or rurally-focused financial institutions
   - Cooperatives
   - Supply chain managers
   - Agricultural PE / Debt Funds

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[11] Ecorys and Carnegie Consult (2015), MASSIF Evaluation, Financial Inclusion in developing countries 2006-2014, Final report.
[12] MASSIF The Next Frontier 2017-2026
[13] MASSIF Policy Memorandum (BEMO), received from Ministry of Foreign Affairs
[14] MASSIF Investment Criteria and Guidelines
[15] Noted that for fund or direct equity investments MASSIF can invest alongside other investors without any different position
[16] MASSIF Investment Criteria and Guidelines

- Fin Techs
- Insurance corporates

3. **Women-owned (M)SMEs**[17]
   The new strategy also specified that MASSIF should increase access to finance for women, both in the micro and SME segments, and including bank account ownership.
   - MASSIF could contribute to tackling supply-side issues around W(M)SMEs lack of access to finance by providing funding to FIs, MFIs, NBFIs, funds or other types of intermediates to be on-lent to W(M)SME or to businesses with a female customer focus;
   - CD funding can contribute to this theme by helping clients identify, serve, and monitor the W(M)SME-client segment and by creating and supporting projects that help to increase women's access to education, financial literacy training and networking opportunities as well as gender equality within organisations.

4. **Innovations in Inclusive Business** to improve access to basic goods and services:[18]
   The new strategy also specified that MASSIF aims to increase access to finance for corporates that are developing new basic and productive goods as well as services for Bottom of the Pyramid (BoP) individuals. The main focus is expected to be on banking services but also supporting (financial) institutions enabling BoP individuals to finance the purchase of basic and productive goods. In line with the Sustainable Development Goals, basic goods and services included energy, education, health and sanitation. MASSIF's strategy in this area is two-fold:
   - **An indirect (supply-side) approach**, supporting innovations in goods and services for the BoP through dedicated funds.
   - **A direct (demand-side) approach**, where MASSIF supports end-client purchases or leasing of products and services that are proven and ready to be scaled. MASSIF could also partner here with financial institutions or suppliers providing finance.

2.4 Information sources

To address the evaluation questions stated in the Introduction, we analysed a variety of quantitative and qualitative information sources. We aimed for 'triangulation',[19] which refers to the use of multiple methods or data sources to develop a comprehensive understanding of phenomena.[20] By using multiple sources we minimised bias and ensured that the conclusions would not depend on a particular selection of case studies or interviewees.

The main methods used for this evaluation were (1) a desk review of programme and project documents, (2) portfolio and secondary data analysis, and (3) key informant interviews.

1. **Desk review:** At the portfolio level, the SEO evaluation team reviewed and analysed the available and relevant programme documents about MASSIF (including MASSIF investment criteria, MASSIF active portfolio and MASSIF annual reports). At the case study level, the team

[17] Ibid.
[18] MASSIF investment criteria and guidelines
[19] If triangulation was not possible, the specific source will be stated and no general conclusions will be drawn.
[20] Patton, M. Q. (1999). Enhancing the quality and credibility of qualitative analysis. Health services research, 34(5 Pt 2), 1189.

analysed the project-specific documentation that was made available by FMO for the 20 selected case studies (e.g. Financial Proposals, Client Credit Reviews, documentation available from MASSIF clients, and previous evaluations). The 20 selected case studies are described in the following section.

2. **Data analysis:** The evaluation team analysed the primary financial and impact data available at both portfolio and case study levels, as well as available secondary data that could serve as benchmarks, for example with regard to operating costs, financial performance, and impact indicators (e.g. on average access to finance and employment statistics for case study countries).
3. **Interviews:** The evaluation team conducted a large number of semi-structured interviews. At FMO, these consisted of interviews with members of the FMO evaluation team, MASSIF management, relevant Investment Officers (IO) from Equity and FI departments, E&S officers, Corporate Governance officers, members of the impact team, and other relevant FMO staff. In addition, our case study experts conducted interviews with MASSIF clients, co-investors in those clients, Board or AC members, MFA staff, and other relevant local and international stakeholders.

2.5 Selected case studies

A total of 20 case studies were selected for further in-depth analysis. These 20 case studies were selected in coordination with MFA and FMO, using a list of case study selection criteria described in Appendix B. They are located in Latin America, the Middle East and North Africa (MENA), Sub-Saharan Africa, and Central, South and Southeast Asia.

The original plan to conduct 10 field visits in 4 regions was revised due to travel restrictions and safety concerns brought on by the COVID-19 pandemic. The evaluation team, MFA and FMO decided that instead of conducting 10 field visits and 10 desk studies, SEO would conduct 20 in-depth remote evaluations. These remote evaluations involved: (1) an in-depth desk review; (2) analysis of financial and impact data; and (3) phone/video interviews among (a) FMO investment officers and other relevant FMO staff; (b) phone/video interviews with all FMO clients for whom this was feasible;[21] and (c) phone/video interviews with other relevant stakeholders (including other investors, Board or AC members, and previous evaluators). In addition, our local consultants were able to conduct a limited number of face-to-face interviews. Given national lockdowns and local travel restrictions, this was possible only in two countries.

[21] The evaluation team was able to interview one or more client representatives in 17 out of the 20 case studies. In 3 cases it was not possible to interview the client because the client had already been recently evaluated or was in a difficult situation due to COVID-19. The adjusted approach for these 3 case studies was discussed with and approved by MFA.

Table 2.1 Overview of selected clients and corresponding investments for the case studies

		Country	Year	Debt/equity
1	Client 1	South Asia Country 2 (fund)	2015	Equity
2	Client 2	Global (fund)	2016	Equity
3	Client 3	MENA Country 1	2018	Debt
4	Client 4	Sub-Saharan Africa Country 1	2017	Debt
5	Client 5	Sub-Saharan Africa Country 2	2017	Debt
6	Client 6	Sub-Saharan Africa Country 3 (fund)	2015	Equity
7	Client 7	Southeast Asia Country 4	2014	Equity
8	Client 8	South Asia Country 1	2014	Equity
9	Client 9	Sub-Saharan Africa Country 2	2015	Debt
10	Client 10	South Asia Country 2	2014	Debt
11	Client 11	Latin America Country 1	2014	Debt
12	Client 12	MENA Country 2	2019	Debt
13	Client 13	Sub-Saharan Africa Country 3	2017	Equity
14	Client 14	Central Asia Country 1	2017	Equity
15	Client 15	Central Asia Country 2	2014	Equity
16	Client 16	MENA Country 3	2018	Debt
17	Client 17	Southeast Asia Country 1	2014	Debt
18	Client 18	Sub-Saharan Africa Country 5	2016	Debt
19	Client 19	South Asia Country 2	2019	Equity
20	Client 20	MENA Country 3 (fund)	2017	Debt

Source: SEO Amsterdam Economics

3 Analysis MASSIF fund

3.1 Investment criteria

General FMO investment criteria

FMO's investment criteria[22] state that all investments are tested against three policy principles. These apply to FMO-A investments as well as to investments funded by government funds such as MASSIF. The three policy principles are:

- **Catalytic role:** "maximizing the flow of finance to FMO's target group."
- **Good governance:** "adherence to the principles of good governance in the widest sense ('ESG')."
- **Additionality:** "only providing financial services which the market does not provide, or does not provide on an adequate scale or on reasonable terms".[23]

Furthermore, FMO has an 'exclusion list' consisting of sectors and companies in which neither FMO nor the Borrower can finance any activity, production, use, distribution, business or trade involvement. [24] This list includes the following sectors:

- forced labour or child labour;
- illegal activities or materials;
- cross-border trade in waste and waste products;
- destruction of High Conservation Value areas;
- radioactive materials and unbounded asbestos fibres;
- pornography and/or prostitution;
- racist and/or anti-democratic media.

FMO is also not allowed to finance companies for which the following products form a substantial part of business activities:

- Alcoholic Beverages (except beer and wine);
- Tobacco;
- Weapons and munitions; or
- Gambling, casinos and equivalent enterprises.

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22 FMO Investment Criteria (November 2019).

23 FMO defines two main sources of additionality: (1) Financial additionality and (2) ESG additionality. These definitions are discussed in more detail in Chapter 2, as well as in Chapter 5.

24 Additionally, FMO requires that all clients comply with applicable environmental, social and human rights laws in their home and host countries. FMO follows, among other standards, the IFC performance standards.

MASSIF investment criteria[25]

Since 2017, MASSIF investments focus on four target groups. From 2006, MASSIF focused on poverty reduction through encouraging employment and inclusive business, financial sector development and good corporate governance.[26] Microfinance, SME finance and agri-finance were the primary target sectors. Effective 2017, MASSIF adopted its new 'Next Frontier' strategy wherein all MASSIF investments need to target at least one of the following groups:

a. the unbanked;
b. agri and rural (M)SMEs;
c. women-owned (M)SMEs; and
d. innovative corporates that develop new basic and productive goods or services for individuals at the Bottom of the Pyramid.

MASSIF offers and encourages local currency (LCY) financing to minimise exchange rate risks for their clients. By providing LCY loans, MASSIF takes over the exchange rate risk from the client. Since MASSIF is a global fund, it is allowed to provide unhedged LCY loans, but since MASSIF is expected to price its investments in line with market standards, a TCX[27] quote is necessary as benchmark pricing for LCY loans. In case financing is provided in 'hard currency' (typically USD or EUR), 'it needs to be clearly substantiated that the end-client risk is mitigated'.

The tenor of MASSIF investments varies per type of investment. Debt investments have an average tenor between three and seven years, with an average grace period of one to two years. Furthermore, bullet structures[28] are strongly discouraged. Equity investments ideally have a predetermined exit strategy. With a direct equity investment, the expected exit moment lies between five and seven years after the initial investment. An equity investment in a fund may have a tenor up to 10 years, with two optional one-year extensions.

The MASSIF fund has portfolio limits aimed at reducing regional/country, currency and exposure risks. The portfolio limits (in percent of total fund assets) are as follows:

- Maximum 40% per continent (excluding Africa);
- Minimum 40% in Africa;[29]
- Maximum 20% per country;
- Maximum 20% per local currency (LCY);
- Maximum 40% in funds;
- Maximum 7.5% per single client;
- Maximum 10% per group, where 'group' is defined in FMO's concentration risk policy.

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[25] MASSIF Investment Criteria and Guidelines.

[26] Ecorys and Carnegy Consult (2015), Massif Evaluation: Financial Inclusion in developing countries 2006-2014.

[27] TCX is a fund that was established in 2007 by a group of international development finance institutions (DFIs), following an initiative by FMO. TCX's primary function is to hedge against exchange rate risk by providing simple risk-mitigation tools, primarily cross-currency forwards and cross-currency swaps, to its shareholders and in some case to the clients of its shareholders. Under a cross-currency swap, TCX effectively commits to compensate its counterparty client for a loss that such counterparty may suffer as a result of the depreciation of the counterparty's domestic currency against the US dollar or euro.

[28] A bullet loan is a loan that requires a large lump-sum payment at the end of the term. Bullet loan borrowers will often have the option to make no payments over the life of the loan or to make interest-only payments along the way.

[29] This minimum is set to increase impact and not to reduce risks (as is the case of the other portfolio limits).

In addition, there are several other MASSIF-specific investment criteria:[30]

- **Eligible countries:** countries on the DGGF country list and the World Bank-designated Low-Income Countries ('LICs') and fragile and conflict-affected states. [31]
- **Return requirements:** There is no pre-determined minimum return requirement for MASSIF investments, but the fund as a whole should at least be revolvable on average (over multiple years). Moreover, market conformity is leading, i.e., MASSIF investments should not have an upfront (expected) negative impact on the revolvability of the MASSIF Fund, otherwise they could distort markets.
- **Client exposure limits:** For debt investments, risk participations and guarantees, FMO's exposure cannot exceed 25 percent of total client assets. Higher percentages are allowed for investments in start-ups, young institutions and agricultural clients. For equity investments, the exposure limits lay between 10 and 49.9 percent of total share capital.
- **Seed Capital Development support:** subject to specific conditions and guidelines, MASSIF can offer to (potential) clients seed capital and development support up to a maximum amount of EUR 500,000 per transaction.
- **ESG and CPP:** The FMO policies for managing ESG risk (E&S and CG) and CPP policies also apply to MASSIF investments. For more about these policies see Chapter 3. Capacity Development can be offered to clients in markets with emerging ESG and CPP standards.

MASSIF vs FMO-A investment criteria[32]

MASSIF investment criteria allow for a different and higher risk profile than FMO-A. MASSIF investments do not have to comply with the FMO-A Sector Specific Investment Criteria and Financial structure and product criteria. For example, for a bank to receive an FMO-A loan the bank should have a minimum track record of 5 years and be profitable. This is not the case for MASSIF, which makes MASSIF more accessible for clients with a limited track record and a potentially higher risk profile.[33]

In order to allow MASSIF to invest in riskier clients, it has less strict requirements regarding the financial health of the investee. FMO-A has detailed profitability, liquidity and asset quality requirements concerning the financial health of different types of clients (banks, FIs, energy, agribusiness, forestry). The lack of such detailed requirements in MASSIFs investment criteria offers more flexibility.

[30] While an assessment of the appropriateness of these investment criteria is beyond the scope of this evaluation, we come back to this in the concluding chapter, e.g. when discussing the value added of MASSIF relative to the Dutch Good Growth Fund (DGGF).

[31] The current list of DGGF countries is provided here: https://english.dggf.nl/country-list . The current list of World Bank LICs is provided here: https://data.worldbank.org/income-level/low-income. However, we understand that the list of eligible countries is agreed upon at renewal of mandate, and MFA has the freedom to exclude/include some countries.

[32] FMO investment criteria (November 2019) & MASSIF investment criteria and guidelines (2017)

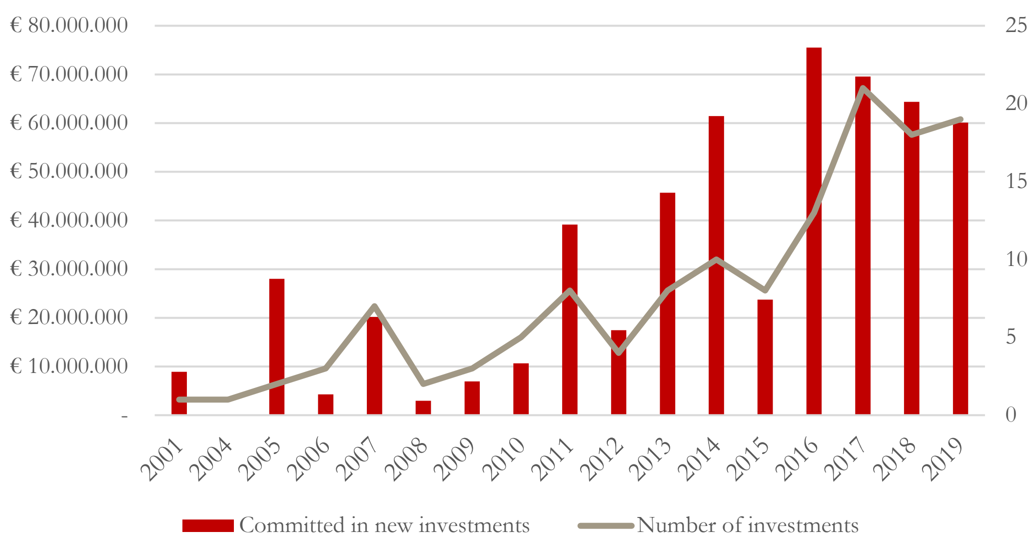
[33] As described in the chapter on Additionality, our case studies showed that such clients indeed were able to access MASSIEF more easily than FMO-A.

3.2 Portfolio analysis

3.2.1 Distribution of MASSIF investments

As of December 2019, the MASSIF portfolio consisted of 133 active investments,[34] **with a total FMO commitment of almost EUR 545 million.** This portfolio contained active investments from 2001 to 2019. Figure 3.1 shows that the largest number of investments (21) started in 2017, while 2016 was the year with the largest committed amount in new investments. Figure 3.2 shows that equity investments and commercial loans accounted for 59 percent and 40 percent of the total committed portfolio, respectively. Equity investments can either be direct investments or indirect investments in an equity fund (which itself invests in businesses). Guarantees and mezzanine investments together accounted for the remaining one percent of the total committed portfolio. As Figure 3.3 shows, 43 percent of MASSIF clients were 'Other Financial Institutions,' typically microfinance institutions (MFIs).

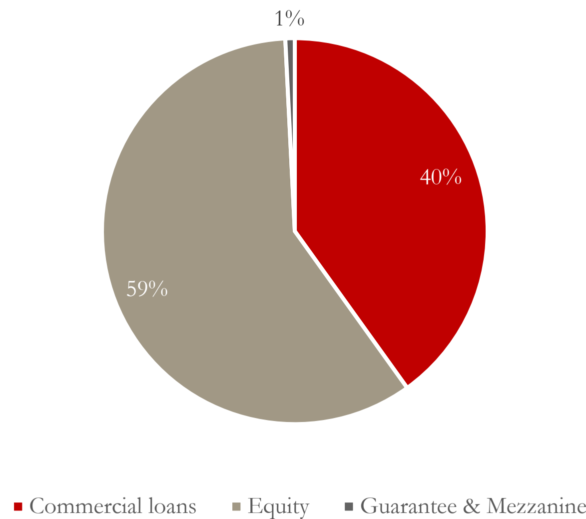
Figure 3.1 The new investments from 2016 account for the largest annual committed amount



Source: FMO MASSIF portfolio of active investments as of 31/12/2019

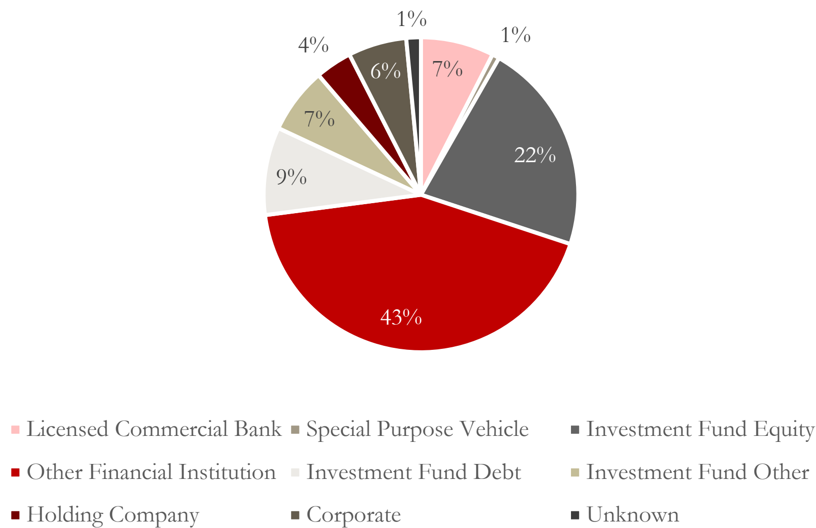
[34] Investments with a committed portfolio equal or smaller than EUR 0 are excluded from the analysis.

Figure 3.2 Equity investments accounted for 59% of the total committed portfolio at end-2019



Source: FMO MASSIF portfolio of active investments as of 31/12/2019. Data are in value of investments

Figure 3.3 MASSIF customers are mostly 'Other financial institutions' (typically MFIs)



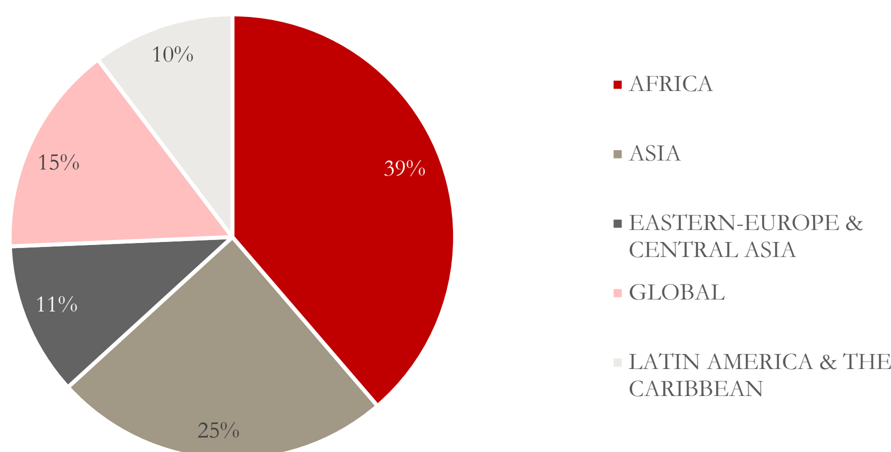
Source: FMO MASSIF portfolio of active investments as of 31/12/2019. Data are in value of investments

Africa and Asia accounted for almost 65 percent of MASSIF's committed portfolio as of end-2019. Of the total committed portfolio, 39 percent of investments were in Africa (virtually identical to the target of 40 percent)[35] and 25 percent in Asia. The remaining 36 percent were global investments or investments in either Eastern-Europe & Central Asia or in Latin America & The Caribbean (see Figure 3.4). Furthermore, India was the individual country with the largest committed amount (EUR 32 million). Most active investments (84 percent) were in non-fragile

[35] The actual exposure to Africa is higher because of a few funds registered as 'global' (such as Visionfund) that are either fully or partially dedicated to Africa.

states, the other 16 percent were in fragile states. Investments in fragile states accounted for 14 percent of the committed portfolio.

Figure 3.4 Africa accounted for about 40% of MASSIF's committed portfolio as of end-2019



Source: FMO MASSIF portfolio of active investments as of 31/12/2019. Note that some global investments are also partially or fully dedicated to Africa.

Most MASSIF investments are in countries with an intermediate to high country risk score. Figure 3.5 shows the number of investments by country rating. FMO assigns each country with a *F-score* ranging from F1 to F20. The higher the F-score, the higher the country risk. These F-scores correspond to Moody's and S&P ratings, F1 being AAA (Dutch Government) and F20 being CC.[36] Fragile states are considered to be most risky, whereas emerging markets such as India typically get a lower risk rating.

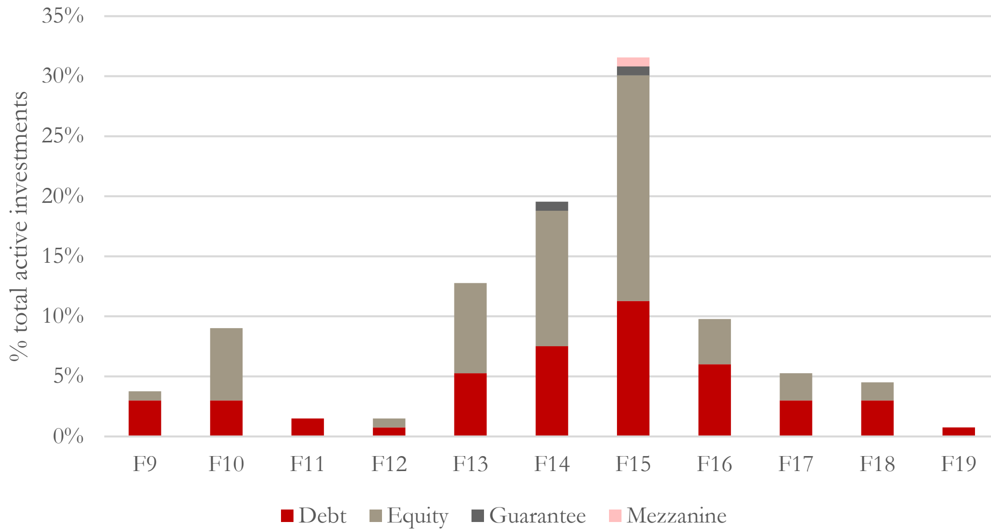
There are no MASSIF investments in countries with a truly low risk score (below F9).[37] The least risky countries are Indonesia, the Philippines (F9), India (F10) and South Africa (F11).[38] These scores correspond to S&P ratings BBB to B+, constituting moderate credit risk. There are also relatively few MASSIF investments in countries with a very high credit risk, such as Lebanon (F19), Haiti and Zimbabwe (F18) and Congo and Afghanistan (F17). Most MASSIF investments are in F14 and F15 countries. These include countries such as Kenya, Jordan, Myanmar and Nicaragua. Most investments in FIs serving multiple countries (either in Africa or Globally) are also classified under F15.

36 According to S&P the 'CC' rating is used when a default has not yet occurred but S&P Global Ratings expects default to be a virtual certainty, regardless of the anticipated time to default.

37 Risk rating mentioned are ratings as of December 2019 and may have changed since the initial investment was done.

38 A significant share (nine out of fourteen) of these F9-F11 investments are 'older' investments (pre 2015) which are still in portfolio.

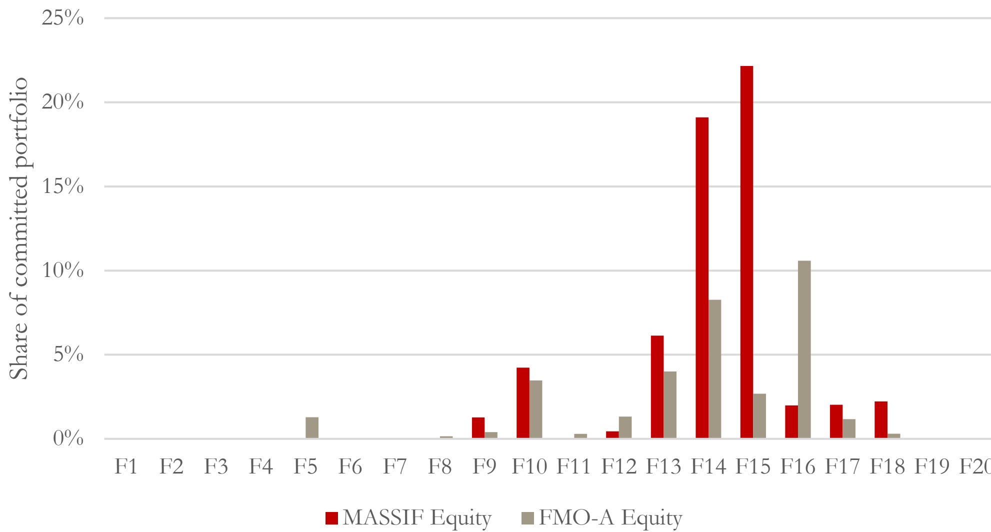
Figure 3.5 Most active MASSIF investments are in countries with moderately high risk (F14 and F15)



Source: FMO MASSIF portfolio of active investments as of 31/12/2019

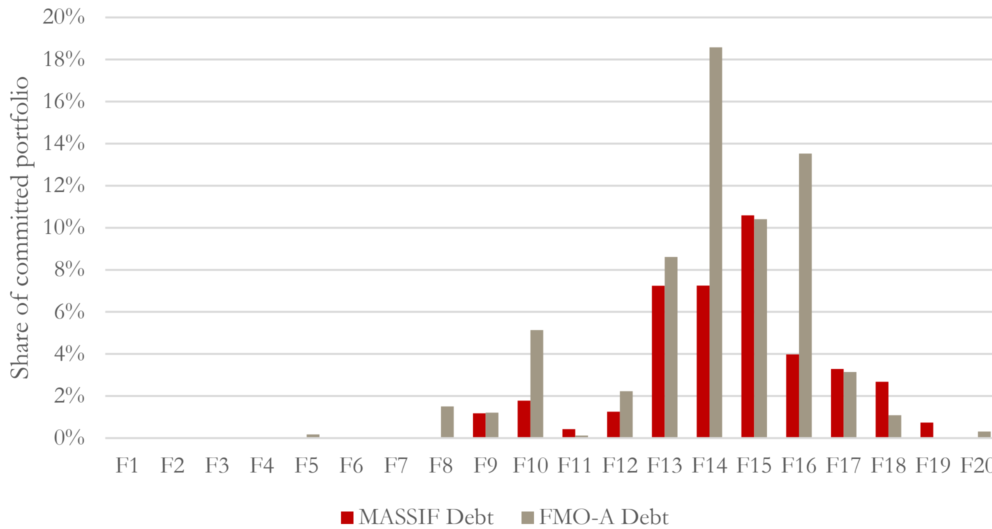
At first sight, the country risk distributions for MASSIF and FMO-A portfolios are quite similar. Similar to MASSIF, most FMO-A commitments are in countries with F13 to F16 country risk scores. As much as 78 percent of the MASSIF committed portfolio is in these countries, but this number is virtually identical for FMO-A (77 percent). However, MASSIF has no commitments in countries below F9, while FMO-A does have some investments in low-risk F5 and F8 countries (see Figure 3.6 and Figure 3.7). Conversely, MASSIF has slightly more commitments in countries with very high country-risk ratings (F18 and F19)—but not a lot more.

Figure 3.6 Compared to FMO-A, MASSIF's portfolio is more geared towards equity investments



Source: FMO MASSIF portfolio of active investments as of 31/12/2019 and FMO-A portfolio as of 31/12/2018

Figure 3.7 FMO-A has a larger share of debt investments but is also active in high-risk countries



Source: FMO MASSIF portfolio of active investments as of 31/12/2019 and FMO-A portfolio as of 31/12/2018

The main difference between the MASSIF and FMO-A portfolios is that MASSIF has a higher share of equity investments. Around 40 percent of the MASSIF portfolio consists of equity investments in F14 and F15 countries, compared with just over 10 percent for FMO-A (Figure 3.6). FMO-A does have a significant share of equity investments in F16 countries, but this is due in part to a large 247 million USD investment in the establishment of African investment company Arise BV (co-funded by Norfund and Rabobank). For each country risk category, FMO-A has a similar or larger share of debt financing than MASSIF (Figure 3.7). The only exceptions are F18 and F19 countries, where MASSIF is relatively more active in debt financing.

Client risk does differ between MASSIF and FMO-A, with MASSIF taking more credit risk. Even though the country risk distribution may look similar between MASSIF and FMO-A, the investment criteria of MASSIF imply that the credit risk of MASSIF investees in these countries should be higher than that of FMO-A investees; otherwise MASSIF would not be 'additional' to FMO-A.[39] It is difficult to test whether this holds at the portfolio level, because the credit risk ratings of MASSIF clients are not available at an aggregate level (or at least they were not in the MASSIF dashboard data received by the SEO evaluation team). However, as described in Chapter 5, we found that in 19 out of our 20 case studies, the MASSIF investments would not have qualified for FMO-A funding because the credit risk would have been too high for FMO-A. Typical reasons for not funding those due to lack of track record, lack of profitability, financial stability, or the nature of the organisation (for example, an NGO or social enterprise).

More than 45 percent of MASSIF investments from 2017-2019 target the 'unbanked'. As mentioned in Section 3.1 on 'Investment criteria', all MASSIF investments since 2017 need to target at least one of the following groups: (a) the unbanked, (b) agri and rural (M)SMEs, (c) women-owned (M)SMEs and/or (d) innovative corporates that are developing new basic or

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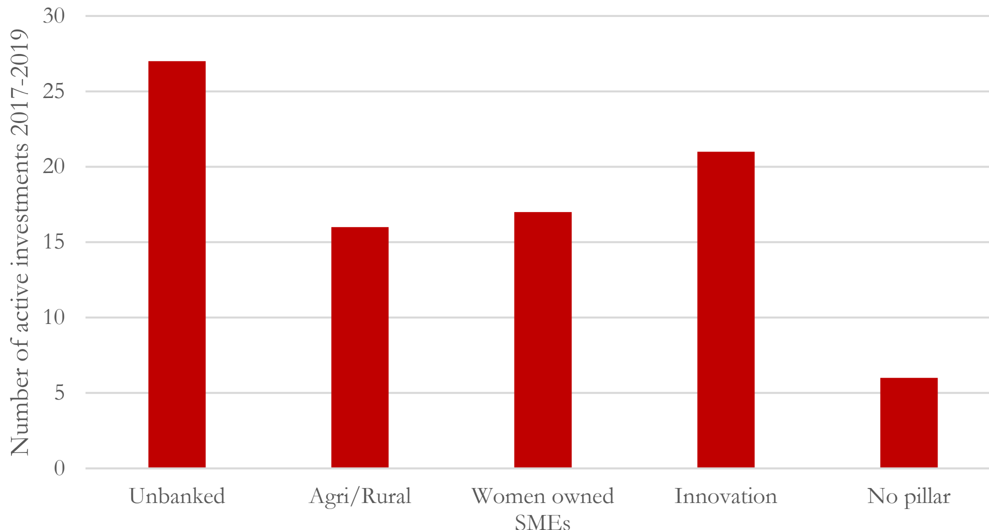
[39] In general, however, country risk also influences credit risk, e.g., there are rules specifying that the country risk itself limits how good a company can be rated internally (maximally 2-3 notches higher).

productive goods and services for Bottom of the Pyramid individuals. Figure 3.8 shows that most investments target the unbanked, followed by innovations in goods and services. Six out of the 58 investments (between 2017 and 2019) are not categorised under any pillar.[40] Most of the remaining investments are categorised under more than one pillar.

Figure 3.8 27 investments from the period 2017-2019 target the 'unbanked'



Source: FMO MASSIF portfolio of active investments as of 31/12/2019
Note: most investments are categorised under more than one pillar

Despite FMO's strong reputation in the area of local currency financing, only 13 percent of the committed portfolio is in fact provided in local currency (Figure 3.9). To minimise currency risks for their customers, MASSIF offers and encourages local currency loans (albeit with a maximum of 20 percent for any individual local currency, as described in Section 3.1). According to FMO's MASSIF team, all clients are in fact offered local currency finance, but the majority prefer loans denominated in EUR or USD. As a result, over 85 percent of the MASSIF committed portfolio is denoted in USD or EUR.

MASSIF's actual exposure to foreign currency risk is far higher than 13 percent, because of the large share of equity investments, which is also an important method to reduce risks for FI clients. As Figure 3.2 shows, nearly 60 percent of the MASSIF portfolio at end-2019 consisted of private equity investments. While these are typically denominated in USD or EUR, they do not imply a currency risk for the FI, as the amount does not need to be repaid, and the valuation risks are FMO's. An equity investment can therefore be an alternative method to de-risk investments and enable FIs to make riskier investments to service unserved or underserved target groups.

Nevertheless, it can be misleading to treat equity deals as local currency investments. In public reports, FMO sometimes states that the majority of its MASSIF portfolio consists of local

[40] MASSIF has a EUR 10 million exclusion from the four focus topics (and/or country list) agreed upon by the ministry. We understand from MFA that this exclusion is mainly there to provide a bit more flexibility, for example for investments in funds that are active in both MASSIF and non-MASSIF countries.

currency loans, when equity deals are considered 'local currency given the local exposure'.[41] FMO's argument is that investing long term in a local financial institution exposes MASSIF to risks that are correlated with local currency risk.[42] However, depending on the exact currency mismatch of the financial institution and its borrowers (which may be partly hedged due to e.g. USD deposits or USD export revenues), the risk for MASSIF is not exactly equal to local currency risk. The local currency exposure of MASSIF would therefore be overestimated when considering all equity investments as equivalent to local currency investments.

Excluding equity investments from the portfolio, the share of local currency loans in percent of total MASSIF debt investments was 40 percent. As of end-2019, MASSIF's currency risk exposure for loans to the private sector was 183 million in EUR equivalent, of which 74 million (40 percent) was denoted in currencies other than EUR, USD, or Swiss Franc.[43] This is still somewhat low given MASSIF's efforts to encourage local currency finance.

The majority of MASSIF's debt portfolio remains in foreign currency, which could reflect an underestimation of FX risks by MASSIF clients. Both the MASSIF team and our case studies confirmed that MASSIF clients often prefer FX loans, for three reasons. First, some economies are largely dollarized and virtually all local transactions are conducted in U.S. dollars (e.g. Zimbabwe, Lebanon). Second, clients often find local currency loans too expensive, as a result of the FX hedging costs incorporated in the pricing.[44] This is especially true in countries with high exchange rate volatility, for which TCX pricing may be prohibitive. With hindsight, however, it often turns out that end-borrowers may have been better off with local currency loans (e.g. in Lebanon). This suggests that the main reason MASSIF clients prefer FX loans is that they underestimate local currency risks. In such cases, MASSIF could possibly do more to encourage local currency finance.[45]

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41 For example, the 2018 Annual Report states that: "The Fund offers loans in emerging market currencies. We aim to match the currency needs of local banks and corporates, thereby reducing their currency risk. On December 31, 2018, 80% of the committed portfolio was in emerging market currencies. Please note that all equity deals are considered local currency given the local exposure."

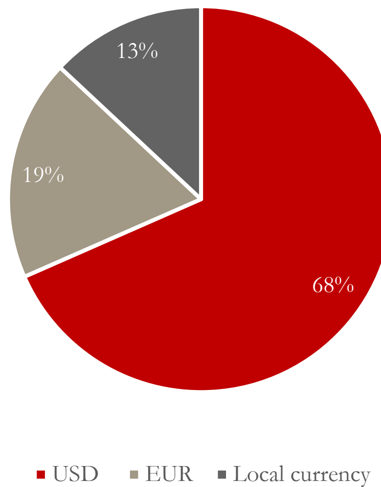
42 For example, in case a major currency depreciation, borrowers with LCY assets and USD liabilities may not be able to repay their USD loans, which in turn affects the market valuation of the FI and their ability to repay debt.

43 MASSIF 2019 annual report currency risk exposure. Page 62.

44 As noted in section 3.1, while MASSIF local currency investments are not hedged via TCX, MASSIF prices its local currency investments using TCX quotes as the market benchmark.

45 We get back to this point in the concluding chapter.

Figure 3.9 68% of the committed portfolio is in USD; 19% in Euros



Source: FMO MASSIF portfolio of active investments as of 31/12/2019

3.2.2 Strategic labels

MASSIF investments also go through FMO's own internal impact measurement systems and definitions. In this section, we briefly describe how FMO tries to 'steer' the impact of its overall portfolio, including MASSIF.

FMO's labels highlight the way in which individual investments align with certain criteria related to key strategic goals. FMO sets itself targets around labels (the share of its portfolio directed towards certain strategic goals) and uses them as a steering metric.

The Reducing Inequalities label is most relevant to MASSIF. The Reducing Inequalities label relates to SDG 10: Reduce inequality within and among countries. Reducing inequalities is also connected to gender and equality of opportunity for women and men (as reflected in FMO's gender strategy and SDG 5). Two tracks underlie the SDG 10 label: investment in a least-developed country (reducing inequality among countries) and investment in inclusive business (reducing inequality within countries). These two tracks are combined in one target: an investment can acquire the Reduced Inequalities label by investing in a least developed country or in inclusive business.

Out of EUR 545m total committed portfolio of MASSIF, EUR 348m (64%) is labelled as Reducing Inequalities (RI). This means that the labelled individual investment was in a least developed country (LDC – reducing inequalities among countries), or was in an inclusive business (reducing inequalities within countries) or in both. Out of the total RI volume, EUR 182m (52%) comes from investments in inclusive businesses, EUR 92m (27%) comes from investments in LDCs and EUR 73m (21%) comes from investments in inclusive businesses in an LDC. The labels are part of FMOs new 2025 strategy (June 2017), older investments do not carry labels.

Currently FMO's strategic labels are calculated ex-ante. This means that a label is granted before the investment is made and is not further checked or revisited ex-post. FMO is working on

an ex-post label measurement methodology which will be applicable to the entire portfolio by YE 2020.

3.2.3 Portfolio limits vs actual portfolio

As discussed in Section 3.1, the MASSIF fund has portfolio limits aimed at reducing its regional/country, currency and exposure risks. The table below shows to what extent the portfolio is within the agreed limits (December 2019). As the table indicates, all criteria were met except for one which was very nearly met (39% instead of 40% share in Africa).

Table 3.1 MASSIF's portfolio stayed within most portfolio limits

Portfolio limits	Actual portfolio	Portfolio within limits
Maximum 40% of Fund per Continent (excluding Africa)	Maximum 25%	✓
Minimum 40% of Fund in Africa	39%[46]	~
Maximum 20% of Fund per Country	Maximum 6%	✓
Maximum 20% of Fund per LCY	4,3%[47]	✓
Maximum 40% of Fund in funds	40%	✓
Maximum 7.5% of Fund per Single Client Limit	Maximum 4.16%	✓
Maximum 10% of Fund per Group, where Group is defined in FMO's concentration risk policy	<10%	✓

Source: SEO Amsterdam Economics (based on MASSIF Investment criteria and portfolio analysis)

3.2.4 FMO Customer Satisfaction Survey

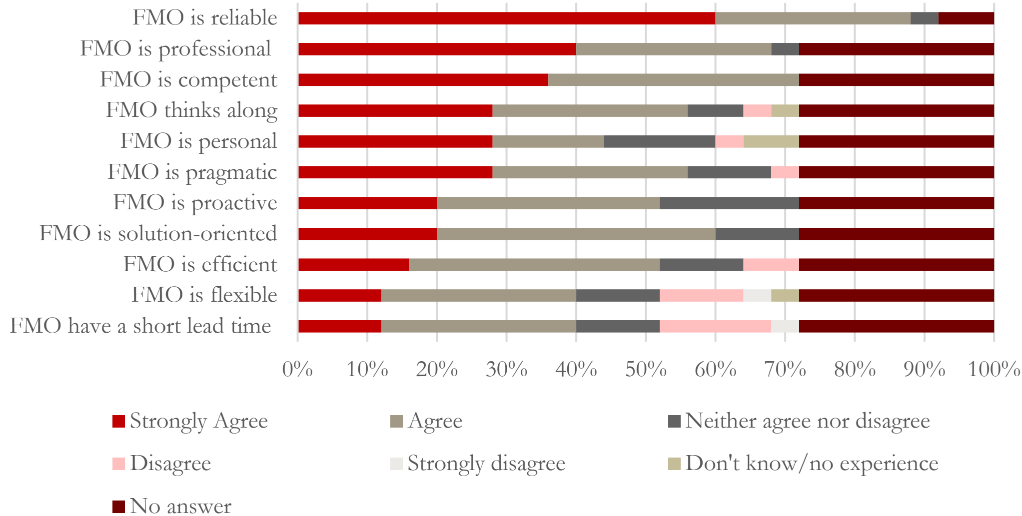
In 2019, FMO conducted a Customer Satisfaction Survey among MASSIF clients. The SEO evaluation team received a database with survey results, including the responses of 25 respondents from 24 different MASSIF clients. The 2019 survey was sent to 310 FMO clients of which 143 responded (25 from MASSIF clients). It was sent to all active debt and guarantee clients[48] and the survey was executed by CustomEyes, an external contractor. Because of the small MASSIF sample and the survey results should be interpreted with caution. However, the survey does offer insights into client perceptions of MASSIF.

Survey respondents attributed multiple positive characteristics to FMO. Figure 2.10 shows that these respondents considered FMO very reliable, professional and competent. Respondents were somewhat less positive about FMO's efficiency, flexibility and lead time.[49] This is in line with

46 Note that MASSIF has a few global registered funds (e.g. Visionfund) that are dedicated (mainly) to Africa.
47 Uzbekistan Sum. Massif does have a large USD exposure (>50 percent) but the USD is in this case not considered a LCY.
48 The survey was not sent to equity investees. The reason being that equity investees are not clients per se, and FMO's relationship with equity investees is fundamentally different from that with debt clients.
49 Note that 7 out of the 25 respondents did not respond to most of these statements.

the outcomes of our own twenty case studies (Appendix B). In general, however, the views on FMO were quite positive, as confirmed by the overall Net Promoter Score (NPS) of 68.[50]

Figure 3.10 Respondents find FMO very reliable and professional, but less efficient and flexible

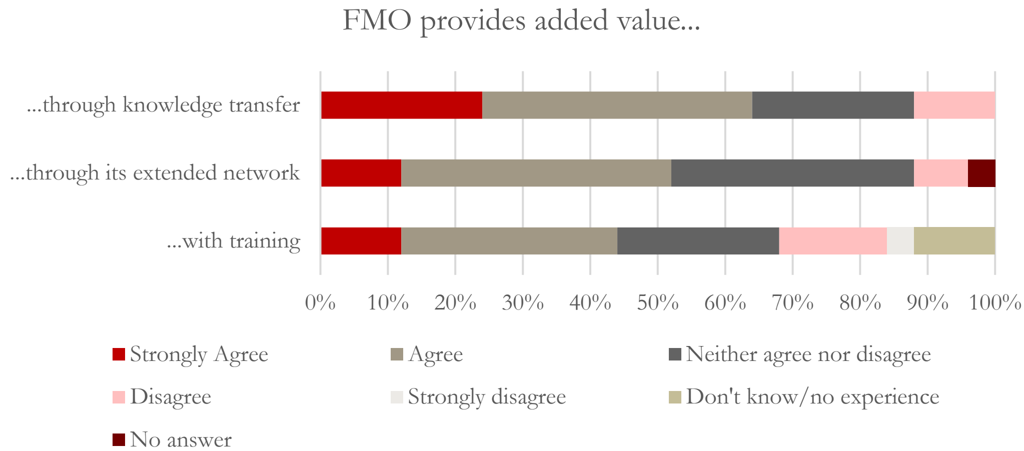


Source: SEO Amsterdam Economics based on FMO's Customer Satisfaction Survey data

The survey results suggest that MASSIF provides added value and was catalytic in attracting other financing. As Figure 3.10 shows, more than half of the respondents indicated that FMO provided added value through knowledge transfer and their extended network. However, the responses suggest that FMO provided less added value through training. Figure 3.11 suggests that almost 70 percent of respondents believed FMO's investments were catalytic in helping their organisation to attract more financing. However, the majority (13 out of 25) only stated that "it was easier to attract financing after FMO had provided financing" without necessarily explicitly attributing the additional financing to FMO. While this statement does not necessarily mean a causal relation exists, it is in line with our case study findings. Investees report a greater ease of attracting finance, either because of a signalling effect (FMOs 'seal of approval') or because additional equity from FMO enable them to attract more debt.

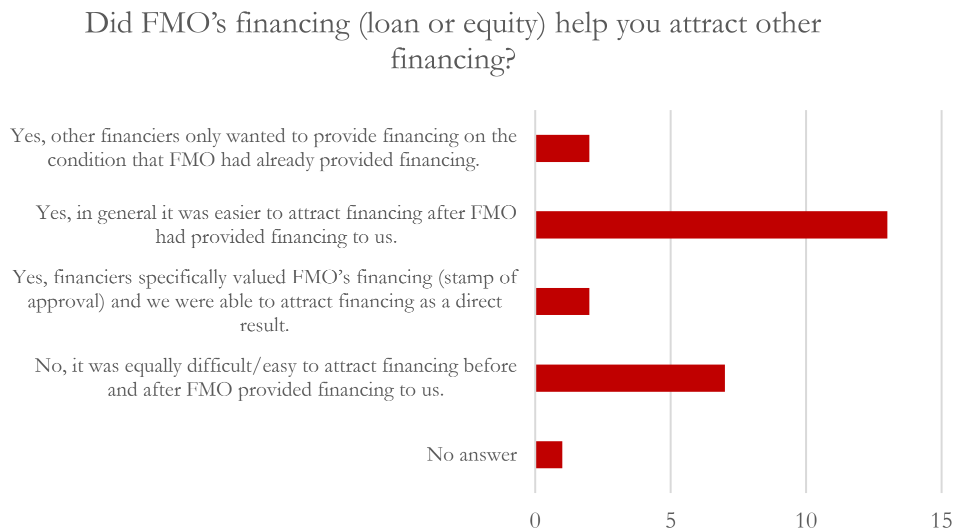
[50] NPS is a management tool that can be used to measure the loyalty of a firm's customer relationships. The NPS score is calculated by subtracting the percentage of customers who are Detractors (who would not recommend the firm to e.g. a friend) from the percentage of customers who are Promoters (who would recommend the firm to e.g. a friend). The NPS score can range between -100 (all customers are Detractors) and 100 (all customers are Promoters).

Figure 3.11 Respondents indicate that FMO mostly provides added value through knowledge transfer



Source: SEO Amsterdam Economics based on FMO's Customer Satisfaction Survey data

Figure 3.12 Survey responses suggest some evidence of catalytic effects



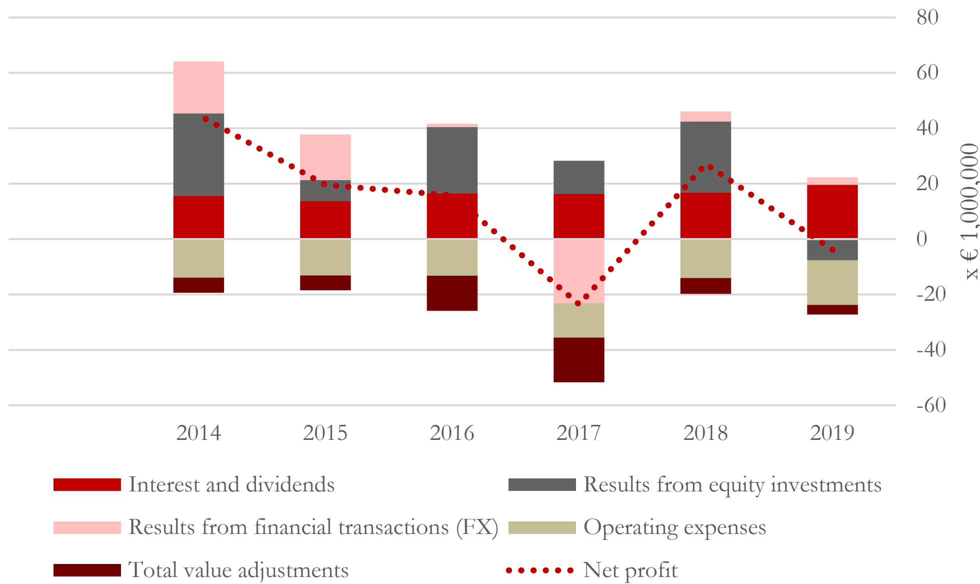
Source: SEO Amsterdam Economics based on FMO's Customer Satisfaction Survey data

3.3 Efficiency and financial performance

3.3.1 Profit and loss

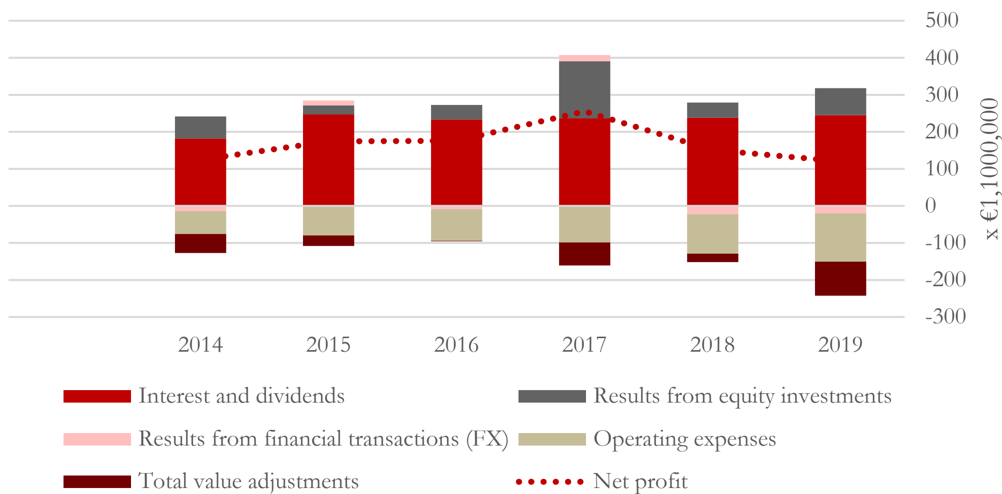
MASSIFs financial performance fluctuates more than that of FMO-A. Figure 3.13 and 3.14 provide a visual display of the profit and loss accounts of MASSIF and FMO-A for the years 2014-2019, interest and dividend income are quite stable but there are relatively large deviations in results from equity investments, value adjustments (mainly write-offs for expected credit loss) and in particular financial transactions, which primarily reflect foreign currency gains and losses.

Figure 3.13 Massif profit and loss 2014-2019



Source: SEO Amsterdam Economics based on MASSIF annual reports for 2014-2019

Figure 3.14 FMO-A profit and loss 2014-2019



Source: SEO Amsterdam Economics based on FMO annual reports 2014-2019

During the past few years, the level of MASSIF profits fluctuated quite a bit. MASSIF's net profits between 2014-2019 fluctuated between -0.8 and 11.6 percent of the fund capital, whereas FMO-A's net profits fluctuated between 1.3 and 3.1 percent of its total assets. The fact that MASSIF's profitability fluctuated more was due largely to foreign currency gains and losses, as MASSIF is much more sensitive to the Euro-dollar exchange rate. The 2019 MASSIF annual report stated that a 10% USD depreciation would result in a EUR 27 million deterioration of MASSIF's profit and loss account. This is significant with respect to MASSIFs average net profits (2014-2019) of just over EUR 13 million per year. The same 10% USD depreciation would result in a EUR 148

million deterioration of FMO-A's profit and loss account. While sizable, this impact is less than FMO-A's average (2014-2019) net profits of EUR 166 million a year.

An important difference between MASSIF and FMO-A is that FMO-A can leverage its portfolio by attracting debt. About two thirds of FMO-As assets consist of debt. This means that FMO-A has a significantly higher return on equity than MASSIF. FMO-A's average return on equity between 2014-2019 was twice as high (6.2 percent) as MASSIFs (3.1 percent). Nevertheless, MASSIF was on average more profitable than FMO-A during this same period (2.9 percent versus 2.0 percent). Excluding 2014, however, (which is not technically part of this evaluation), FMO-A (2.0 percent) outperformed MASSIF (1.5 percent).

Since MASSF invests more in equity, MASSIF net profits are also less stable from year to year. The years 2014, 2016 and 2018 saw significant results from equity investments and were profitable as a whole. The years 2014, 2015 and 2017 were also heavily affected by exchange rate volatility (especially between the euro and the dollar, and between the euro and local currencies linked to the dollar). In 2017, this resulted in a net loss for the MASSIF fund as a whole.

The currency risk appetite for MASSIF is different than for FMO-A. The FMO-A 2019 annual report states:

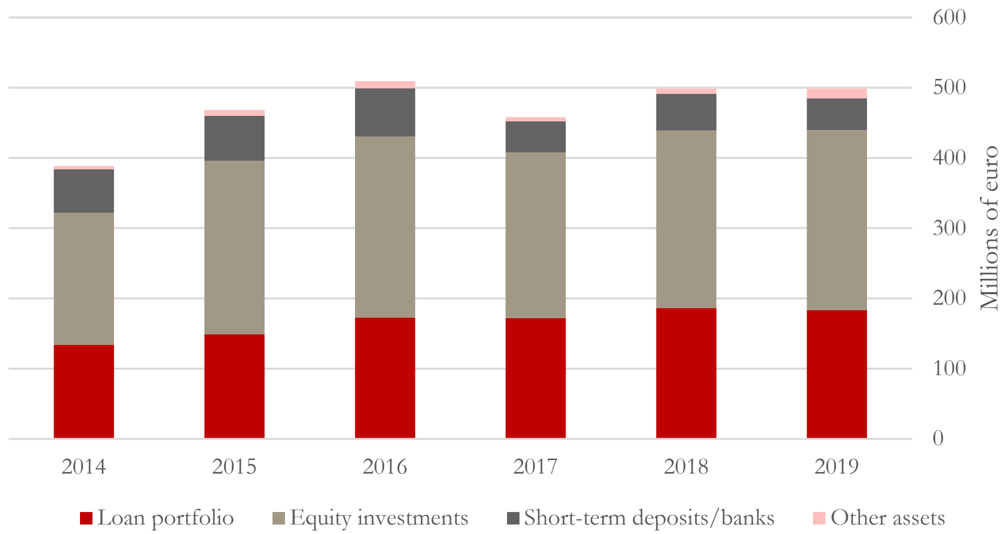
> *"FMO has limited appetite for currency risk. Exposures are hedged through matching currency characteristics of assets with liabilities, or through derivative transactions such as cross-currency swaps and FX forwards conducted with either commercial parties or with The Currency Exchange Fund (TCX Fund N.V.).*
>
> In contrast, the MASSIF 2019 annual report states:
>
> *"Due to its commitment to the implementation of the Fund's development agenda and impact objectives, the Fund does not exclusively look for investments that counter-balance this currency risk exposure in its portfolio; the Fund also does not use derivatives and other financial instruments to hedge against the currency risk, and avoids bearing the cost of these engineered measures."*

In 2019, over half of MASSIFs currency risk exposure was to the US dollar. A mere 20 percent of investments was denoted in euro (the currency in which MASSIF is funded by MFA). The next biggest exposure is to the Uzbekistan Som (just over 4 percent of portfolio).

3.3.2 Portfolio

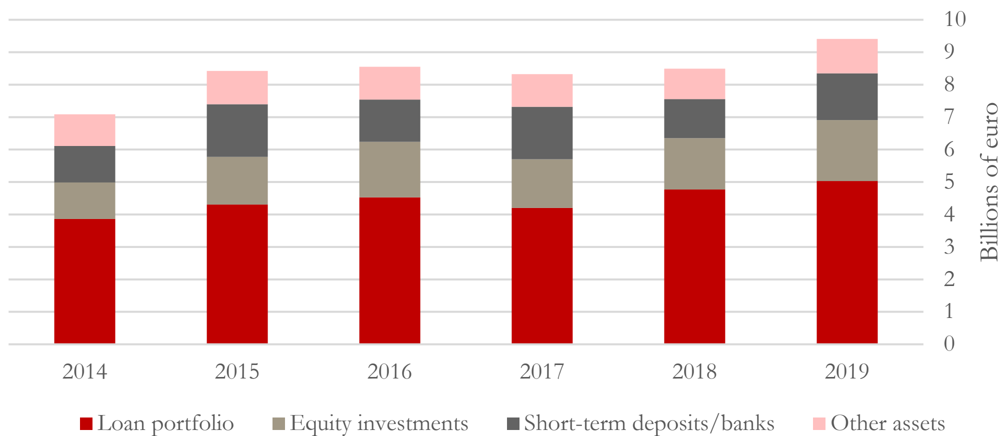
In line with its risk appetite, MASSIFs portfolio carries relatively more equity investments than FMO-A. This explains MASSIFs sensitivity to results on equity (as well as write offs on equity) as displayed in Figure 3.13 and Figure 3.14.

Figure 3.15 The MASSIF portfolio consists of just over fifty percent equity investments



Source: SEO Amsterdam Economics based on FMO annual reports 2014-2019

Figure 3.16 The FMO-A portfolio consists of relatively more loans and less equity



Source: SEO Amsterdam Economics based on FMO annual reports 2014-2019

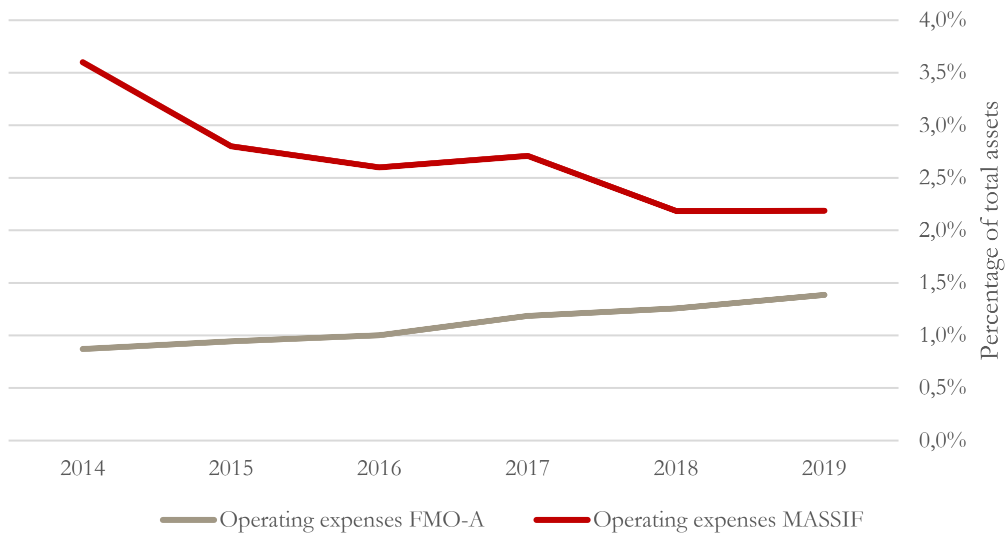
3.3.3 FMO remuneration and operating expense

Between 2014 and 2019, MASSIF's operating expenses decreased from 3.6 to just over 2 percent of total assets (see Figure 3.17).[51] While absolute operating expenses did not decrease significantly in this period, the volume of total assets increased more than 25 percent explaining the decreasing relative operating expenses. Since 2018, a new agreement between FMO and DGIS is in place, in which FMO receives annual management fees worth 2.0% of the total committed portfolio.[52]

[51] Total assets in 2019 were 498 million, committed portfolio just over 542 million. FMOs remuneration is 2 percent of the committed portfolio and thus about 2.2 percent of total assets.

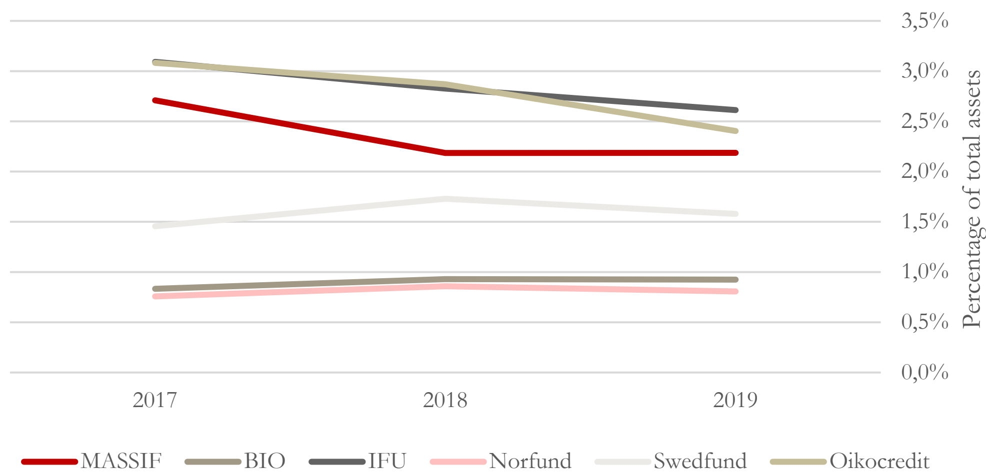
[52] Which is the sum of the current net outstanding portfolio and committed but not disbursed investments.

Figure 3.17 MASSIFs operating expenses in % of assets are higher than those of FMO-A.



Source: SEO Amsterdam Economics, based on MASSIF and FMO annual reports. Total operating expense for FMO-A is based on the P&L in the annual report and includes staff costs, administrative expenses and depreciations and impairment of fixed assets. The operating expenses of MASSIF include remuneration to FMO and other operating expenses. The Capacity Development expenses and the evaluation expenses reported in MASSIF's annual reports are excluded from this analysis.

Figure 3.18 MASSIF's operating expenses in percent of assets are below IFU's and Oikocredit but above BIO's, Norfund's and Swedfund's



Source: SEO Amsterdam Economics, based on annual reports for MASSIF, BIO, IFU, Norfund and Swedfund.

MASSIF's operating expenses are broadly in line with those of similar funds. Figure 3.18 shows that the operating expenses of the Danish development bank (IFU) [53] were around 2.5-3

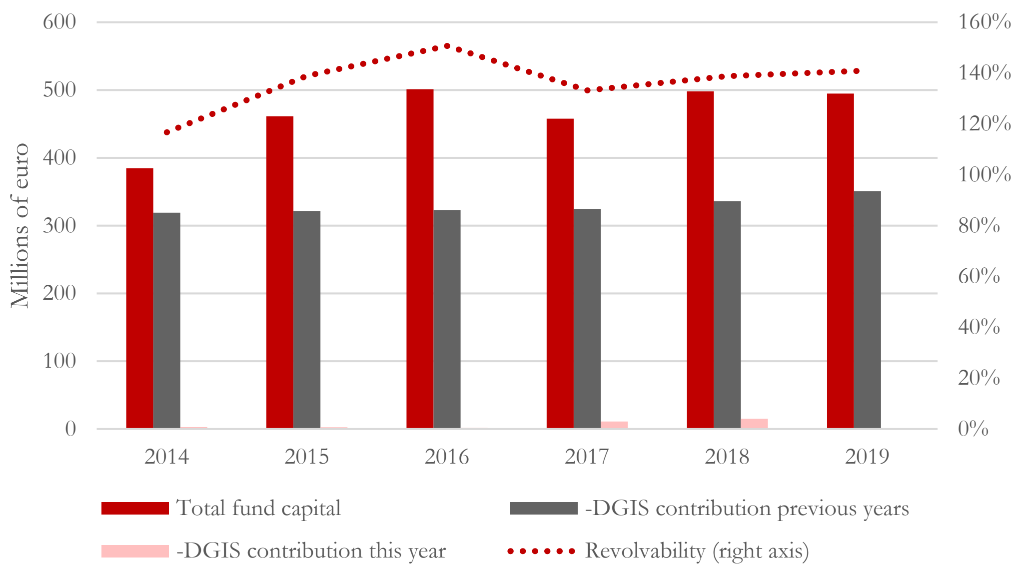
[53] Operating expenses of IFU comprise expenses for management, administrative staff, office expenses, depreciation of fixed assets and leasehold improvements, etc. (IFU annual reports).

percent of total assets. Oikocredit has similar operating expenses[54] compared to total assets. MASSIF's operating expenses[55] as a percentage of total assets were just above 2 percent in 2018 and 2019. The operating expenses of the Belgium development bank (BIO) [56] and the Norwegian Investment Fund for developing countries (Norfund)[57] only account for one percent of total assets. The operating expenses of the Development Finance Institution of the Swedish state (Swedfund)[58] are around 1.5% of its total assets.

Comparing operating expenses between DFI funds is complicated, because the nature of each DFI fund is different. On the one hand, one might expect larger funds such as Norfund (USD 2 billion), BIO (USD 1 billion) and Oikocredit (USD 1.2 billion) to benefit more from economies of scale than a smaller fund like MASSIF. On the other hand, MASSIF can benefit from the same infrastructure as FMO-A (over USD 9 billion). BIO and Oikocredit are similar in size yet have vastly different operating expenses. Another factor is that operating expenses for a high-risk DFI fund such as MASSIF might be higher relative to more commercial DFI funds. While it is therefore difficult to find the perfect benchmark, we can say that overall MASSIF's operating expenses appear to be reasonable, given MASSIFs size and investment profile.

3.3.4 Revolvability

Figure 3.19 MASSIF's overall revolvability has been relatively stable since 2015



Source: SEO Amsterdam Economics, based on MASSIF annual reports 2014-2019

54 Personnel, travels and other expenses.
55 The operating expenses of MASSIF include remuneration to FMO and other operating expenses. The Capacity development expenses and the Evaluation expenses reported in MASSIF's annual reports is excluded from this analysis as it is not part of the operating expenses of the other funds.
56 BIO annual reports do not specify the composition of the operating expenses.
57 Total operating expenses include payroll expenses, depreciation tangible fixed assets and other operating expenses (Norfund annual reports).
58 Operating expenses of Swedfund include other external costs, personnel costs, other operating expenses and depreciation of tangible assets (Swedfund annual reports).

During 2006-2019, MASSIF has by far outperformed its overall revolvability target of 100 percent. Full (100 percent) revolvability is reached when total fund capital is at least as much as the cumulative contributions to the fund by DGIS. As of end-2019, MASSIF was 141 percent revolvable. This is similar to the 139 percent revolvability at the start of this evaluation period in 2015.

Between 2014 and 2015, revolvability increased steeply, largely reflecting an administrative increase in the value of the equity portfolio built up in previous years (2006-2014). In general, FMO notes that equity successes can only be truly assessed five or even ten years after the investment was conducted. Until then, the valuation estimates largely depend on accounting standards employed. As FMO writes in its MASSIF 2015 annual report:

> *"Growth in the equity portfolio in 2015 is driven by changes in accounting conventions that enable MASSIF to formally recognise and report value creation in its equity portfolio built up over the years. (…) In recent years FMO has further improved its valuation process for equity investments and in addition more reliable information has become available. As a consequence, equity investments that were previously measured at cost or lower recoverable amount (as a best estimate for fair value), have been accounted for at fair value (…)"*

During the current evaluation period (2015-2019), MASSIF's overall revolvability remained broadly stable, suggesting that MASSIF took just the right amount of risk. As the chart shows, cumulative revolvability remained around 140 percent during 2015-2019, which means that the revolvability of the investments (as reflected by current 'fair value') made during this period was around 100 percent. The current high level of around 140 percent for the overall period 2006-2019 therefore still reflects the build-up in value that took place earlier (2006-2014), largely stemming from well-performing equity investments in that period.

MASSIFs relatively successful track record and high revolvability as of 2019 provide a comfortable buffer for the negative impact of COVID-19. While it is still too early to assess the full impact of COVID-19, MASSIFs committed portfolio already shrank by more than 6 percent between December 2019 and September 2020 (from EUR 545 million to 511 million).

Going forward, MASSIF's revolvability requirement of 100 percent continues to be appropriate. If it were set higher, then MASSIF would have less incentive to take risks and the additionality of MASSIF relative to FMO-A would be questionable. If it were set lower, this would effectively mean a subsidy, as the Dutch government would be funding MASSIF investments that have an expected negative rate of return from the outset. Such an implicit subsidy could risk being 'market distorting' if it allowed MASSIF to offer funding at a rate below the rate that market participants might be willing to offer. However, a subsidy element could potentially be justified in cases where (a) there is hardly or no market yet, (b) the expected development impact is high, and (c) potential catalytic effects or demonstration are high, i.e. the investment itself could over time make further investments in the client commercially viable. In order to ensure that such cases are treated separately from cases where a subsidy is not needed, it might be preferable to set up a special sub-fund to stimulate such investments, rather than an across-the-board lowering of the

revolvability target.[59] The additional overhead costs of running such a sub-fund would depend on whether it is structured as a separate legal entity or a more internally labelled version which would apply modified investment criteria to eligible investments but otherwise would follow the same approval and monitoring processes as MASSIF (See Section 7.6).

3.3.5 Financial results of individual investments

MASSIF's overall financial results are the sum of the results of individual investments, which vary. Figure 3.20 shows that 37 out of 65 equity investments currently in the portfolio (annual report 2019) are valued at the same or less than their original value. This means that FMO has adjusted the value of these investments downward in response to new information. The other 28 are currently valued more than what was originally invested.

Figure 3.20 The return on equity investments varies greatly.

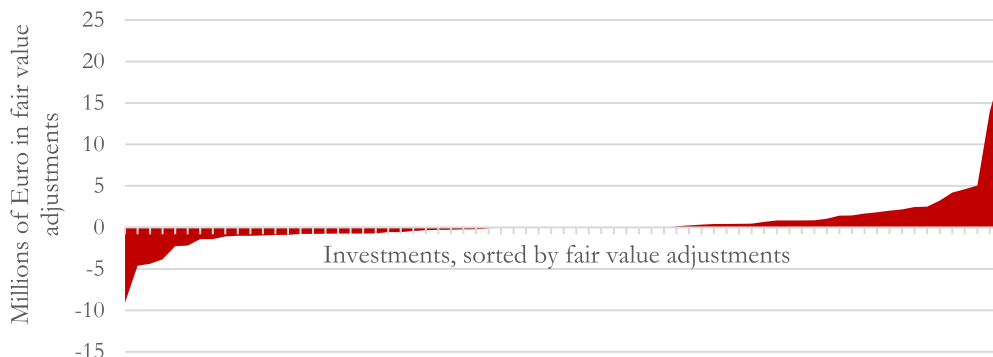
Source: SEO Amsterdam Economics based on current portfolio outlined in MASSIF annual report 2019 (non-public version)

A significant proportion of equity results achieved is due to a limited set of successful MASSIF investments. This becomes clear in Figure 3.21, which uses the same underlying data as Figure 3.20 but presents the fair value adjustments in Euro, instead of in number of investments. At the other end of the scale there are 11 investments on which MASSIF has lost a million euros or more (at 2019 year-end estimated fair value). The majority (9 out of 11) of these investments were equity fund investments. Figure 3.21 is indicative of the inherent risks taken with equity investments. Some deals may grow to be worth two or three times as much as was originally

[59] Some DFIs have such funds for specific countries or specific sectors. For example, EBRD mobilised donor funding for its "Early Transition Countries Initiative" to allow it to accept higher risks in the projects it finances in countries with the most significant 'transition challenges': https://www.ebrd.com/what-we-do/sectors-and-topics/early-transition-countries-initiative.html

invested whereas others will have to be completely written off. This is typical and expected in the private equity industry.

Figure 3.21 A limited number of equity investments is responsible for most of the return



Source: SEO Amsterdam Economics based on current portfolio outlined in MASSIF annual report 2019 (non-public version)

Most MASSIF equity investments have an 'average' return on equity. This makes sense because these data refer to the current portfolio. In that sense they represent a point of time estimation because they do not include successful or unsuccessful investments exited by MASSIF at an earlier stage. However, the current portfolio does show the general dynamics of equity investments and how a limited set of outliers can ultimately determine the success of the fund.

Distinguishing (ex-ante) between successful and unsuccessful equity investments is one of the biggest challenges for investors, including MASSIF. The data from the annual reports currently do not allow for the identification of success factors or common traits of successful equity investments. MASSIF did commission a 'track record' study which includes some analysis on equity performance and loan return.[60] One finding was that investments from vintage year 2008 and 2009 were exited with a substantial margin. Although this is not made explicit, it might very well be that these successful investments are part of the reason the revolvability of the fund increased sharply in 2014. Another finding is that the annual growth rate of equity investments (IRR) between 2007 and 2017 was by far highest in Asia (over 15 percent) and significantly lower in Africa (5 – 6 percent) and Latin America (4 – 5 percent). By further improving the portfolio data collected for equity investments, more analysis of the factors that determine successful or unsuccessful equity investments could be conducted.

The dynamics are different for the loan portfolio. Because of fixed interest rates, it is less likely that a few highly successful loans become drivers of the overall portfolio performance. However, MASSIF does carry the downward risk of clients defaulting. Out of all 54 loans in the 2019 portfolio, nine were valued (by 2019 year-end) at less than 95 percent of their original value, with three valued at less than 60 percent of their original value. The credit loss on these three investments alone is estimated by MASSIF at over EUR 17 million.

[60] Bosma C. Bakardzhiev (2019). Track Record MASSIF, April 2019

4 Environmental, Social and Governance (ESG) risks

This chapter first describes the ESG policies and procedures that apply to MASSIF. Subsequently, we discuss our case study findings on the application of ESG risk identification, ESG risk management and ESG risk monitoring.

4.1 ESG policies and procedures

This chapter describes FMO's policies regarding Environmental and Social (E&S) risks, Corporate Governance (CG) risks, and Client Protection Principles (CPP), and the way these are applied to MASSIF investments. In order to avoid overlap with the ongoing FMO-A evaluation, it was decided that the MASSIF evaluation would focus on the application of FMO's E&S policies on MASSIF investments, while the FMO-A evaluation would assess FMO's general E&S risk management policies and their implementation.[61]

Since MASSIF investments are predominantly in Financial Institutions (FI), the focus of this chapter is on FI-specific ESG risk management. MASSIF clients are typically FIs, Microfinance institutions, banks or investment funds which in turn have clients in other sectors. In terms of implementation, E&S, CG and CPP risk management for these sectors is different than for other sectors, such as agriculture or energy. FMO's policy for FIs is typically to help them manage ESG and CPP risks themselves, as a large part of the risks inherent to MASSIF transactions are usually borne at the end-beneficiary level. Accordingly, although abiding by the same general FMO E&S, CG and CPP policies, MASSIF investments are generally managed in a different manner from other investments given their particular sectoral profile.

This chapter is structured as follows. For each of the sustainability dimensions (E&S, CG and CPP), we proceed in three steps. First, we examine FMO's policy regarding *risk identification and assessment*. Second, we assess the *risk management and mitigation* systems FMO implements to account for and deal with these perceived risks. Third, we investigate the *monitoring tools* used to gauge the client's progress in mitigating E&S, CG and CPP risks over time. Finally, we draw conclusions regarding the actual application of these policies and tools, based on our case study findings (see Section 4.2). Section 5.3 discusses the value added of ESG policies and capacity development under the heading of 'non-financial additionality.'

4.1.1 E&S risk policy

The E&S policy framework is the same for all FMO operations. MASSIF investments abide by FMO's general Sustainability Policy framework. Their E&S risk is screened on a scale from 'C' (low risk) to 'A' (high risk) in order to decide whether to implement specific E&S risk management systems. These can take the form of continuous monitoring and/or Capacity Development (CD).

[61] Itad (2020), Inception Report: Evaluation of the Agreement between the State and FMO.

For Financial Institutions (FI) and Private Equity (PE) Funds, which constitute the majority of MASSIF investments, FMO's E&S risk categorisation is further defined in Table 4.1.

Given FMO's sector specific risk management, MASSIF investments are typically managed in a way that is tailored to FIs and investment funds, which have an inherently different E&S risk profile from other FMO investees. MASSIF primarily invests in FIs and investment funds that are meant to on-lend to, or invest in, different segments of society.[62] This entails that, for each client it invests in, the MASSIF fund is exposed to the E&S risks inherent to the entire economy their clients operate in. MASSIF clients usually have their own portfolio, composed of loans and investments in businesses and individuals in their domestic economy, and are thus subject to economy-wide risks. By having a stake in or lending out to such clients, FMO is effectively exposed to their E&S risks, which vary depending on the sectors they invest in. For instance, end-beneficiaries can invest in the energy, infrastructure or agribusiness sectors, which can represent high E&S risks, or be involved in child labour, safety- or human rights violations.

E&S risks for small banks, FIs and funds are typically low. This is due to scale: the MFIs and the small banks in the portfolio typically invest in small-scale actors, such as smallholders or (M)SME, for which the perceived E&S risk is usually relatively small.

Table 4.1 E&S risk categories for FIs and PE funds

FIs	**Category FI-A (high risk)**	FIs with an existing or proposed portfolio that includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
	Category FI-B (medium risk)	FIs with an existing or proposed portfolio that includes, or is expected to include, business activities that have potential limited adverse environmental or social risks or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures; or includes a very limited number of business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
	Category FI-C (low risk)	FIs with an existing or proposed portfolio that includes and is expected to include business activities that predominantly have minimal or no adverse environmental or social impacts.
PE funds	**Category A (high risk)**	Private Equity Funds which (intend to) invest >15% of its portfolio in high risk (e.g. Category A or B+ as defined above for Direct Investments).
	Category B (medium risk)	Private Equity Funds which (intend to) invest <=15% of its portfolio in high risk (e.g. Category A or B+ as defined above for Direct Investments).

Source: "Sustainability Policy" document in FMO's Sustainability Policy Universe, 2016. Obtainable at https://www.fmo.nl/policies-and-position-statements.

FMO deal teams usually choose to help MASSIF clients manage E&S risks themselves.[63] In 5 out of 20 case studies, FMO actively engaged with clients to help them manage and mitigate E&S risks. According to an FMO officer, it is impossible for FMO to assess and mitigate E&S risks directly due to the distance between FMO and the end-beneficiary. In their view, it is better to do so indirectly by actively engaging with clients, "helping to make them champions in managing E&S risks in their portfolio". In 4 out of these 5 cases, a Capacity Development (CD) project supported a client to improve their own E&S risk assessment, management and mitigation.

62 MASSIF Annual Report, 2019, accessed at https://massif.fmo.nl/2019/.

63 This decision is taken after a preliminary risk screen which assesses whether the deal is eligible and does not trigger any breach of IFC's exclusion list. A thorough KYC check is also performed in each investment. We describe these criteria further below.

FMO collaborates with other banks and Development Finance Institutions (DFIs) in developing a common framework for E&S risk assessment, management and monitoring, sharing information and knowledge, and jointly financing and engaging with clients. FMO is a member of the Association of bilateral European DFIs (EDFI), has a Friendship Facility agreement[64] with Proparco and the German Investment and Development Company (DEG), and a Master Cooperation Agreement[65] with the International Finance Corporation (IFC).

FMO's E&S standards stem from the "EDFI Harmonised E&S Procedures and Standards for Financial Institutions". These were approved in 2019 by the EDFI community, in consultation with Multilateral Development Banks (MDBs)[66] and include its risk classification methodology and E&S management and monitoring decision-making process. According to FMO, EDFIs have applied these standards since 2020.

E&S risk identification and assessment

Once a client has been selected, its E&S risk is assessed during both the 'Clearance-in-Principle' (CIP) and the Due Diligence (FP) phases using the "Rapid Risk Screen" (RRS) tool. This tool, which is part of FMO's "ESG toolkit", enables the investment team to classify clients as 'A', 'B' or 'C' risk. An FI's E&S risk is assessed by breaking down its portfolio risk and ensuring that it is not exposed to activities that are part of FMO's Exclusion List.[67] Since September 2020, this tool has been fully integrated within FMO's Sustainability Information System (SIS).

During the CIP phase, the client's risk is assessed by examining its portfolio's composition and sectoral exposure. The FI's E&S category depends on whether its portfolio has a significant (larger than 20 percent) exposure to high risk sectors, such as the oil or gas industries, and/or whether a large portion (over 80 percent) is in retail or involves micro-businesses. This risk category is increased, decreased or remains the same depending on a more granular analysis of the FI's portfolio, including (i) its exposure to so-called "IFC Performance Standards Triggered transactions"[68]; (ii) its exposure to short-term finance; and (iii) its average loan size or financial engagement. As we have seen in Section 3.2, the portfolios of MASSIF investees are generally composed mostly of loans with a small average size that are short-term (less than one year), which are typically perceived as less risky in E&S terms. Client-specific E&S issues identified by the investment team can increase its risk category.

In a last step, the portfolio is checked against FMO's Exclusion List. This includes "non-permitted" categories in which FMO cannot invest, and "permitted" categories in which FMO can invest up to a 10 percent threshold for a given underlying portfolio volume (for financial

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64 In 2012, the three DFIs created a co-financing facility enabling them to pool their resources and delegating project selection, screening and monitoring to one of the members.

65 This agreement facilitates project co-financing in key development sectors.

66 See https://www.edfi.eu/policy/.

67 The Exclusion List contains the list of sectors FMO will not invest in, or invest in to a limited extent.

68 This is defined as project finance and corporate loans related to project finance with a total project cost larger than US$10mln and a tenor larger than 36 months, or with a facility size that is larger than US$5mln and a tenor larger than 36 months (from FMO's Sustainability Policy document and the ESG toolkit's Rapid Risk Screen.)

institutions and investment funds) or consolidated balance sheet or earnings (for companies).[69] According to FMO's investment criteria, no investment by FMO, its borrowers or any affiliated party (e.g. shareholders and subsidiaries) can breach this threshold for any given "permitted" product category (alcoholic beverages; tobacco; weapons and munitions; or gambling activities).[70] The FI's portfolio is also checked for any exposure to activities dependent on the coal industry, ensuring that these remain below 20 percent of underlying portfolio volumes.[71] Table 4.2 presents the risk categorisation process in more detail.

In addition, the client portfolio's share of loans per industry sector is assessed and its top ten clients (in terms of outstanding exposure) are listed and assessed. The E&S risks associated with these top ten clients is subsequently assessed using, among other sources, RepRisk, an AI-powered platform providing ESG risk indicators and metrics on companies and projects around the world using information from public sources and stakeholders.[72] RepRisk's research method consists in scanning thousands of information sources on 28 predefined ESG issues to compute an ESG exposure score, the RepRisk Index. Owing to its rigorous methodology, RepRisk is usually considered an objective and reliable source of data on ESG risks. [73]

E&S risk screening is further conducted through a general E&S questionnaire (ESQ), sent and completed by the client during the CIP phase. Through the ESQ, FMO investigates the client's E&S governance structures, such as the presence of an E&S officer and whether E&S is incorporated in the credit process. It also helps determine whether an Environmental and Social Management System (ESMS) is present and sufficiently developed. Lastly, it requires the client to list ESMS-relevant loan book information, such as the industry sectors its clients operate in, as well as its top ten clients. This questionnaire is meant to provide the investment team with more information on the client's E&S management performance, as an input for the FP and the general E&S due diligence.

At the FP stage, this risk categorisation is either confirmed or changed. The same risk screen conducted during the CIP phase is applied, using the RRS tool. The client's compliance with FMO's Exclusion List is also checked again. In addition, the client's top ten clients as well as the client's exposure to high-risk sectors is verified a second time. Within the period between the CIP and the FP phases, FMO deal teams assess client exposure to large corporate loans, including project finance. This enables a more thorough assessment of the actual E&S risks in its portfolio, which is then discussed with the client during the E&S due diligence. For high-risk (A-rated) clients, this assessment is conducted physically, at the client's premises. The client's risk category can then increase, decrease, or remain the same.

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69 From "The FMO Sustainability Policy Universe", available at https://www.fmo.nl/policies-and-position-statements, and FMO's Investment Criteria (November 2019), p. 9.

70 See also https://www.fmo-im.nl/en/exclusion-list.

71 ESG Rapid Risk Screen (January 2020).

72 See https://www.reprisk.com/.

73 Ezeokoli, O., Statman, M., & Urdapilleta, O. (2017). Environmental, Social, and Governance (ESG) Investment Tools: A Review of the Current Field.

Table 4.2 Most financial institutions in our case study sample are in the low E&S risk category

<table>
<tr><th>Risk category</th><th>Basic criteria</th><th>Upgrade criteria</th><th>Downgrade criteria</th><th>Case studies in this category[74]</th></tr>
<tr><td>FI-A (high)</td><td>High exposure to high-risk sectors (more than 20% of the total portfolio)</td><td rowspan="3">More than 10% or more than USD 300mln of portfolio exposed to IFC PS-triggered transactions

Specific E&S challenges[75]</td><td rowspan="3">More than 75% of portfolio exposed to short-term financing (less than 12 months)

The average loan size or financial engagement is lower than EUR 25 000.</td><td>0</td></tr>
<tr><td>FI-B (medium)</td><td>Low exposure to high-risk sectors (lower than 20% of the total portfolio)
Less than 80% of portfolio in retail or micro business</td><td>3</td></tr>
<tr><td>FI-C (low)</td><td>Low exposure to high-risk sectors (lower than 20% of the total portfolio)
More than 80% of portfolio in retail or micro business</td><td>10</td></tr>
</table>

Source: SEO Amsterdam Economics, based on FMO's Investment Criteria (November 2019) and the EDFI's harmonised E&S screening framework.

Case studies and interviews with FMO employees suggest that the majority of MASSIF investments are at most B-rated because they are not significantly exposed to high-risk sectors.[76] Moreover, the relatively small scale of MASSIF FI activities entails that their portfolios are exposed to a large number of retail or micro businesses and/or to short-term finance and/or to low average loan sizes, which means that their E&S risk is usually further downgraded to "C". Out of our 13 case studies that are financial institutions, 10 had an E&S risk rating of FI-C, 3 of FI-B, and none was rated FI-A. Out of the entire case study sample, only one was rated A, 6 obtained a rating of B, and 13 of C.

Both CIP and FP-stage RRS have recently introduced a "contextual risk assessment" requirement. As part of this assessment, the IO and/or E&S Officer is required to list any exposure to contextual risks that could increase the transaction's E&S risk. Important contextual risks include human rights, indigenous peoples, land rights, climate impact, water, deforestation, and negative NGO or media attention.[77] This risk assessment does not change the formal E&S risk rating but can alter the manner with which E&S risks are subsequently managed. For instance, a B-rated institution can be managed as an A-rated one if the contextual risk of exposure to human rights violations is relatively high. As an E&S officer told us, "Even a C-rated client may have a human rights impact that we decide to manage and monitor." This is part of FMO's strategy of trying to embed human rights issues at every step of the investment process.[78]

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74 Only the financial institutions in our case study sample we included here. The risk ratings listed are FMO's own risk classifications.

75 E&S challenges include country-specific E&S issues such as indigenous people, land rights, water and deforestations, as well as negative NGO or media attention.

76 FMO Investment Criteria, November 2019.

77 ESG RRS (January 2020), E&S CIP and FP E&S.

78 See FMO's first Human Rights Progress Report, 2017-2018, accessible at https://www.fmo.nl/news-detail/62ddcf18-8041-4968-b0e3-0bc257750e08/fmo-publishes-its-first-human-rights-progress-report and FMO's Position Statement on Human Rights, accessible at https://www.fmo.nl/news-detail/62ea0bff-d3cd-42f5-888e-e906c191a990/walking-the-talk-on-human-rights.

E&S risk management and mitigation

All medium to high (FI-A and FI-B) E&S risk-rated FIs are required to adhere to the IFC E&S Performance Standards[79] and its associated World Bank Group Environmental Health Safety Guidelines,[80] for all IFC PS-triggered transactions (see above for more details). Clients rated C, on the other hand, merely have to adhere to applicable national and international law, the exclusion list, as well as the Client Protection Principles (CPP; see below for more details). These requirements are enshrined in the signed contract. Moreover, for clients in the FI-A and FI-B categories, ESG specialists can be included in the deal team and throughout the duration of the contract. This is standard practice for category A clients, and done when needed for category B clients. The extent of their involvement depends on a decision taken by FMO's Front Office, based on the RRS outcome.

An E&S Action Plan (ESAP) is included in the contract if a client does not meet FMO's minimum requirements and/or if measures need to be taken to mitigate identified E&S risks. This is generally the case for A-rated clients and for B-rated clients with IFC PS-triggered transaction. The ESAP outlines all the E&S risk management action items a client will have to undertake in order to mitigate its E&S risks, including changes in its governance structure[81], Capacity Development aimed at E&S management staff training, the drafting of an E&S policy document, and the use of a set of E&S risk assessment tools. The ESAP's ultimate aim is to launch an E&S Risk Management System (ESMS) at the FI in question. The ESMS has to at least cover the client's IFC PS-triggered transactions and contextual issues, as well as, for A-rated clients, any activity in high-risk sectors.[82] All contractual agreements regarding E&S risk management are summarised and listed in the E&S Review Summary (ESRS), which is then attached to the FP for review.

Out of the 20 case studies we examined, FMO helped draft an ESAP in 3 out of 20 cases. This was either done during the due diligence process or following MASSIF's investment. In the former case, an ESAP was drafted to help the (A-rated) client manage the relatively high E&S risks generated by its portfolio through the implementation of a complete ESMS (including, for instance, the establishment of dedicated staff capacity). In the latter case, which occurred only once, the publication of a third-party public report on the potential implication of FMO's (B-rated) client in human rights infringements led to the elaboration of an ESAP, co-drafted by FMO, its client and an independent external consultancy.

FMO's newest financial proposal (FP) template[83] serves to structure E&S risk screening and management. In it, the IO has to fill in a client's risk category, the factors having led to the client being categorised as such, and, if significant risks are identified, the E&S Action Plan items that are to be put into place in order to mitigate them (see below for a description of those). Factors leading to a particular risk screen that can be listed include (i) direct impacts, related to the client's

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79 Accessible at: https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/

80 Accessible at https://www.ifc.org

81 Changes in the client's governance structure as a means to mitigate E&S risks can be discussed together with a corporate governance officer during due diligence in the case of C-rated clients as well. See below for more information on the CG Action Plans (CGAP).

82 FMO Investment Criteria, November 2019.

83 Template version 29-10-2019.

portfolio, (ii) contextual impacts, e.g. related to country risk (iii) the likelihood and severity of such potential impact, (iv) credit and reputational risks posed to FMO, and (v) gaps between the client's labour and social standards and policies and IFC's Performance Standards as well as measures to be implemented (after funding is provided) to fill identified gaps.

E&S risks can also be managed through the provision of CD, which is one of the tools that FMO can use to improve its clients' E&S policies and procedures. As of yet, there is no standardised procedure used by FMO to determine a client's need for CD based on its E&S risk classification.

E&S risk monitoring

The extent of E&S monitoring depends on the FI's E&S risk category as well as the transaction's identified contextual risks. For "A" and "B"-rated clients and/or for which significant contextual risks have been identified, FMO regularly checks whether it has completed a sufficient number of ESAP action items before previously agreed dates using an internal E&S tracking IT system called SusTrack. FMO has added a new monitoring tool, the ESG Performance Tracker, to SusTrack in order to streamline monitoring. New indicators were recently implemented to more easily gauge a client's progress on its ESAP action items. Each client progresses from 'red' (starting point) to 'orange' or 'green' (the ultimate goal) on its individual action item. FMO's goal is to see a certain percentage of 'red' items progress annually. All trackers are incorporated into FMO's Sustainability Information System (SIS).

FMO also requires "A" and "B"-rated clients to complete an E&S Annual Monitoring Report (AMR) and forward it to their Investment Officer (IO). The AMR includes questions about ESMS implementation, portfolio composition, and clients. It thereby offers a more detailed assessment of a client's E&S management progress.

Regardless of their risk profile, the Client Credit Review (CCR) is expected to include each client's progress regarding E&S management as well as any change in perceived E&S risks. The E&S officer in charge provides textual input for medium- to high-risk clients (FI-B to FI-A), works with an E&S Manager in the case of novel perceived E&S risks with the client, and uses up-to-date E&S performance and portfolio data to assess the client's E&S risk evolution. In addition, the ESG team might decide to conduct monitoring visits and/or independent external monitoring, depending on a client's risk profile. It can also commission development impact evaluations.

4.1.2 Corporate Governance (CG) risk policy

Corporate Governance (CG) risk assessment, management and monitoring for MASSIF investments are generally governed by FMO's general CG policy. Clients are screened on a scale from 1 (high risk) to 3 (low risk), based on the maturity and ownership of their governance structures. Subsequently, it is concluded whether the CG is deemed adequate or not and whether mitigating actions are required (as discussed further below).

Since MASSIF clients are typically smaller and less complex FIs, their CG structure is less developed. The dominant risk factor for typical MASSIF clients is the poor quality of the structure

and functioning of their Boards, which usually suffer from key-person risks related to their founder's oversized influence, and necessitate stronger top-level management, independent Directors and succession planning. Moreover, CG responsibility is not always officially assigned within the firm, or its activities are not sufficiently transparent and disclosed. In such cases, the CG risk perceived by FMO is relatively high. The countries where MASSIF clients operate often lack substantial regulations regarding CG in a country and/or lack knowledge about CG management and concepts, or the presence of a corporate governance 'culture'. These factors explain the moderate CG risk profile of our case study sample: out of the 16 transactions that obtained a CG risk rating: [84] 2 were low, 12 were moderate, and 1 was high.

In equity investments, FMO has direct access to a client's Board and thus can influence governance changes. FMO typically nominates (Supervisory) Board members who, through their active participation in the client's Board meetings, can have a direct impact on its policies and procedures. This occurred for 3 out of 4 MASSIF equity investments into firms we have studied (this excludes PE fund investments, which entail an Advisory Council (AC) Board member nomination). Nonetheless, since CG conditions are included in a shareholders' agreement (which includes generic CG-related clauses) and not a contract, changes in CG policies and procedures require convincing the client to undertake them. It is also possible that the client's Board might not be receptive to FMO's Board member's requests.

FMO's investment is expected to have a catalytic impact through developing the client's CG structure. Indeed, FMO's investment can reduce a client's perceived risk in the eyes of other potential investors through developing its CG structure. In other words, helping a client improve its CG procedures may, in the medium- to long-run, help catalyse further investments.

Along with 34 other DFIs, FMO has adopted the CG Development Framework (CGDF), a "common approach on how to address [CG] risks and opportunities in DFI investment operations"[85] which is based on the IFC's CG methodology. An FMO Corporate Governance officer is the Chair of the CGDF working group. Each signatory of the CGDF aims to incorporate CG in its operations according to the CGDF methodology and harmonised assessment standards, and to collaborate and share knowledge with other signatories.

FMO's CG assessment and management methodology is different in the case of private equity (PE) funds, which have a standardised CG setup, and for which FMO's classic CG methodology does not apply. As a CG officer explained, most PE funds have a standard structure, which includes fund managers, limited partners (LPs) and general partners (GPs). In such cases, FMO merely investigates whether anything in the firm's CG structure is "out of the ordinary". With PE funds, FMO nominates an AC member in order to "play an active role", while it is usually reluctant to take Internal Control (IC) seats, except if IC is not independent from the Management Team or if IC members' experience is too low. [86]

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84 FMO does not give CG risk ratings to Private Equity funds because of their particular governance structures (see below).
85 See http://cgdevelopmentframework.com/#.
86 FMO Investment Criteria, November 2019.

CG risk assessment

The initial CG risk rating is determined by a high-level questionnaire completed during the CIP phase, administered by an IO. It includes a total of ten true/false general questions, on five attributes (two questions per attribute) deemed essential to assess CG risk: (i) the client's commitment to CG, (ii) the structure and functioning of its Board of Directors, (iii) its control environment and processes, (iv) transparency and disclosure, and (v) shareholder rights. A CG officer conceded that this questionnaire is purposefully incomplete, since it is used as an "early, easy assessment of whether an investment is high risk or not", and to determine whether or not to include a CG officer in the Due Diligence process. Hence, it is not a screening instrument per se.

In the case of financial institutions, if one or more questions are answered with "true",[87] a CG officer (CGO) is consulted. As a result of this consultation, the CGO can decide, jointly with the investment team, whether to be involved as early as the due diligence phase. Unlike E&S officers, who oversee the vast majority of FMO's transactions, CG officers typically only deal with high-risk investments and/or those where FMO considers itself able to add sizeable value, as a CG officer we interviewed pointed out.

At the FP stage, a more detailed questionnaire is completed by the investment team or CGO. It includes 25 open-ended questions to be briefly answered by the IO or CGO, following due diligence, 5 for each CG attribute. For each question, the client is classified into three different levels of CG maturity: 'basic', 'emerging' and 'developed'. These classifications are substantiated with a short explanation of each maturity rating, which are based solely on evidence available at the present time: they should not rely on assumptions about the future.[88] More questions can be addressed if the client in question is family-owned or a technology/FinTech firm.[89]

A CG risk score is given to the client based on the maturity of its CG structure, and the corresponding expectations. Based on expert judgement, FMO decides whether a given client's CG practices are in line with what should be expected from it, based on circumstantial evidence. For instance, FMO might be comfortable with basic CG practices in the case of a small MFI, and thus give it a relatively low risk rating, while considering similarly basic CG policies risky in the case of a large regional bank. The IO/CGO must then indicate which risk mitigating activities to undertake in case a client's CG development is deemed insufficient.

The investment team (and/or CGO, if involved in the transaction) also meets with the client's Directors, executive management and other staff responsible for implementing and managing the CG framework. These meetings help the IO/CGO better understand the client's CG policies, procedures and structures. The questions asked are based on the "Due Diligence Questions" document, which is an annex to the CG ESG toolkit questionnaire. The Due Diligence Questions are structured around the same five CG topics as the CIP and FP stage risk screen questionnaires, and are meant to help the deal team structure its meetings on CG with key company representatives. The DD questionnaire is only employed by the deal team, as a supporting tool; the CG officer usually does not use it.

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[87] This number "is (to be) amended from time to time". From FMO's Investment Criteria, November 2019.
[88] RRS, CIP CG, 2019
[89] These questions were applied during our evaluation timeframe (2015-2019), but ceased to be applied as of 7th September 2020.

For its country-level CG risk assessments, FMO uses the Economist's Intelligence Unit (EIU) bank risk indicator to gauge a country's governance quality.[90] A question derived from the EIU is used in the CIP questionnaire as a proxy for CG risk.

CG risk management and mitigation

The implementation of CG risk management and mitigation differs for debt and equity investments.

For debt investments, FMO can require a CG Action Plan (CGAP) or impose individual action items as mitigation measures if the CG structure is deemed insufficient at the time of the investment. A CGAP is like an ESAP in that it includes a series of specific goals and targets the client must achieve in order to attain a particular CG standard. FMO can also impose individual action items on the client without requiring the implementation of an action plan. If CG risks are deemed limited, the investment team might also suggest the "acceptance of existing [CG] risks, in particular if there is no internal champion within the client that would facilitate the improvement on their governance practices or if the regulatory environment does not allow for improvements".[91]

CG mitigation measures were taken in 5 out of 10 debt investments in FIs included in our case study sample. In 3 out of these 10 debt investments, FMO formulated CGAPs, while in 2 out of 10 FMO formulated individual CG action items. The latter were related to (i) addressing key-person risk; (ii) improving the independence of the client's Board; (iii) improving the client's control environment and processes; and (iv) ensuring regulatory compliance. In 5 out of 10 cases, no mitigation measures were taken.

For equity investments (into corporates or FIs), CG targets are often built into the transaction as a requirement during the contracting phase. In that case, CG improvements are thus not set simply as ex ante conditions but as goals, which are part of FMO's investment motive. This gives FMO "more flexibility" to deal with CG risks, as a CG officer told us. Moreover, FMO aims, as part of its investment criteria, to nominate a member at the client's (Supervisory) Board. [92] Board member nominations are done with the goal of playing an active role in the client's CG development. FMO nominees have a fiduciary duty to the company.

FMO also provides CD to train their clients to manage CG risks themselves, but there does not appear to be a clear, systematic policy to standardise the use of CD based on a client's risk assessment. Out of our 20 case studies, 5 directly received CG-related CD, generally in the form of staff training and policies and procedures improvements. The goal of CG-related CD is to help clients attain international CG standards, in line with the CGDF's aims. It is also done by using a CG 'Progression Matrix', which charts the client's progress in the five CG risk areas. Yet it is not clear to what extent this Progression Matrix is used in practice to propose CD in certain areas. We understand that FMO is currently working on incorporating CD into its Sustainability Information System (SIS), which would offer the opportunity of standardising the provision of CG-related CD to clients.

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[90] See https://ihsmarkit.com/products/country-risk-analysis-forecasting.html.
[91] Manual for CG toolkit for banks, NFIs and MFIs, accessible at https://www.fmo.nl/esg-toolkit.
[92] However, the majority of MASSIF clients have a one-tier Board (thus no Supervisory Board).

Just as for E&S, the current FP template structures the deal team's approach to CG risk screening and management. The deal team fills in an FP table that summarises the client's risk score on each of the five abovementioned CG topics, as well as any CG risk management items or systems that are to be included during the investment life cycle or at the time of the signing of the contract (see below for a description of those). The FP template also notes whether a CG officer has participated in the due diligence phase and completed a CG review.

CG risk monitoring

CG monitoring is similar to E&S monitoring: depending on the client's CG risk profile, FMO staff maintains contact with the client to evaluate its progress on its action items or CGAP in the CCR file. In some cases, an annual ESG performance report is required to gauge the client's development. The CG progression matrix is also meant to be a self-evaluation tool for the client, and thus acts as a framework letting it manage and evaluate CG risks itself. Monitoring visits, independent external monitoring and evaluations can also be conducted depending on the client's risk profile.

4.1.3 Consumer Protection Principles (CPP) risk policy

The Consumer Protection Principles (CPPs) are about managing risks potentially affecting the end-client, such as over-indebtedness, lack of transparency, or irresponsible pricing. Hence, they are especially important when dealing with MFIs and FinTech firms, whose business model relies on serving individuals. As such, CPPs are an important point of concern in the MASSIF portfolio, since "the largest part of the risk lies in their dealings with the end-user", an IO we interviewed stated. FMO is currently in the process of modifying and updating its CPP assessment, management and monitoring framework to tailor it better to other sectors, such as agribusiness, FinTech and off-grid energy. [93] It is also collaborating with Accion (and others) to adapt CPPs to digital finance.

The CPPs revolve around the seven principles of (i) appropriate product design and delivery, (ii) prevention of over-indebtedness, (iii) transparency, (iv) responsible pricing, (v) fair and respectful treatment of clients, (vi) privacy of client data and (vii) mechanisms for complaints resolution.[94] FMO employs these principles as a framework to assess its clients on a scale from FI-C (low risk) to FI-A (high risk). More details about FMO's CPP risk categorisation can be found in Table 4.3.

CPP risk screening

The client's CPP risk category is first formally determined during the CIP phase, using the ESG toolkit's RRS. The RRS CPP risk screening is only conducted for institutions that fulfil FMO's "Eligibility Criteria" for CPP management, which is defined as a "loan portfolio containing

93 In 2018, FMO already financed an initiative by GOGLA, the global association for the off-grid solar energy industry, to apply CPPs to elaborate a consumer protection code aiming to become a sector standard. See https://aef.fmo.nl/2018/reports/ar2018/case-studies/case-study-consumer-protection-code-in-the-offgrid-solar-sector.

94 See https://www.smartcampaign.org/.

at least 30 percent of retail loans, in terms of volume, to *private individuals* with loan sizes of under EUR 10,000 or under EUR 50,000 for mortgages"[95] Other institutions are automatically considered as category C and are not screened further at this stage.[96]

Table 4.3 All CPP-eligible case studies are in the low to moderate risk category

Risk category	Criteria	Case studies in this category[97]
A (high)	Banks, NBFIs with a loan portfolio containing more than 30% small loans (<EUR 10,000 or <EUR 50,000 for mortgages) to natural persons or, in case of blended business models, companies that sell more than 30% of turnover on credit to individuals. At least 3 RRS indicators apply/ major gaps confirmed during FP.	0
B (medium)	Banks, NBFIs with a loan portfolio containing more than 30% small loans (<EUR 10,000 or <EUR 50,000 for mortgages) to natural persons or, in case of blended business models, companies that sell more than 30% of turnover on credit to individuals. Less than 3 RRS indicators apply/ minor gaps confirmed during FP.	9
C (low)	Banks, NBFIs with a loan portfolio containing less than 30% small loans (<EUR 10,000 or <EUR 50,000 for mortgages) to natural persons or, in case of blended business models, companies that sell less than 30% of turnover on credit to individuals.	8

Source: FMO Memo on CPP Policy, February 2014.

For those institutions that do fulfil the eligibility criteria for CPP management, the RRS assesses the client's ability and inclination to adopt CPP best practices. This entails assessing (i) whether the FI's missions, or its shareholder, possess a clear social objective; (ii) the competitiveness of the business environment and the FI's penetration, profitability/pricing and business model; and (iii) the extent and quality of financial regulation within the sector.

In general, the range of indicators the investment team examines to assess CPP risk at this stage follow a "tailored approach" depending on the MFI's business model. For example, in the case of an MFI dealing with group loans, the assessor will determine whether it has implemented flat rates and/or aggressive lending and collecting practices. In contrast, user data protection and privacy issues are central to the risk assessment of a FinTech company, an FMO IO told us.

At the FP stage, for A and B-rated clients, a more detailed account of the client's CPP practices is conducted by the IO using the RRS tool to verify the risk category. This includes short descriptions of the client's (i) ownership and mission, (ii) business environment and model, (iii) lending practices and (iv) regulatory environment, based on the IO's findings throughout the DD process. The IO uses a CPP Due Diligence questionnaire to structure and gather information from the client directly. The client's risk classification can then change based on these findings. In addition, the IO is required to briefly fill in her/his assessment of the client's standing in each of the seven Smart Campaign principles (see above). Lastly, further details need to be inputted on (i) extraordinary circumstances that have affected the FI's CPP risk classification, (ii) the presence of

95 From FMO's ESG Toolkit, CPP CIP RRS tool.
96 Although, for those institutions, the investment team might still decide to conduct specific CPP risk management and mitigation activities. This depends on factors such as country and governance risks.
97 Note that a CPP rating was given in only 17 out of our 20 case studies. No CPP rating is given in cases where the client's, or client's investees', portfolio is not significantly exposed to natural persons. The risk ratings listed are FMO's own risk categorisations.

a partner involved in the transaction proposal, (iii) the FI's willingness and ability to improve in CPP practices, and (iv) whether a margin reduction for CPP improvement is being discussed. [98]

Our case studies suggest that high CPP risk ratings ("A") are rarely given. In our case study sample, out of the 17 investments that qualified for CPP (i.e., for which the client's, or client's investees', portfolio is significantly exposed to natural persons), 8 were rated "C" and 9 were rated "B". None of the 17 case studies had a high risk rating (A).

For "C"-rated clients, the category is verified at the FP stage through a confirmation of the portfolio composition. If the client's portfolio is composed of less than 30 percent of loans to natural persons, the risk category remains the same. If, on the other hand, the portfolio composition has changed between the CIP and FP stages, the same detailed screening as for A and B-rated clients must be conducted.

However, if a C-rated client's medium- to long-run strategy is to grow its consumer loan book, FMO can enter into discussions about how to manage the CPP risks generated by this increased exposure to natural persons. As an FMO CPP expert mentioned, FMO has, in some cases, had to impose constraints on some of its client's consumer loan portfolio growth path in order to limit CPP-related risks.

Client risk management and mitigation

FMO's CPP screening and management is structured by the FP template. CPP is included in the latter document by listing (i) the client's CPP classification, (ii) mitigating factors, (iii) FMO's plan for helping the client incorporate CPPs into its activities (as well as the client's willingness and commitment to doing so), and (iv) risks of over-indebtedness inherent to the client's business environment and business model. The full CPP RRS needs to be attached to its annex, for all A- and B-rated clients.

End-beneficiary protection requirements are included in the contract as a Client Protection Principles Action Plan (CAP) to account for identified CPP risks. This is automatically required for A-rated clients, and depends on the IO's decision for B-rated clients (in other cases, a CAP can be implemented as a credit condition if specific gaps are identified). Such requirements attempt to mitigate CPP risks over time by requiring the client to adopt better consumer protection practices. A CAP was drafted for 2 out of the 17 case studies for which CPPs were applicable. One was elaborated with the aim of obtaining a Smart certification (see below) in the future, the other to elaborate new in-house CPP policies.

For instance, FMO can require that the client obtains a so-called Smart Campaign Certification in the future. [99] To become certified, an FI needs to demonstrate compliance with

98 ESG toolkit RRS tool (January 2020), FP CPP.

99 Note that the Smart Campaign ceased to exist as of July 28th, 2020. The US-based Social Performance Task Force (SPTF) and France-based Comité d'Echange, de Réflexion et sur les Systèmes d'Epargne-Crédit (CERISE) have both committed to preserving and upholding the Smart CPP standards. With regard to CPP certification, however, neither SPTF nor CERISE are accreditation bodies but "are making [themselves] available as a common platform for [CPP] rating agencies". See https://cerise-spm.org/en/blog/sptf-and-cerise-take-over-smart-campaign-implementation-resources/.

the Smart's Campaign's 25 standards of client protection to an independent certification body. FMO can also offer its client an incentive to fulfil its contract conditions and obtain a Smart certification, which can take the form of an interest reduction or a higher amount disbursed. For one of the transactions we examined, FMO included Smart certification as a requirement. Several other clients obtained it through the involvement of Accion, a global non-profit investing mostly in the microfinance sector, which co-invested with FMO in three of our case studies.

Besides, FMO's investment criteria recommend that CPP consultants be included in all transactions with A-rated clients (while this is optional for B-rated clients). For A-rated clients, this should be done from the DD stage onwards, while it can be after the DD stage for B-rated clients. The CPP consultant is then tasked with conducting a full-fledged assessment of the client's CPP practices. In our case studies, we did not have an example of an A-rated client, but there were 4 examples of B-rated clients where such a full-fledged assessment was conducted.

For both A- and B-rated clients, a CD grant can be allocated for assistance with identifying gaps in clients' CPP practices and/or with improving these practices. Whether or not CD is provided is decided on a case-by-case basis, based on the transaction team's judgement. A decision to provide CD in this area can also be made at a later stage during the investment's life cycle if perceived CPP risks increase significantly. In our case studies, CPP-related CD was provided in 3 case studies. In one case, CD was entirely provided by Accion, and related to improving CPP policies and procedures and obtaining Smart certification. In another, CD was provided to identify gaps in CPP policies and procedures and elaborate a CPP action plan. In the last case, a CD grant was provided by FMO to carry out an assessment of Smart Campaign compliance and drive the client towards certification.

Our case studies suggest that the design and use of the CD instrument to mitigate CPP risks could be optimised. On the one hand, as described in Section 4.2, there were at least three cases where CD on CPP was not provided but could have been useful to reduce CPP risks (although there was no evidence that significant CPP risks materialised). On the other hand, there were at least two cases where the CD offered to obtain Smart certification was perceived mostly as a burden, with limited benefits (as these clients already had strong CPP policies). Perhaps in part due to such experiences, an FMO IO noted that Smart certification is no longer seen as "the holy grail" or as its sole focal point for CPP: FMO considers it only one of many tools to improve CPP risk management.

CPP monitoring

MASSIF clients progress on CPP practices is monitored through the CCR. This is also where client progress on the Smart certification process is detailed. For A- and B-rated clients, annual CPP reporting is mandatory and enshrined in the contract. For A-rated clients, a CPP manager/coordinator is appointed and tasked with informing FMO on any significant changes regarding the client's progress on CPP.[100]

[100] Memo on CPP policy (February 2014), CPP working group.

4.2 Case study findings on ESG risks

Table 4.4 Overview of non-financial (ESG) risks per case study

		E&S risks	CG risks	CPP risks
1	Client 1	Moderate	Not applicable	Not applicable
2	Client 2	Moderate	Low	Moderate
3	Client 3	Low	Moderate	Moderate
4	Client 4	Moderate	Moderate	Moderate
5	Client 5	Low	Moderate	Moderate
6	Client 6	Moderate	Moderate	Low
7	Client 7	Low	Moderate	Moderate
8	Client 8	High	Low	Not applicable
9	Client 9	Low	Moderate	Low
10	Client 10	Moderate	Moderate	Moderate
11	Client 11	Low	Moderate	Moderate
12	Client 12	Low	Moderate	Low
13	Client 13	Moderate	Moderate	Low
14	Client 14	Moderate	Not applicable	Not applicable
15	Client 15	Moderate	High	Low
16	Client 16	Low	Moderately high	Low
17	Client 17	Low	Moderate	Moderate
18	Client 18	Low	Low	Low
19	Client 19	Low	High	Moderate
20	Client 20	Moderate	Low	Low

Source: SEO Amsterdam Economics (based on case study reports)

Our case studies suggest that CD provided to MASSIF clients in ESG areas was typically well received. While this CD impact is not systematically reported (which is an area of improvement included in our recommendations), our case studies suggest that CD often helped reduce ESG risks.

When CD was provided <u>directly</u>, by hiring a consultant via a CD grant, CD often had a <u>significantly positive impact</u> on clients.

- **Example 1:** MASSIF actively contributed (along with other investors) to building Client 8's E&S capacity through the implementation of a multi-year CD programme.
- **Example 2:** Although not labelled as a formal CD project, FMO provided valued technical assistance in the area of ESG for two of Client 14 Fund's investments.
- **Example 3:** FMO enabled Client 18 in Sub-Saharan Africa to obtain access to international, high-quality expertise for the development of an E&S Management System (ESMS) that it would not have had the financial capacity to contract on its own.
- **Example 4**: Clients 8 and 10 were very positive about the FMOxChange programme, which allowed them to learn from the business practices of other FMO investees.

When CD was provided <u>indirectly</u>, by investing in clients' own CD/TA funds, this also generally had a <u>positive impact</u> on the development of end-beneficiary ESG policies and

procedures. Indirect CD typically took place in private equity funds, or co-investors in financial institutions already had their own CD funds.

- **Example 1:** Client 7's capacities in various areas were strengthened by another investors' CD programme, which was financially supported by MASSIF. The other investor considered MASSIF's funding "critical" for their CD programme.
- **Example 2:** Owing to its investment in Client 20's technical assistance fund, FMO appeared to have had a positive impact on CPP practices in the MENA region.

The impact of CD on FMO's clients is not systematically reported. Our separate evaluation of the B-CD fund shows that this is a general challenge for CD. According to a CD team representative, three reasons are:

- **The CD team has limited human resource capacity**. Since monitoring and reporting the impact of CD projects requires additional resources, the CD team does not have an incentive to do so. Nonetheless, FMO's CD budget has been increasing in recent years[101] and FMO is currently developing a framework for improving the monitoring and reporting of CD.
- **CD projects are varied, and thus cannot be monitored using universal indicators.** CD projects are quite heterogenous, and do not allow for standardised indicators used by FMO for impact monitoring (e.g. jobs created, GHG emissions, and other more specific indicators).
- **It is difficult to attribute results to CD.** It is complicated to establish a causal relationship between CD and results.[102] The impact of CD is complex and relates to changes in habits and paradigms, and thus requires hybrid methodological approaches that are not yet fully developed.[103] Moreover, FMO's general policy is to remain cautious and modest about reporting its own impact.

MASSIF's E&S risk rating methodology is sound overall, but certain indirect E&S risks (for clients of clients of clients) are not sufficiently accounted for in funds. For example, the E&S risk rating for Client 2 was low (C), but this rating did not take into account potential indirect risks pertaining to Client 2's end-beneficiaries (the end-clients of Client 2's investees). As explained in section 4.1.1., a client's risk rating is based on its portfolio composition and sectoral exposure. FMO gave Client 2 a C-rating because of its low E&S-risk portfolio profile. This meant that FMO did monitor Client 2 to the extent that it would have if it were given an A- or B-rating. As mentioned in Client 2 case study report, however, Client 2 does not conduct a rigorous assessment of its own clients' E&S risk profile prior to investing, and can thus be oblivious to the E&S risks generated by its own investment portfolio. Accordingly, FMO's C-rating, by reducing monitoring requirements in such a way, arguably led it to excessively discount and thereby insufficiently manage existing (indirect) E&S risks. A solution could be to require such funds to assess their own indirect risks more rigorously, or to help them develop an E&S management strategy. There was no evidence however that any serious E&S risk materialised as a result of underestimating the risks.

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[101] FMO's 2018 Annual Report.

[102] Their impact usually depends on factors related to the specific circumstances in which CD is given (e.g. are other CD projects given at the same time by other donors?), the organisational structure of the receiving client (e.g., how well will CD knowledge given to top management staff, for instance through an FMOxChange programme, trickle down to the rest of the staff?), and other contextual factors.

[103] B. Vallejo, U. Wehn (2016). "Capacity Development Evaluation: The Challenge of the Results Agenda and Measuring Return on Investment in the Global South". *World Development*, Vol. 79, pp. 1-13.

In some cases, FMO-nominated Board members managed to have an impact on reducing the firm's ESG risks. This was typically done either by diversifying the Board's shareholder representation or more directly, by pushing for positive changes in the firm's governance.

- **Example 1:** By appointing its own independent Board nominee on Client 20's Supervisory Board, FMO diversified Client 20's Board away from another DFI oversight (the Board was only composed of employees of another DFI at the time of MASSIF's investment). This improved the firm's governance by preventing an excessive concentration of representation and power of another DFI in the Board.
- **Example 2:** By appointing its own Board nominee on Client 11's Board, MASSIF helped further mitigate the succession risk that was generated by Client 11's lack of formal governance succession system.
- **Example 3:** At Client 6, FMO nominated an experienced Board member able to add significant value to the Board thanks to his SME finance expertise.

In one case, FMO's Board member's influence was too contrived for FMO to have any meaningful impact. In this case (Client 15), the firm's owner had an oversized influence on the Board and had little receptivity to change. International shareholders (FMO and another DFI) also considered the workings of the Board opaque. This constrained the FMO nominees' ability to have an impact. Moreover, FMO's first two Board nominees did not have either the linguistic or technical abilities to add significant value to the Board discussions. In this context, the resulting impact of MASSIF's equity investment was relatively small.

Improving clients' CPP, be it through a CPP Smart Campaign certification or other requirements, yielded mixed results as well:

1. In some cases, FMO's CD support and conditionality in the area of CPP clearly contributed to an improvement in CPP policies.
    - **Example 1:** As a result of FMO's appointment of an external consultant and the drafting of a CPP action plan resulting from it, Client 4 implemented an array of new CPP policies. For an early-stage company such as Client 4, this was seen as a very positive development, as CPP policies and procedures were virtually elaborated from scratch thanks to MASSIF's doing.
    - **Example 2:** MASSIF also introduced Client 16 to CPP industry standards, and in doing so helped it improve its CPP procedures.

2. However, for clients with already strong CPP policies, MASSIF's requirement of obtaining CPP certification was sometimes perceived as a burden with, in one case (Example 2, Client 7), limited actual benefits.
    - **Example 1:** Smart CPP certification was included as a condition for the MASSIF loan disbursement to Client 17. At the time, Client 17 was strong in CPP procedures relative to the country's microfinance landscape, so the client mostly perceived this as a burden and claimed that including this conditionality only at the final stages of the loan approval process delayed the loan disbursement by a year, causing a liquidity shortage at a time of high demand for credit. However, an evaluation study on CPP commissioned by FMO found that Client 17 was able to comply with Smart CPP standards without suffering from significant costs in terms of reduced lending or increased operational costs. Moreover,

imposing this certification had a purpose country's thin CPP regulatory frameworks. It also had a positive impact on Client 17, improving loan transparency and pricing.

- **Example 2:** MASSIF financially supported extensive CD on CPP issues provided to Client 7 by its partner Accion, which is the global leader in Smart certification. Despite significant involvement from Accion, the process of obtaining the Smart certification still had not been completed at the time of the evaluation. According to Client 7 representatives, it had already met all CPP requirements and had very strong CPP policies, but just obtaining the final 'Smart' stamp from Accion had been a long and bureaucratic process with little real value-added at this point.

3. At the other extreme, there are cases where FMO could have done more in the CPP area, either in terms of CPP risk management (Example 1, Client 6) or screening (Example 2, Client 4).
   - **Example 1:** MASSIF found Client 6's CPP procedures to be adequate. Nonetheless, our case study indicates that clients still complain about not knowing or understanding loan conditions at the time of acceptance. This suggests that CPP procedures could be further strengthened, and MASSIF could possibly have done more in this area, both in terms of screening and managing CPP risks.
   - **Example 2:** The CPP action plan drafted for Client 4 did not include adequate steps to tackle the root cause of its insufficiently transparent credit terms. Indeed, Client 4's credit terms were identified as being too complex given the low literacy and numeracy levels of Client 4 farmers. FMO's CPP action plan only required Client 4 to develop relatively high-level transparency policies. However, as was recommended by an external consultant, a better approach would have been to adopt a concrete communication strategy to make its credit terms more human-centred and visually understandable. The issue here is that FMO could have better assessed the transparency of Client 4 service provision conditions already during its CPP risk screening phase using its 'tailored approach' (see section 4.3.1). Client 4 is currently working on making their communication strategy more effective. To their credit, FMO did recently offer a CD budget to Client 4, and is currently waiting for their response.

5 Additionality and catalytic effects

This Chapter assesses MASSIF investments according to three criteria:

1. Financial additionality
2. Catalytic and demonstration effects
3. Non-financial additionality

Assessing the additionality of MASSIF investments is a crucial part of testing MASSIF's Theory of Change (ToC). The reconstructed ToC shows the additionality of MASSIF must be assessed in order to attribute the observed outcomes to the MASSIF intervention. If MASSIF is not additional to other investors (neither financially nor non-financially), then any impact observed would also have occurred if another investor had financed the client instead of MASSIF. Moreover, a lack of additionality could potentially mean crowding out other investors, and it is crucially important to MFA that its public funding does not crowd out private funding. It was therefore agreed between MFA and FMO[104] that MASSIF should be additional to other market players, including both commercial investors and other Development Finance Institutions (DFIs).

MASSIF's long-term impact depends on whether it is catalytic and has demonstration effects. In the original FMO "Scorecard", catalytic effects were treated as part of financial additionality. In more recent FPs, however, FMO refers to catalytic effects as "mobilising effects" and treats them as a separate category, hence we treat them here as a separate category as well. "Demonstration effects" are not in the original MASSIF ToC and are not considered by MFA as something that MASSIF should be held accountable for. Unlike additionality and catalytic effects, the (potential) demonstration effects of an investment are not an investment criterion for FMO/MASSIF and is therefore not included in the investment decision (unlike at some other DFIs, e.g. EBRD). Since demonstration effects are nevertheless an important channel through which MASSIF can achieve systemic effects, we do report on these effects and recommend MASSIF to monitor them more systematically in the future. As demonstration effects are also a way to mobilise additional investments, we discuss them as a type of catalytic effect.

5.1 Financial additionality

5.1.1 Definitions

The concept of financial additionality refers to the extent public input resources (in this case, Dutch government funding) are additional to what might anyway be invested in the client (as well as the timing of it).[105] This means that MASSIF should only be providing financial services that the market does not provide, or does not provide on an adequate scale or on reasonable terms.[106] MASSIF is also mandated to take higher risks in order to reach underserved

[104] MASSIF Policy Memorandum (BEMO), received from Ministry of Foreign Affairs

[105] Definition of additionality used by the Donor Committee for Enterprise Development (DCED 2014), "Demonstrating Additionality in Private Sector Development Initiatives".

[106] Definition of additionality as stated in FMO's Investment Criteria, November 2019

groups and generate high development impact in high-risk markets that otherwise would not be served. MASSIF does this by adding to the volume of development finance, through the selection of its partners, and through the choice of its financial products.

Two types of additionality are distinguished in this evaluation:

1. **MASSIF's financial additionality for its FI clients**: the extent to which MASSIF improved access to funding for financial institutions (including investment funds) that was not readily available from commercial financiers, impact investors, or DFIs on an adequate scale or on reasonable terms.
2. **The FI's financial additionality for its clients:** the extent to which FIs improved access to finance (loans or capital) for (M)SMEs that was not readily available to them from other sources on an adequate scale or on reasonable terms.

This section focuses on the first type of additionality, while the second type is discussed in Chapter 6. The second type is not called "additionality" at FMO, but is discussed in terms of the (expected) impact that MASSIF partners have on improving access to finance for its end-clients (i.e., the extent to which these were underserved in suitable finance before and after the MASSIF financing).

5.1.2 Case study findings on additionality

The following subsections discuss our findings based on our 20 case studies. Each case study assessed all types of additionality, and rated them as 'low', 'moderate' or 'high,' based on careful analysis of data, documents and discussions with FMO staff, client representatives, and other stakeholders. A rating 'low' means that the MASSIF investee already had substantial alternative access to finance, to the point that MASSIF added little that could not have been obtained elsewhere. A rating 'high' means that the MASSIF investee could not have accessed finance alternatively. A 'medium' rating means that although the investee could have obtained alternative finance, this would have been difficult, insufficient or unsuitable, or MASSIF had other value added. Table 5.1 provides a high-level overview of these ratings. These ratings should be treated as indicative and somewhat subjective, as different case studies were reviewed by different consultants, based on interviews with a limited set of stakeholders whom each had particular biases. A 3-point rating can never do justice to the nuances of each case and should not be seen as a hard result. Nevertheless, we hope that the ratings, along with the examples mentioned in the summaries below, will provide a useful overview of the additionality of MASSIF.

Table 5.1 (Non)financial additionality and catalytic effects per case study

		Financial additionality			Catalytic effects	Nonfinancial additionality
		Relative to private investors	*Relative to other DFIs*	*Relative to FMO-A*		
1	Client 1	High	Moderate/ High	High	Moderate	Moderate
2	Client 2	Low	High	Moderate	Moderate	Moderate
3	Client 3	High	Moderate	High	Low	Moderate
4	Client 4	High	High	High	Moderate	High
5	Client 5	Low	Low	Low	Low	Moderate
6	Client 6	High	Moderate	High	Moderate	Low
7	Client 7	High	High	High	High	Moderate
8	Client 8	High	High	High	High	High
9	Client 9	High	High	High	Moderate	Moderate
10	Client 10	High	High	High	High	Moderate
11	Client 11	High	Moderate	High	Moderate	High
12	Client 12	High	High	High	High	Low
13	Client 13	Moderate	High	High	Moderate	Moderate
14	Client 14	High	High	High	Low	Moderate
15	Client 15	High	High	High	Moderate	Low
16	Client 16	High	Moderate	High	High	Moderate
17	Client 17	Low	Low	High	Low	Moderate
18	Client 18	High	High	High	High	High
19	Client 19	High	High	High	High	High
20	Client 20	High	Low	High	High	Moderate

Source: SEO Amsterdam Economics (based on case study reports)

5.1.3 Main sources of financial additionality

In our case studies, three sources of financial additionality were most common. These sources were: (1) closing a funding gap; (2) being critical to establishing a fund or FI, or to its survival; and (3) taking more risk in the type of funding offered (longer tenors, local currency loans, equity, etc).

1. **In nearly all cases, MASSIF investments helped to close a funding gap:** raising the total available capital for SME financing. In the absence of MASSIF, the financing activity (e.g. fund or credit line) would still have taken place, but with at least one less partner and less capital. Cases where MASSIF's additionality was mainly related to closing the funding gap were the Client 13, Client 4, Client 12, Client 16, Client 10 and Client 11. In nearly all other cases the funding gap argument is valid to some or a large extent.

2. **Several cases suggest that MASSIF was instrumental or important in establishing a viable fund or financial institution, or ensuring its survival.**
    - Among MASSIF investments in investment funds, these were cases where the fund may not have taken off without MASSIF, as there would not have been sufficient capital to establish the fund. Examples are Clients 1, 8 and 14.

- Among MASSIF investments in MFIs and banks, there were cases where the financial institution itself would probably not have started or survived without MASSIF. This was the case for e.g. Client 7 and Client 18.

3. **Finally, there were several cases where MASSIF took more risk in the *type* of funding it offered**. This included loans with longer tenors, financing in local currency, mezzanine or growth equity, and partial risk coverage through first-loss guarantees or subordinated debt.[107] Examples were Clients 5, 9, 10, 11, and 16.

Other sources of additionality we encountered in our case studies were (a) having potential catalytic effects, or (b) offering non-financial benefits. Catalytic effects are discussed in the next section but could also be considered a source of (indirect) financial additionality. In a number of cases, the funding of MASSIF was by itself only mildly financially additional at the time of investment but MASSIF could still create important catalytic effects at a later stage simply because of its "stamp of approval", which is particularly important for capital hungry firms (e.g. Client 2, Client 16, Client 19). Unlike private and commercial financiers, the involvement of FMO also brings access to fund knowledge, good governance, ESG, and much more. This channel of additionality is discussed under "non-financial additionality" below.

Client preference for FMO-MASSIF over other investors for being cheaper is not a source of additionality, since commercial or DFI funding was available on reasonable terms in these cases. This was the case, e.g., for Client 17, Client 5 and Client 9. In both Southeast Asia Country 1 and Sub-Saharan Africa Country 2, loans from MASSIF were cheaper than those of commercial investors as well as other DFIs because an advantageous double tax treaty between those countries and the Netherlands. However, being cheaper can never be a justifiable ground for additionality as it could distort the market and potentially crowd out other investors. If commercial investors, other DFIs, or FMO-A were willing to invest at a higher but still 'reasonable' rate,[108] then MASSIF should not under-price them as this would kill the market or prevent its development. While we did not find hard evidence of this (as crowding out effects are very difficult to assess), there was evidence in one case that another DFI dropped out of an investment deal because MASSIF was cheaper.

5.1.4 Financial additionality relative to commercial and private market

MASSIF should always be additional to the commercial and private market. However, "private" capital is diverse, consisting of entirely commercial funding on the one hand, and highly risk-tolerant social capital on the other. For example, Client 2's investors are comprised of banks, insurance companies, pension funds, and completed by VC investors; which all may be assumed to have invested in order to realise financial gains. But there are also private foundations, family offices, impact investment funds, social investors, and even private individuals, some of which may have a higher risk tolerance and more explicit developmental mandate than MASSIF. Indeed, the impact investment community includes seed capital funds that target highly risky unproven

[107] These are all examples of "risk mitigation through the financing product offered which is not readily available from commercial parties on workable terms" (FMO Investment Criteria, November 2019).

[108] Recall that the FMO investment criteria define additionality as "only providing financial services which the market does not provide, or does not provide on an adequate scale or on reasonable terms."

ventures as well as funds targeting highly unserved groups, such as women, youth, IDPs, and fragile states. These investors complement each other, including MASSIF.[109] In this report we distinguish private "commercial" capital from private "impact" investors, but recognise that even within these sub-categories large variations exist.

In half of the case studies, access to commercial capital was non-existent at the time of MASSIF's investment. This was due to the novelty of the activity, the perceived high risk (e.g., of SME lending), the lack of profitability (especially for early-stage initiatives), or local market conditions. Examples include Clients 3, 4, 6, 8, 9, 11, 12, 15 (for equity), 18 and 20. In the case of Client 1, it was noted that (commercial) investors in South East Asia enjoy many investment opportunities, and cannot be bothered by a small fund from an unproven manager investing in early-stage risky businesses. As to Client 3, an MFI with NGO status is simply not on the commercial financiers' radar.

Conversely, nearly half of MASSIF investees did have access to commercial finance, while nearly three-quarters had obtained funds from impact investors. Case study analysis shows that (at the time of the MASSIF investment) 9 clients had already accessed commercial capital including VC investors, 13 clients had received impact funds, while 5 clients had neither.

Having (some) access to other sources of finance does not necessarily invalidate the additionality of MASSIF, for reasons detailed in this section (e.g. reducing funding gap, risk reduction). For example, local banks had already provided finance to Client 17 and Client 10 local banks, but still welcomed MASSIF as it helped raise the funds available for SME lending (see "close the funding gap" above). Likewise, Client 19 had, and could have obtained, more private capital (e.g. from VC investors), but this would have been progressively insufficient because of its rapid upscaling. Client 7 attracted debt capital from many (private and DFI) sources, but only after MASSIF and two other international shareholders had made a substantial equity investment (catalytic effect). The Client 13 typically co-invests with commercial and impact investors (and Client 13), and in most cases the Facility is needed to reach the required investment capital.

In two cases, SEO judged additionality to be low because private funding was in principle available, albeit more expensive, while there were no clear other grounds for additionality. This was the case in Client 17 and Client 5, although MASSIF offered some benefits besides pricing, including longer loan tenures, conveniently larger amounts, and easier collateral requirements. In these two cases, we still consider financial additionality to be low, because the tenor extension was attractive but not crucial according to bank representatives.

In a few cases, there was no immediate funding gap but there were other sources of financial additionality.

- Client 3 already had many small impact investors and might have collected some more funds, but strategically opted for MASSIF to diversify its funding base and access larger loans.
- In the case of Client 2, the fund manager was able to raise its minimum required fund capital (and beyond) from a variety of private sources, and could have dispended with MASSIF . Indeed, at some point the manager was tempted to do so. Still, Client 2 opted to include

[109] An example is the Seed Capital provided by DGGF in favour of early stage initiatives (e.g. unproven investment funds by unproven fund managers).

MASSIF and another DFI in its funding base for strategic reasons – chiefly financial stability, access to follow-on capital for its investees, and credibility.[110]

- Client 16 exhibited a similar situation, as it already had obtained substantial private capital mainly from VC funds. However, MASSIF, being the first institutional investor in Client 16, opened the door to other DFIs, from which Client 16 needed funding, to enter its country's market.
- Client 19, could also have obtained private (VC) finance, but opted for MASSIF and another investor as first institutional equity investors, in order to leverage their financial expertise and international networks. In addition to specific know-how, FMO and the other investor also brought their wide international networks, hence access to other funding agencies for future upscaling.

Expanding the concept of additionality, half of the case study investees noted that DFIs offer three important benefits over commercial capital and impact investors:[111]

1. **Financial fire power.** Whereas private investors often invest one or two million USD, DFIs typically have superior capacity and can easily invest USD 5 million or more from their core capital). For investment funds, getting a few DFIs on board is usually imperative to reach the minimum fund amount and be able to close. Furthermore, DFIs are able to take part in follow-on financing (investee upscaling) as well.[112] Banks and MFIs also like DFI finance for this reason, and many case studies show that MASSIF (or FMO) made a succession of debt and equity investments as their needs evolve along their growth path. Such stability is vital for funds and financial institutions alike. At some point in their development, a fast-growing financing company or fund just needs to attract large-scale international capital, in which case DFIs are often the first point of entry.
2. **Commitment.** DFIs' active contribution to governance, strategy and knowledge development of the investees is valued. Private (commercial and impact) investors rarely (can) do this. Furthermore, DFIs tend to look at institutions with a long-term perspective, which private investors often do not, and may continue their support during national or institutional crisis situations. Accordingly, DFIs are generally better aligned with management's developmental vision. For instance, DFIs may allow an early-stage FinTech firm to remain pre-profit for years, which private investors generally do not, or may stand by its bank and MFI clients when the economy is stalling and portfolio losses are mounting. Some of the above is in fact an element of non-financial additionality.
3. **Credibility.** Association with a (large) DFI can open the door to future institutional as well as private capital. Indeed, many investors deem the investment by a DFI a seal of approval, given its extensive due diligence processes. This is even more so when "top dog" DFIs such as FMO and IFC invest (see our discussion of catalysing effects, in Section 5.2 below).

We conclude that MASSIF has mostly been additional to both impact investors and private commercial capital. Although MASSIF regularly coinvests with commercial financiers and private impact investors, these are generally 'bit players', investing small amounts only, and not

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[110] See Client 2 case study for a discussion on the reasons to include DFIs in the funding base.

[111] As these issues were not part of our interview template, this came up unsolicited.

[112] Client 13 has 17 investors. The top four investors, all DFI, contributed 55% of capital. The five smallest, all small private investors in the amounts of USD 100,000 to USD 250,000, contributed just 1% together. We see a similar pattern in all case studies. Local banks, impact investors, and even foreign commercial financiers rarely provide the amounts DFIs do – they do not even come close.

invested in a future partnership. Impact investors are very good at launching early stage initiatives, while (local) banks can help small MFIs. Once the operations scale up, however, DFIs are often the first port of call. Furthermore, although in some cases investees might have relied on non-DFI and non-ODA impact funds, VC investors and commercial capital, these cannot match the other benefits that DFI (FMO) association brings, in particular for small and new financing initiatives in developing countries.

5.1.5 Financial additionality relative to other DFIs

As noted earlier, MASSIF was explicitly designed to be additional to other market players, including to DFIs. The MASSIF investment criteria explicitly state that "In case an intermediary already receives DFI or (commercial) funding then MASSIF investments [are] to have an additional character." MFA confirmed that this additionality requirement only applies to the core capital of DFIs (i.e., operations funded from DFI core capital, like FMO-A) and not to the ODA-funds of DFIs (i.e., operations funded by public funds like MASSIF).

While DFIs are not commercial investors, they are typically required to provide finance at (near) commercial terms, so as to avoid crowding out private investors including banks.[113] Compared to purely commercial investors, however, they also have development mandates and targets that require them to take a bit more risk than commercial financiers would, while also being more sensitive to ESG and tax compliance risks. DFIs can do this because they are typically funded with public capital, along with private funds sourced in the capital market. They also use their sovereign guarantees to source capital at low cost. With this 'core capital', DFIs usually finance (larger) financial institutions in developing countries, large corporates,[114] infrastructure, and to some extent the more mature investment funds.

However, many DFIs also manage special government funds like MASSIF that are fully funded by Official Development Assistance (ODA). These ODA-funds are often mobilised to finance the higher-risk, higher-impact investments, such as smaller SME investment funds, MFIs, small banks, or special target groups (e.g., women, youth, fragile states, clean energy). Just as FMO manages MASSIF, Building Prospects (previously IDF), and other government funds, CDC has a publicly funded SME impact fund, EIB has the ACP Investment Fund, IFC has GAFSP, and so on. The Netherlands of course also has the ODA-funded Dutch Good Growth Fund (DGGF).

Neither MFA nor FMO itself expects MASSIF to be additional to these ODA-funds managed by other DFIs. While this is not formally written down explicitly in any Investment Criteria, MASSIF in practice has often invested in parallel with similar ODA funds of other DFIs. As MFA explained, ODA funding is only expected to be additional to non-ODA funding, which includes DFI investments financed with their 'core capital'.

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113 See Multilateral Development Banks' Harmonized Framework for Additionality in Private Sector Operation - https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/development+impact/resources/201809-mdbs-additionality-framework

114 DFIs typically do not lend directly to smaller companies, as this would mean competing with local banks or MFIs (plus very high operational costs). DFIs therefore tend to finance companies indirectly, via financial institutions or investment funds.

Despite additionality to DFIs being a requirement, Financial Proposals do not include a formal assessment of MASSIF's additionality relative to DFIs. While FMO claims to assess this informally during screening stages and due diligence,[115] FPs for MASSIF investments typically discuss additionality relative to commercial investors only. This appears to be the case because the FP template for MASSIF investments is the same as for FMO-A investments, while the latter is not expected to be additional to other DFIs.

The analysis of additionality relative to DFIs should ideally distinguish between ODA-funded and non-ODA funded DFI investments. Since the evaluation team was only informed about this distinction at a late stage, it was difficult to reconstruct *ex post* which DFI investments were ODA or non-ODA, given the limited information available Since ODA reporting practice is not always transparent, FMO investment officers often also do not know from which source (ODA or non-ODA) other DFIs financed their investments, and fund managers usually do not know this either.[116] In our case study findings, presented below, we therefore discuss additionality relative to other DFIs under the assumption that these were largely non-ODA funds, but it is possible that some DFI investments were in fact ODA-funded, in which case the additionality may be underestimated (i.e. sometimes a low score may be given when in fact the other DFI used ODA funds). One of our recommendations would be that this is monitored more systematically by MASSIF deal teams in the future, to the extent ODA reporting practice allows this. However, given that the additionality relative to DFIs in our case studies was typically already moderate or even high, this is not expected to significantly change to MASSIF's decision making.

Nearly half of our case studies (9 out of 20) illustrate that MASSIF was either the only DFI investing, or was investing along only one or two other DFIs.

- **Example 1:** MASSIF was the first, and initially the only, DFI to invest in Client 4 – although other DFIs had been solicited. Client 12 is another such example – the (debt) investment by MASSIF of just USD 1 million (in local currency) was probably too insignificant for any other DFI. In Client 10, MASSIF was also the first international lender, helping to close the funding gap as the amount was relatively important.
- **Example 2:** At Clients 1 and 2, the fund managers declared that (all) other DFIs had been invited but nearly all declined. This would confirm MASSIF's additionality vis-à-vis the wider DFI community, with MASSIF having a larger appetite for unproven ventures, small deals and risk.
- **Example 3:** Client 6's fund manager declared it had explicitly sought out and selected DFIs and impact funds that match its needs and philosophy, just not inviting the others. We doubt, however, that many others would have been forthcoming.

In only one case, SEO rated MASSIF's additionality with respect to other DFIs as low. This was mostly based on FMO's own assessment that the client (Client 20) could have accessed other DFI funding without great difficulty. In-depth interviews revealed that Client 20 took a strategic decision in this case by asking MASSIF to invest (in equity) in order to (a) be associated with FMO

[115] FMO noted that its Public Investment Management (PIM) team does look at the additionality of FMO relative to other public funding / ODA-funded parties and other DFI funding provided – even more in recent times. This is not necessarily captured in the credit assessment however, as it is done at earlier screening stages, and FPs are written by deal teams (vs PIM).

[116] For example, in the fund listing for one client, CDC Impact Fund was listed as "CDC", just as MASSIF is often identified as "FMO".

(stamp of approval) and (b) be less reliant on other DFI investors. Nonetheless, assisting an investee in diversifying its shareholder structure is arguably not a legitimate source of additionality, given that virtually every MASSIF investment does so by definition. It also does not fulfil MASSIF's investment criteria. Hence, SEO classified MASSIF's additionality regarding other DFIs as low in this one case.

In over half of the cases, a multitude of DFIs invested, sometimes in consortium. DFIs are used to invest alongside others, and generally consider this advantageous as there are more eyes and viewpoints on the governance organs.[117] Client 13 eventually had five DFIs and a few impact funds, while Client 8 attracted four DFI investors. Client 3 had already attracted many impact investors and a few DFIs too, but only a few that were able to invest the amount MASSIF was investing (USD 5 million). Client 9 also needed MASSIF to complete its funding, as its various impact investors were only providing small amounts. All of Client 6's investors were DFIs and impact funds as well. Client 11 has received finance from many DFIs and social funders, which coordinated among each other, but MASSIF is distinguished by its local currency funding and the fact that it continued to engage in difficult times when others did not. For instance, in Client 15, MASSIF and another DFI were the only DFIs to acquire equity stakes early on, when Central Asia Country 2 was still closed off to foreign investment, while other DFIs merely provided it with (less risky) debt financing later on.

Overall, we have no strong indications that MASSIF displaced other DFIs, and most clients continued to have a funding gap even after obtaining funding from other DFIs. In many of the above-mentioned cases, other DFIs had declined to participate, while private impact investors generally invested in small amounts only. In the absence of MASSIF, the total amount of mobilised funding would simply have been less (i.e., the key source of additionality was the 'funding gap' mentioned in the beginning of this chapter).

In some case studies, MASSIF invested alongside other DFIs operating from ODA-funds, and their combined ODA funds could be considered jointly additional.

- **Example 1:** MASSIF invested alongside another impact fund in Client 13, among other DFIs. Both the impact fund and FMO would not have used their own 'core' funds for this investment, given the unproven nature of Client 13 and its fund manager. In the absence of the other impact fund, MASSIF would not have topped up the missing amount, and in the absence of MASSIF, the other impact fund would not have done so either. It is questionable that Client 13 would have been able to collect the funds elsewhere, so the other impact fund and MASSIF acting together as anchor investors at first close was highly additional.
- **Example 2:** Similarly, Client 14 was funded by three ODA funds (including MASSIF and DGGF). The fact that these were all ODA was understandable given the high country risk involved.
- **Example 3:** Excessive country risk was also the reason that MASSIF was the only DFI to engage with Client 18 (in 2011-12) through equity and debt products, and in 2016 again. So (at that time) MASSIF appeared not merely additional to other DFIs, but to ODA funds as well.

[117] DFIs also have concentration limits to consider, so in some cases must act with others as the alternative would be that they could not invest at all.

In quite a few cases, MASSIF co-invested with DGGF. These are cases of special importance, as DGGF is also funded by the Dutch government, and is 100 percent ODA-funded like MASSIF. We counted 11 such cases in the MASSIF portfolio, the most important of which were Client 1, Client 13, Client 14 and Client 8, and two others that were not part of this evaluation. Although the mandates of MASSIF and DGGF (track 2) are similar, DGGF was designed with a higher risk tolerance than MASSIF, and explicitly looks for investments in the "missing middle" in underserved markets, including fragile states.[118] One would therefore not expect MASSIF and DGGF to co-invest, which they nonetheless have done a lot.

Most co-investments date from DGGF's early years, when it was under pressure to build up a portfolio and prove its existence.[119] Interviews with DGGF stakeholders suggest that DGGF therefore initially went for the 'low hanging fruit', i.e., eligible clients that satisfied all its criteria but had also already been invested in by other DFIs, including MASSIF. However, a vintage analysis conducted in the context of the DGGF evaluation[120] shows that DGGF over time shifted to more experimental and risky ventures (block IV and V investments), and increased its focus on women, youth and fragile states. These later DGGF investments include some funds and banks that MASSIF would probably not invest in. The overlap between DGGF2 and MASSIF has therefore reduced but has not disappeared given that MASSIF still serves similar target groups and early-stage investment funds.

MASSIF has also often co-invested with social investors and impact funds. In the context of the DFI additionality discussion, it would make sense to distinguish between the more commercial impact investors and those private impact funds that have a strong development focus, and in many ways resemble the ODA-funded developmental activities of DFIs. The Netherlands is particularly rich in such impact funds, which include the various Triodos funds, DOB Equity, IncluVest, St Doen, and many more. Our case studies revealed several instances where MASSIF co-invested alongside such impact investors (e.g. Client 13, Client 2, Client 3). However, the analysis above broadly remains valid, and we are not aware of cases when such private investors were impeded from investing just because of MASSIF. The source of MASSIF additionality is mainly related to the amounts invested, with MASSIF investing vastly larger sums than impact investors.

5.1.6 Financial additionality relative to FMO-A

As noted earlier, MASSIF should be additional to FMO-A.

We conclude that MASSIF was nearly always additional to FMO-A. In all case studies, the FMO deal team had verified the suitability of the investment for FMO-A. In all cases except one

118 The higher risk tolerance is chiefly expressed through DGGF's Seed Capital instrument, which does not have the revolvability requirement.

119 According to an FMO representative, cases where DGGF came in later than or together with FMO are less than 20 percent. Almost all of the cases where FMO invested earlier were Financial Institutions existing for many years, where FMO was more a general lender but DGGF made a loan specifically for missing middle SMEs. With respect to Fund and Seed Capital investments, FMO indicated to have followed DGGF more than twice as often as otherwise.

120 The DGGF evaluation report commissioned by MFA (August 2020) contains an analysis of the DGGF risk profile by vintage years. Out of the 11 cases where DGGF overlapped with MASSIF, two dated from 2017, two from 2018 and none from 2019.

(described below), the evaluation team concluded that FMO-A could not have financed the investment. Reasons for FMO-A to refuse a deal were chiefly its risk assessment, including SME risk, country and political risk, or having to deal with an inexperienced and unproven fund manager (lack of track record). Another reason was sometimes the size of the investment, as FMO-A is reluctant to make small investments (< EUR 10 million), although there were exceptions. Equity investments were also typically deemed too risky for FMO-A. In Client 15, FMO-A had already provided debt financing, but could not provide equity (as MASSIF did), among other reasons due to significant exit and transfer risks, which made the transaction fall outside of its risk criteria.[121]

In one case, it appears that FMO-A could have financed the investment. In this case, Client 5, the main argument given for funding with MASSIF was that the amount was below FMO-A's minimum ticket size of EUR 10 million. However, this was only because MASSIF was seeking a strategic collaboration with an impact investor, which in itself is not a source of additionality. The total loan size needed was USD 15 million, which was within FMO-A's minimum investment threshold. Moreover, it seemed clear that Client 5 would have been able to obtain suitable financing through a combination of commercial and private impact investor funding. This means that ODA-funded DFI resources (like MASSIF) were not additional to private capital, nor to non-ODA funded DFI financing, including FMO-A.

Case studies also included clients that had graduated from MASSIF to FMO-A. It is interesting that FMO-A's risk perception can sometimes change rapidly, or perhaps the investee develops to the point that such risk has been sufficiently reduced. A case in point is Client 2, as FMO-A co-invested in Client 2 investees in follow-up investment rounds, as well as its successor. In this case, MASSIF can be said to have 'catalysed' FMO-A, which is discussed in the next section. Client 7 was another example that graduated to FMO-A a few years after MASSIF invested, but only for debt – MASSIF continued to provide equity finance given the higher risks involved in equity. Similarly, MASSIF made an equity investment in Client 15, which it had not yet exited by the time of this evaluation, while FMO-A provided debt to Client 15 both before and after the MASSIF equity investment. Client 10 and Client 17 graduated from MASSIF to FMO-A as well. Client 13, however, was still shunned by FMO-A at the time of its second fund, while clients with small and risky operations such as Client 4 (farmer and social impact focus) are still far away from FMO-A funding.

Some MASSIF clients were not able to graduate to FMO-A because of continued high country risk. An example is Client 14, however good the institution may be. In this case MASSIF is and will remain additional as long the country situation, hence as FMO-A's country risk rating, does not improve. The latter happened in Client 18, which eventually graduated from MASSIF to FMO-A through ARISE (although the country risk rating may have been revised back down since then).

[121] The case studies do reveal some instances where FMO-A declined to invest (but MASSIF did), while some other DFIs accepted. This would suggest that those DFIs evaluated the risk differently, or perhaps such DFIs used ODA-type of funds. We do not have sufficiently detailed information to judge. It is clear, however, that some DFIs (e.g. Norfund) do have more risk appetite than FMO-A.

5.2 Catalytic and demonstration effects

One of the explicit goals of MASSIF, being a development fund, is to catalyse other finance, i.e., mobilise additional investments. Apart from being additional, MASSIF is expected to encourage other financiers to take part following the example of MASSIF, hence maximising the flow of finance to MASSIF's target groups. By taking an early commitment and sometimes additional risk, MASSIF shows its early confidence, may be de-risking transactions for FMO-A and other international financial institutions (IFIs), as well as 'crowding in' commercial and impact investors into higher risk markets. Thus, MASSIF is catalytic where it results in other financiers investing either alongside MASSIF or doing so sequentially, taking their lead from MASSIF.

Following our reconstructed ToC, we can classify catalytic effects into two categories:

1. ***Ex-ante* mobilisation of other investors in the same FI** through its role in identifying and developing a particular investment project, MASSIF can mobilise other investors from the very start, e.g. via syndicated loans, shared equity, or other forms of co-financing. In such cases FMO's investment decision is coordinated with others.
2. ***Ex-post* mobilisation of other investors in the same FI:** by investing in a particular type of FI client (possibly combined with capacity development and policy dialogue), MASSIF makes these FI clients more attractive for further financing by other investors. This can generally occur because of two channels:
   a. reducing perceived risks by providing a 'stamp of approval';
   b. reducing actual risks by improving fundamentals.

In addition to these two types of mobilising effects, MASSIF can also have demonstration effects at various levels. MFA considers these as 'positive side effects' that MASSIF should strive for, but does not consider them as something MASSIF should be held accountable for. However, as shown in our reconstructed Theory of Change, demonstration effects are important because they can multiply MASSIF's impact in various ways. As explained in Chapter 2, such demonstration effects can occur at (at least) three different levels:

1. **Demonstration effects at the investor level:** by demonstrating that investments in certain types of FIs or investment funds can be profitable or impactful, MASSIF investments can serve as a "showcase" and encourage investments by other investors in other similar FIs (e.g. investors becoming more interested in fintech funds)
2. **Demonstration effects at the FI level:** by demonstrating that a certain FI business model (e.g., offering a new financial product or service, or serving certain underserved segments) can be profitable, the MASSIF investees can serve as a "showcase" and encourage other FIs to do the same.
3. **Demonstration effects at the MSME level**: by demonstrating that a certain MSME business model (e.g., producing new goods or services) can be profitable, the MSME clients of MASSIF's clients can serve as a "showcase" and can encourage other MSMEs to do the same.[122]

[122] As we were unable to do field research including company visits, we cannot report back on this type of demonstration effects in a comprehensive manner.

The assessment of catalytic (mobilisation) and demonstration effects in our case studies was challenging, as FMO itself does not (yet) systematically monitor or report on ex-post mobilisation effects, and no field visits could be undertaken to witness wider demonstration effects. While the evaluation team spoke with other investors whenever possible, it was beyond the scope of this evaluation to assess all possible mobilisation and demonstration effects that could potentially have taken place. FMO itself also does not report on ex-post mobilisation or demonstration effects except as part of occasional in-depth evaluations.[123] Nevertheless, the evaluation team reported examples of demonstration effects whenever these were found, and in all case studies an attempt was made to qualitatively assess the extent to which MASSIF contributed to mobilising additional private capital flows (scored as low, medium, or high).

5.2.1 Case study findings on catalytic effects

Catalytic effects of the first type ('ex-ante mobilisation') were most clearly visible in investment funds, as these require the pooling of multiple investors to reach (first) close. In at least five cases MASSIF helped the fund manager to 'recruit' other co-funders, with MASSIF sometimes serving the 'cornerstone investor' role.

- **Example 1:** In Client 8 MASSIF was engaged right from the start as anchor investor, took an early commitment to an unproven fund in a risky post-conflict country, supported the fund manager in raising capital (e.g. by talking to potential investors) and offering advice on deal structuring. MASSIF helped catalyse client 8 as well.
- **Example 2:** In Clients 1 and 13 MASSIF was among several early investors, which were co-dependent and catalysed each other without either being the sole anchor investor. In Client 6 prospective investors even set down physically to hammer out fund details. They then jointly catalysed investors in second and following close, also raising additional capital for investees during the scaling stages (e.g. Client 13 investees) as well as successor funds.

The second type of catalytic effects ('ex-post mobilisation') was more common. In at least half of the case studies MASSIF is thought to have attracted other investors indirectly, *following* an FMO-MASSIF investment. This can be investors joining in second close or even a successor fund, or investors providing equity or debt to financial institutions after MASSIF has done so.[124]

- **Example 1:** In Client 2, MASSIF was one of the very last investors, so not immediately catalytic. However, FMO subsequently took a very active role in raising capital for the successor fund, with other DFIs asking FMO for its experiences in investing in this novel investment thesis.
- **Example 2:** A similar signalling effect may have encouraged other investors to support Client 4,while the positive effect of being associated with FMO was mentioned by Clients 9 and 11 as

[123] According to FMO staff, FMO does not report or capture mobilisation ex post on a yearly basis "because there is no formal definition in the sector, and it is hard to capture and attribute." However, in line with OECD requirements, MFA publishes an annual report on the measurement and reporting of the total amount of private finance for international cooperation mobilised by the Netherlands. This includes estimates for the total (aggregate) amount of private finance mobilised by MASSIF: https://www.government.nl/binaries/government/documents/reports/2020/05/12/mobilised-private-climate-finance-report-2019/Mobilised+private+%28climate%29+finance+report+2019.pdf

[124] Whereas in the "ex-ante mobilisation" case the causality of MASSIF funding in catalysing others is generally quite strong, in the "ex-post mobilisation" case the causality is often more difficult to prove.

well. Client 9 eventually raised debt and equity from both DFIs and commercial banks. Client 16 and Client 19 are similar examples.

- **Example 3:** In Client 7 the initial equity investment by MASSIF and other impact investors catalysed the institution's growth and subsequent access to a wide range of private and development debt. This is an example of the above-mentioned "improving client fundamentals". On a smaller scale this is true for Client 12 as well, which now has both DFIs and commercial funds at its disposal.
- **Example 4:** The equity investment of MASSIF enabled Client 15 to be classified "enterprise with foreign investment", conferring it with a special legal status entailing less government interference, which is thought to have facilitated loans from other DFIs, as well as an equity investment by an impact investor. The MASSIF investment is an example of both the above-mentioned "improving client fundamentals" and "signalling" effects.

Our case studies suggest that the most important channel through which MASSIF mobilised additional capital is the strong 'stamp of approval' effect related to FMO's sheer size, age and strong reputation. Multilateral DFIs such as IFC are still larger, but among the bilateral DFIs, only OPIC (USA) is larger by balance sheet. FMO outclasses DEG, Proparco and CDC, and dwarfs all the others.[125] This means that any action undertaken by FMO is noticed in the investment community, and is probably taken seriously.[126] This was confirmed by various stakeholders, who also noted that DFIs can worry about missing out on opportunities , which is why we often find the same DFIs financing in consortium. This is not to say that DFIs compete head-on; in fact, most are in cordial relations and compare notes at the due diligence stage. As noted in the previous chapter, we also did not find evidence that MASSIF crowded out other DFIs. Rather, it encouraged other DFIs to invest due to FMO's strong reputation.

In a few cases, MASSIF was not directly catalytic. Such cases were Client 3, Client 14, Client 5, and Client 17. The most common reason was that MASSIF was late on the funding table or that the institution already had a well-established funding base. There is often a link between additionality and catalytic effect. For example, an anchor investor, which is usually a sign of additionality, would typically catalyse others in first and second close – or that was the intention when the anchor investment was made. Still, MASSIF can be non-additional, and still be catalytic later on, as illustrated by Client 2.

5.2.2 Case study findings on demonstration effects

Demonstration effects can occur at 3 levels:

1. At investor level (investors copy MASSIF)
2. At FI level (FIs copy MASSIF FI client)
3. At FI client level (clients copy each other)

An example of demonstration effects at the investor level (investors copying MASSIF), includes the Client 13, directly investing alongside an investment fund. This was a novelty

125 Source: OECD. Accessed at: https://public.tableau.com/views/NONODA_DFIs/DFIs_EN?:embed=y&:display_count=no?&:showVizHome=no#1

126 Several equity fund clients alluded to the importance of having FMO on board as a means to convince other DFIs (e.g. Client 2, Client 6 , Client 13).

in the DFI world and may have wider demonstration effects at the DFI level. FMO itself is now considering similar co-investments with other investment funds, as do other DFIs.

Examples of demonstration effects at the investee level (FIs copying the MASSIF FI client's business model), include Client 13, Client 8, and the FinTech funds.

- **Example 1:** Client 13 is seen as a pioneer of venture capital financing in East Africa, which is why it has attracted a lot of attention in the impact investment community. The fund has likely played a major demonstration role in venture capital financing of early stage companies. The fact that Client 13 was raised with relative ease highlights the fund's goodwill in the market. To claim a demonstration effect, however, there should be concrete examples of funds that have replicated the investment model. Beyond Client 13, we are not aware of such examples.
- **Example 2:** In the same vein, Client 8 has played a pioneering role in developing the South Asia Country 1 PE market. As part of its work, Client 8 s working with senior national leaders, policy makers and regulators as well as the private sector to explain and illustrate how private equity works and can contribute to business expansion and private sector development in South Asia Country 1. This has helped reduce obstacles to PE investment in the regulatory environment (e.g. much faster government approvals for investments).
- **Example 3:** The same is true for Client 16, being a forerunner of FinTech in Arab world, and Client 19 for South Asia.

Concrete examples of demonstration effects at the MSME level were not found, but are expected for Client 13, considering that the fund selects its investees for their innovative and disruptive business models. Likewise, Client 2 investees serve a demonstration function, able to reach out to un- or underserved communities. FinTech is being rolled out globally, with many new entrants simply copying business models successfully developed elsewhere. FMO supported ACCION in conducting international events to disseminate lessons learned in FinTech development, hence demonstrating its (developmental) potential.

There were also cases with negative demonstration effects, which still provide useful 'lessons learned' with respect to the development of SME financing technology. In our Client 6 case study, the evaluation team found that the demonstration effect may have been negative as the lending operations were not (yet) sustainable, financial results and the portfolio were weak, hence private financiers were not encouraged to copy this SME mezzanine finance model, and may in fact have been discouraged to try something similar. Similar difficulties faced by other mezzanine finance funds in Africa studied by our evaluation team also suggested that the business model of providing direct loans with mezzanine elements to the "missing middle" is challenging. These funds expend a lot of effort to make relatively small and risky loans in multiple jurisdictions, and all have a high cost structure in proportion to the size of the portfolio. This suggests that the missing middle is "missing" for good reason. Such a 'negative' lesson, which would need to be confirmed by a more in-depth evaluation, could actually be very valuable to SME finance practitioners as it could help them avoid future failures.

5.3 Non-financial additionality

5.3.1 Definitions

As noted in Chapter 2, the concept of 'non-financial additionality' is similar to the concept of 'development additionality.' This is defined by DCED (2014) as "the extent to which the public resources contribute to changes in development-relevant results that would not have materialised without it." In its Investment Criteria of November 2019, FMO used the related concept of 'ESG additionality,' which referred to the following elements:

- "value addition in the field of Environmental, Social and Governance standards."
- "offering unique value-adding services or provides unique expertise in ESG standard setting or in enhancing green and inclusive outcomes, of value to the client."127
- "ensuring that outcome / returns to society will be higher than would otherwise be the case with other parties."
- "an element in a financing package that cannot be easily obtained from other market parties."

In this report, we make a distinction between ESG assessment, management and monitoring on the one hand, and non-financial/ESG additionality on the other. This section investigates the latter, which is defined according to the abovementioned definition and thus has to do with non-financial value addition relative to potential third-party investors. The former, which we examine in Chapter 4, relates specifically to ESG (and CPP) risks and FMO's performance in mitigating them, without an assessment of whether FMO was non-financially "additional" to the market in its risk mitigation strategies. We also interpret the concept of non-financial additionality as somewhat broader than only referring to ESG areas.

5.3.2 Case study findings on nonfinancial additionality

Based on our 20 case studies, we observe that there have been four key channels of non-financial additionality:

1. Advice provided through seats in Boards or Advisory Committees (ACs)
2. CD to its investees
3. CD to clients of investees
4. CD for sector-wide initiatives

The first channel of non-financial additionality is the advice provided by FMO Board nominees or Advisory Committee (AC) members. In many cases, and for investment funds in particular, FMO was able to exercise some influence through its seat on the AC. Discussions at the AC helped funds strengthen their strategy, adopt best practices, or simply have a partner with whom to exchange ideas. In some banks and MFIs, MASSIF invested equity capital, usually giving it a (Supervisory) Board seat. In parallel, FMO is in regular contact with these clients, discusses daily management challenges, visits them and offering its advice as needed. FMO's coaching role is most visible in new initiatives and with new fund managers. FMO is similar to other investors, notably DFIs who typically share FMO's concerns. In fact, FMO and other DFIs making the same

[127] In the new FP template, the question to be answered is: "Is FMO providing a unique value-add service to the client? If so, name category (e.g. E&S, Governance Improvement) and substantiate."

comments only reinforces the message. FMO, however, tends to be additional over private financiers, which are generally less active and engaged in governance.

In 7 out of the 11 case studies where FMO held a Board position or AC position, MASSIF's non-financial additionality was noteworthy. In these cases, FMO Board directors or AC members managed to play a strong role in developing the firm's strategy and improving its governance procedures and policies.

- **Example 1:** In the new Client 1, FMO played a strong coaching role, and provided advice on governance, fund strategy (e.g. regional diversification – not too thinly spread), and PE insights. Similar positive contributions were noted regarding FMO's AC position in other funds, including Clients 8 and 14.
- **Example 2:** In Client 13, stakeholders reported active and recurrent engagement by FMO, for example engaging in AC debates relating to fund governance.
- **Example 3**: Stakeholders reported on the positive and constructive role played by FMO Board Directors in various financial institutions, including Clients 4, 7 and 16.

Where FMO's role in the AC was less active, its non-financial additionality was more moderate. In Client 2, FMO actively took part in the AC, but it has not actively intervened in fund operations. Its role has more been a listening ear and sparring partner. To some extent the non-financial additionality has been reversed, with FMO learning from Client 2. This was intentional.

In the case of one bank, FMO's ability to drive change was too constrained to have any meaningful impact at the Board nominee level, reducing FMO's non-financial additionality low. This was the case of Client 15 in Central Asia Country 2, where FMO has held a Board position for many years but with limited impact. Multiple stakeholders noted that the influence of FMO Board nominees thus far was incremental rather than transformative, in part because vested interests appeared to resist change. Moreover, interviews revealed that FMO's first two Board nominees had been poorly selected for the tasks at hand, and lacked the necessary linguistic and technical knowledge to be sufficiently involved in the bank's operations.

With regards to the two remaining cases, we lack information on Board nominees' impact, as they have just been nominated.

- **Example 1:** In Client 6, FMO initially did not represent itself on the Board, but recently nominated its Director given evident weaknesses in financial performance and SME financing technology.
- **Example 2**: At Client 20, FMO recently appointed a senior FMO executive who is expected to attend the board meetings four times a year. He is expected to bring substantial value to Client 20 owing to his strong risk management background.

The second channel is the CD support provided to MASSIF investees from the MASSIF CD budget. As the case studies show, MASSIF often used CD funds to hire consultants to provide training or advice to MASSIF clients, often but not always related to ESG. Noteworthy is the FMOxChange programme that offers MASSIF client staff the opportunity to visit similar institutions and learn from their experiences. As also noted in our separate evaluation of the B-CD

fund (CD on 'green' and gender issues separately funded by MFA),[128] the CD is generally well received by clients and its potential impact is large, but the impact of CD is currently hardly monitored and there does not (yet) appear to be a systematic way to decide when to provide what type of CD. These conclusions also apply to the CD funded by MASSIF.

In 6 out of the 7 cases where CD was directly provided to MASSIF clients, it generated high non-financial additionality. In particular, the CD successfully enabled clients to improve their staff's technical knowledge and supported upgrades in administrative management, improving efficiency.

- **Example 1:** Client 4, as a an early-stage company it needed extensive capacity building and training. FMO was highly additional in being the first investor to readily provide such services and teaching its management how to operate more efficiently. It has also provided Client 4 with an emergency Covid-19 CD grant, which proved to be very welcome.
- **Example 2:** In Client 11, in which MASSIF is a shareholder, MASSIF supported MIS and ICT upgrading that was needed to convert into a deposit-taking MFI. MASSIF also provided training and support in governance.
- **Example 3:** Client 18 received various CD on ESMS, risk management, which was incorporated into lending practices.

MASSIF also provided CD to the investees of MASSIF clients. The most common approach is to establish a CD fund, co-financed with other DFIs/investors, out of which CD can be provided. Direct CD to the investees of MASSIF clients takes place as well.

In 2 out of the 3 cases where CD was indirectly provided to MASSIF investees' clients through a fund, FMO's additionality was moderate. By definition, indirect CD funds are co-financed along with other investors, making FMO's contribution, although impactful, less additional than direct CD grants.

- **Example 1:** Client 20 received FMO funding for its Technical Assistance Facility, capitalised with other DFIs, through which it has contributed to the development of MSMEs in the region over the 2017-2019 period through consulting services, workshops, and on-the-job training.
- **Example 2:** FMO has invested in Client 13, which, being a direct investor, has offered direct CD to its investees. In one case a comprehensive financial restructuring has taken place with CD support.

In one case, FMO provided direct CD to an investee of a MASSIF, but there was not enough information to evaluate additionality. Although it did not provide CD directly to Client 2, as it did not request it, MASSIF offered consultancy services to Client 2 investees. However, it is unclear whether this was additional. Client 2 operates in the FinTech industry, which is very popular among investors. As such, it is probable that other impact investors/DFIs might have stepped in to provide CD, in case MASSIF was not involved.

Finally, MASSIF has also supported sector-wide initiatives with CD. These have included international learning events, such as the 8 monthly Fintech for Inclusion CEO Forum & Summit, in close cooperation with Accion and its investee Client 2.

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128 SEO Amsterdam Economics, "Evaluation of the B-CD Fund (FMO Capacity Development Programme)", October 2020.

In 2 out of the 3 cases where sector-wide initiatives were financed, FMO proved highly additional through its FMOxChange programme. Owing to the very nature of FMO's exchange programme, which puts MASSIF clients in relation with other clients to foster an exchange of knowledge and ideas, FMO is generally non-financially additional. Indeed, by definition, it is generally the case that other investors cannot bring forth the same type of CD services as FMO, simply because they do not possess such an extensive and broad network of investees globally.

- **Example 1:** Client 5 greatly benefitted from FMO's exchange programme with another client, allowing its staff to learn which new policies, procedures and management techniques to implement in order to become a licensed institution.
- **Example 2:** Two senior managers at Client 10 were supported by FMO to visit an FI operating in the taxi business industry, to learn about issues related to, amongst other, loan origination, customer behaviour, and improving administrative efficiency. Client 10 management considered this visit highly useful.

In the other case where sector-wide CD was provided, MASSIF's additionality was moderate. FMO did not provide CD to Client 2 , which Client 2 now considers a missed opportunity. However, jointly with Accion and a venture capital firm, FMO sponsored the 18-monthly Fintech for Inclusion CEO Forum & Summit, during which Client 2 investees were invited to meet and share knowledge and experiences around FinTech. FMO did play a role here in bringing different partners and players together, and thus its additionality is still moderate in this case.

6 Impact

6.1 Impact monitoring and measurement

6.1.1 Data availability

The number of impact indicators that MFA requires MASSIF to report is limited. As shown in Table 6.1, MFA requires MASSIF to report on four indicators only. In practice, MASSIF reports on three out of those four indicators, plus three additional ones. These impact indicators have not changed since the previous evaluation, which recommended "not to change the indicators and measurement techniques for at least 5 years."[129] While MASSIF is required to report on these indicators, MFA has not set any specific targets per indicator.

Table 6.1 MFA requires FMO to report on only four indicators

Indicators required by MFA	MASSIF indicators reported to MFA[130]
1. Number of companies with a supported plan to invest, trade or provide services	1. Number of MASSIF investments
2. Direct jobs supported (in FTE)	2. Direct jobs at MASSIF investee level
3. Amount of mobilised private finance (in EUR)	3.N/A[131]
4. Number of firms or individuals that obtain financial services	4. Number of micro loans 5. Number of SME loans
	6. Number of depositors
	7. Total assets (investees)

Source: MFA (methodological notes on entrepreneurship and employment); MASSIF annual reports.

FMO collects its data on output, outcome and impact indicators at different intervals during an investment's lifetime. At FMO, all such data are referred to as 'impact data'. The main method of collection for impact data currently is via 'Impact Cards', through which clients are asked to report annually (once at contracting followed by annual reporting at each client credit review) on a range of impact indicators. There are several different types of Impact Cards. The applicable Impact Card depends on the strategy sector and whether the investment is project finance, corporate finance, or an investment in a private equity fund. The strategy sectors are FI, Energy, Agribusiness and Infrastructure, Manufacturing and Services.[132] The indicators collected

129 Ecorys and Carnegie Consult (2015), MASSIF Evaluation, Financial Inclusion in developing countries 2006-2014, Final report.

130 These indicators (except for #2) are included in MASSIF's annual reports 2015-2019. Following a report of the Algemene Rekenkamer that recommended the disclosure of MASSIF performance, MASSIF Annual Reports are made public since 2016. https://www.rekenkamer.nl/publicaties/rapporten/2017/05/17/resultaten-verantwoordingsonderzoek-2016-bij-buitenlandse-handel-en-ontwikkelingssamenwerking

131 FMO does not report this to MFA. However, in 2018 and 2019, the consultancy Trinomics was hired by MFA to calculate the total (aggregate) amount of private finance for international cooperation mobilised by the Netherlands, including via MASSIF: https://www.government.nl/binaries/government/documents/reports/2020/05/12/mobilised-private-climate-finance-report-2019/Mobilised+private+%28climate%29+finance+report+2019.pdf

132 Investments in the sector 'Infrastructure, Manufacturing and Services' have been discontinued since 2017.

depend in part on the Impact Card used; there are also a base set of indicators that are gathered across all Impact Cards.

Although not required by MFA for MASSIF, FMO includes three gender indicators in its Impact Cards::
- Direct employment for women;
- Volume of micro enterprise loans for women;
- Volume of loans for women-owned SMEs.

MASSIF asks its clients to report on the indicators annually. The individual Impact Card data are consequently integrated into database structures. This system works to some extent but also has its flaws. We discuss these below, along with other sources of impact data.

FMO was able to provide the SEO evaluation team with impact data for most MASSIF clients for which this was requested, but the impact data was limited in coverage and difficult to obtain. This happened for several reasons:
1. Some clients had been liquidated, were under management of special operations, or the relationship with FMO was strained in other ways;
2. The provision of impact data by the client to MASSIF was only included in the common terms of agreement in September 2017 (for equity) and April 2018 (for loans) following negotiations with MFA on additional indicators. Thus older clients did not have a legal obligation to supply MASSIF with data, although most of them did fill out the Impact Cards;
3. Finally, while IOs are responsible for making sure that Impact Cards are filled out, coverage problems and backlogs were not uncommon.

Since FMO has different types of instruments—direct (debt and equity) and indirect (equity funds)—the Impact Cards are structured accordingly. This means that the set of indicators collected may differ between debt, direct equity and equity fund investments. This makes sense, but also complicates the analysis of impact at the portfolio level. The monitoring data collected at client level was suitable for simply monitoring client performance, but not for analysing portfolio performance.

6.1.2 Data quality

The coverage and quality of client-level data seems, at best, satisfactory. Data for a specific client may be available for 2014, 2015 and 2017 but not for 2016. Employment figures may increase or decrease tenfold within a year, which raises questions about data reliability.

Client characteristics that are supposed to be collected at contracting are sometimes left blank. Examples are loan portfolio characteristics (e.g., the average tenor of (M)SME loans made by the FI client) and data on other public or private investments in the client, including whether these were in some way catalysed by MASSIF (e.g. co-investments). FMO pointed out that certain indicators can be harder to measure for clients with limited or outdated financial systems (e.g. average tenor), while co-investments can be tricky to assign given that FIs are usually on a continuous drive to find funding blurring the difference between co-investments, parallel investments and consecutive separate investments. In addition, the Impact Cards contain 'thematic'

indicators which in practice are not monitored by the client, resulting in 'NULL' values in the dataset.

Recently, FMO was able to extract historical time-series data on MASSIF impact indicators from its systems for the first time. Prior to that, FMO only made the aggregate impact data available at the portfolio level (and only for the most recent period). In interviews, FMO staff confirmed that data quality is still not optimal at this stage, but that they are working on further improving impact measurement and data quality. At the time of the evaluation, the impact measurement systems (e.g., MASSIF dashboard and Impact Cards) were fragmented, incomplete, contained errors, and required significant manual work. While we understand that improving impact systems take time, these manual and unstructured processes did raise concerns about efficiency and accuracy.

6.1.3 Efforts to improve data quality

The new Impact Measurement and Impact Reporting team (IMIR)[133] at FMO was commissioned in 2019, which added to more capacity and resources. The main reasons for the establishment of IMIR were to better align with advanced market standards on impact measurement and the resulting (higher) expectations of internal and external stakeholders. Part of this was to clarify roles and responsibilities, as the previous set up was highly fragmented without clear governance or ownership of impact data, tools, systems or processes.

In further addressing the data quality issue, FMO is implementing an impact measurement project, called Sustainability Information System (SIS). The objective of SIS is to provide FMO with a systems solution to manage its portfolio such that finance, risk and impact are treated in balance. Since FMO is operating in a dynamic environment, where both markets and methodologies are subject to rapid change, the SIS should be sufficiently flexible to accommodate change. At the time of this evaluation, this system was expected to go live by 2020 Q3.

While FMO's ongoing efforts to improve impact monitoring are noteworthy, the current monitoring system (and the resulting data quality) is suboptimal for a EUR 500 million government fund. The fact that 2019/2020 was the first occasion when time-series/historical data were compiled also means that the data collected was scarcely used before, at least not with the aim to describe and analyse the data at the portfolio level. Chapter 7 includes various recommendations to improve impact monitoring.

6.2 Impact on improving access to finance

MASSIF's impact on access to finance for underserved target groups can partly be measured by increases in MASSIF FI client outreach to these groups. Impact Cards include information on the number and volume of loans (or equity investments) made by MASSIF investees, including to specific target groups (e.g. MSMSs, women, rural borrowers). These can be

133 IMIR is part of the Finance Department, which reports to the CFO. In addition, there is the Impact and ESG department (IESG), which reports to the CIO.

considered output indicators for the MASSIF client, and are important (short-term) outcome indicators for MASSIF.

In order to attribute the reported increases in access to finance for target groups to MASSIF, these increases are ideally compared to a counterfactual scenario, which can be proxied by using benchmarks. While it is always difficult to know what the counterfactual would have looked like (would access to finance for target groups also have improved in the absence of MASSIF?) a practically feasible way to proxy for this counterfactual is to benchmark observed changes in access to finance for target groups (e.g. a reported increase in the volume of loans provided to rural SMEs) against the general access to finance situation in the country for the same target group (other rural SMEs), as a proxy for what the situation would have been like in the absence of the MASSIF investment.

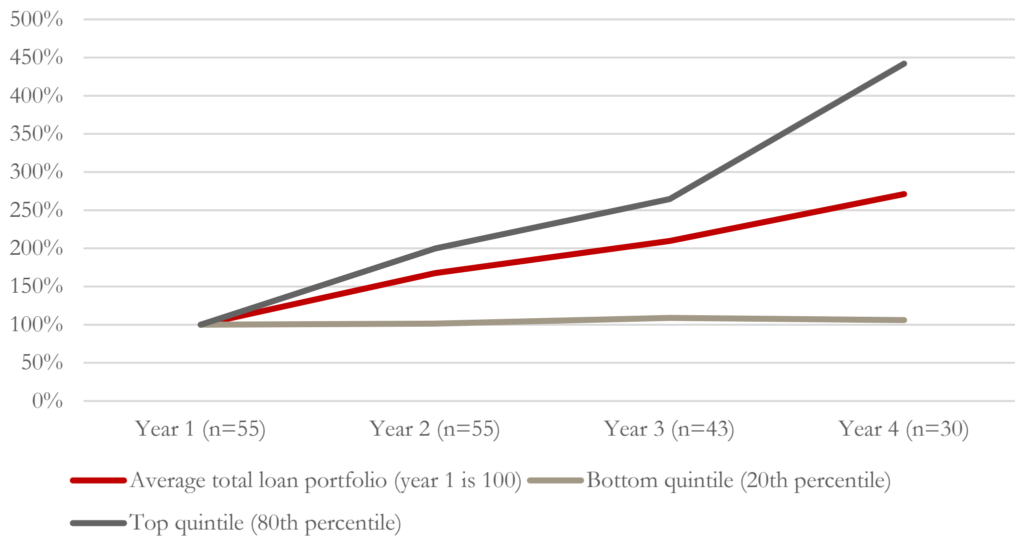
If secondary benchmark data are not available for the specific target group, deal teams should be asked to conduct (or externally commission) an in-depth assessment of the target group's access to finance situation. In effect, this means making an in-depth assessment of the 'additionality' of a FI for its own clients (e.g., if this MASSIF client had not obtained a gender credit line, would its female borrowers have been able to obtain loans from another FI?). Where possible, and subject to travel and budget restrictions, the evaluation team has attempted to make such an assessment in its own case studies.

While reporting impact indicators and benchmarks on access to finance by target group is currently not required by MFA, we would recommend MASSIF to more systematically measure and report this in the future. Reporting expected and actual improvements in access to finance for target groups should be feasible in practice, and is important given MASSIF's objective to compile a database on available access to finance indicators per country and target group. This could then be used to (1) assess the ex-ante expected impact on improving access to finance (to include in FPs), and (2) assess the ex-post impact on improving access to finance (e.g. did access to finance for MASSIF target groups increase more than it did on average in the country or region?) Further suggestions are included in our recommendations in Chapter 7.

6.2.1 Overall client portfolio growth

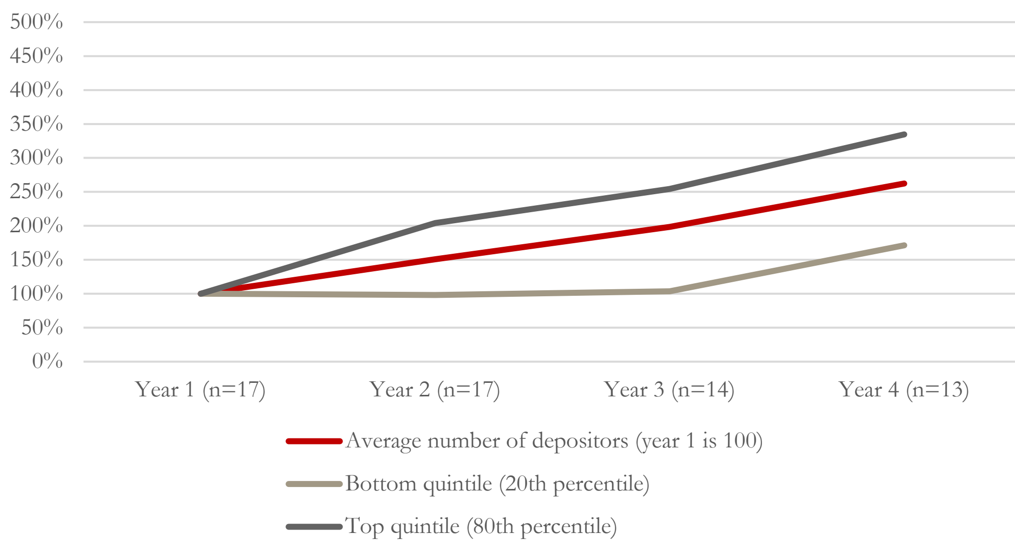
MASSIF clients show significant portfolio growth that may be attributed, at least partially, to the scaling up made possible by the MASSIF investment. In particular, the total loan portfolio and the number of depositors all doubled or tripled (on average) within the first three or four years following the MASSIF investments (see Figure 6.1 and 6.2).

Figure 6.1 The loan portfolio of MASSIF clients doubled over three years (in EUR).



Source: SEO Amsterdam Economics, based on FMO Impact data for 55 clients with between two and four data points for the investment years 2012-2019 (audit years 2013-2019). Not all clients provided data for all four years. Figures are not corrected for differences in size between clients.

Figure 6.2 The number of depositors also showed significant growth



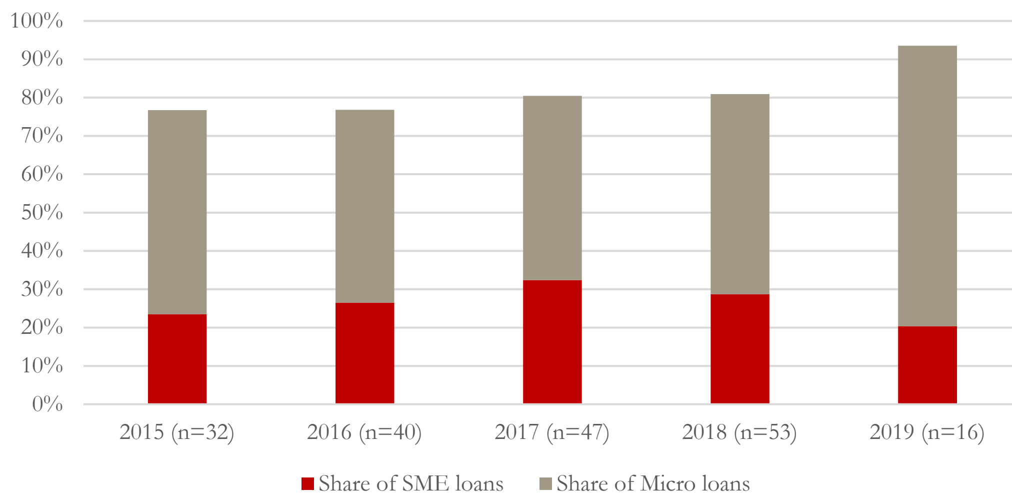
Source: SEO Amsterdam Economics, based on FMO Impact data for 17 clients with between two and four data points for the investment years 2012-2019 (audit years 2013-2019). Not all clients provided data for all five years. Figures are not corrected for differences in size between clients.

This significant client portfolio growth is not necessarily due to MASSIF. On the one hand, it is logical that a MASSIF debt or equity investment allows for portfolio growth, particularly when MASSIF investments are relatively large with respect to client size. On the other hand, the portfolio growth that could be attributed to MASSIF depends on the size of the MASSIF investment relative to other funding sources. While it was possible for IOs to provide this information for certain case studies, it was beyond the scope of this evaluation to systematically compile this information to compute the share of portfolio growth that could be attributed to MASSIF.

6.2.2 Access to finance for MSMEs

Based on client MSME portfolio data, MASSIF appears to be successful in improving access to finance for MSMEs, which is one of the four MASSIF themes under its new strategy. As Figure 6.3 shows, the share of MSME loans has increased over time, with nearly half of all MASSIF client portfolios (on which data are available) consisting of microfinance loans. Depending on the reporting year, client portfolios typically consist of 20-30 percent SME loans and 40-50 percent microfinance loans. The share of microfinance loans appears to be even higher during the 2019 reporting year, but this could be a statistical artefact given that the number of clients that had reported 2019 data is a lot lower (only 16 observations in 2019, compared with 53 observations in 2018). The case study findings on MASSIF's microfinance investments are discussed later in this section, along with a literature review on the effectiveness of microfinance.

Figure 6.3 About 70 percent of client's total gross portfolio consists of (M)SME loans.

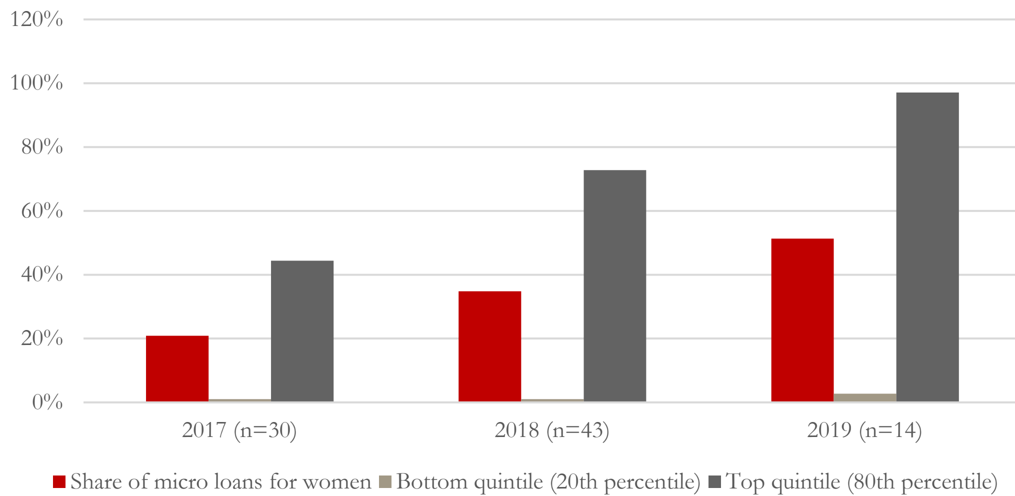


Source: SEO Amsterdam Economics, based on FMO Impact data for 65 clients who reported (at least once) on the size and distribution of their (M)SME portfolio. Data are for the investment years 2012-2019 (audit years 2013-2019). Not all clients have provided data for all five years. Figures are not corrected for differences in size between clients.

6.2.3 Access to finance for women

The share of microloans provided to women was about one-third in 2018 and appears to be growing. The 2019 average suggests an increase to about 50 percent, which may not be representative since this indicator is available for only 14 FIs thus far (see Figure 6.4). MASSIF targets its support to FIs that cater almost exclusively to women (as can be seen in the chart for the 80th percentile), but there are some FI clients (20th percentile) that have only male customers.

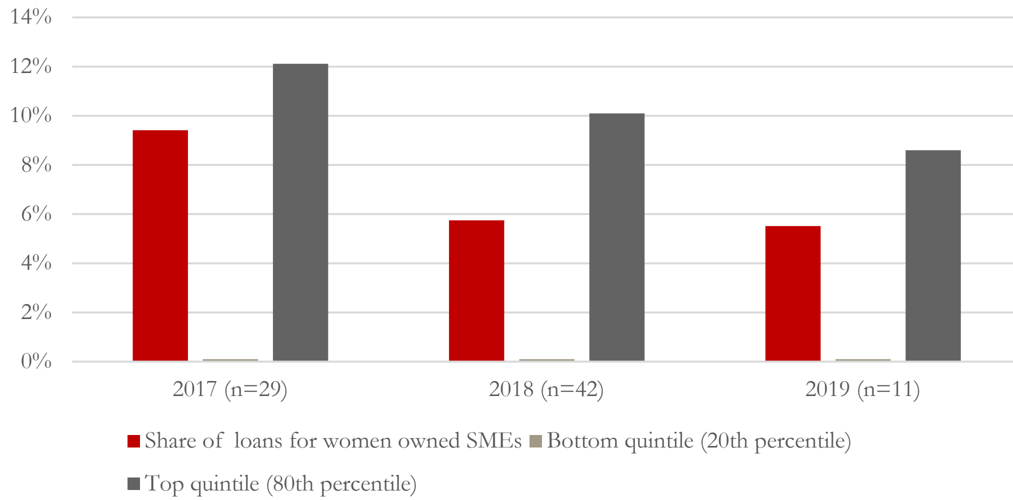
Figure 6.4 The share of microloans provided by MASSIF clients to women appears to be growing



Source: SEO Amsterdam Economics, based on FMO Impact data for 54 clients reporting (at least once) on microloans to women. (Investment years 2012-2019, audit years 2017-2019). Averages may not be representative (particularly for 2019) as not all clients provided data for all years. Figures are not corrected for differences in size between clients.

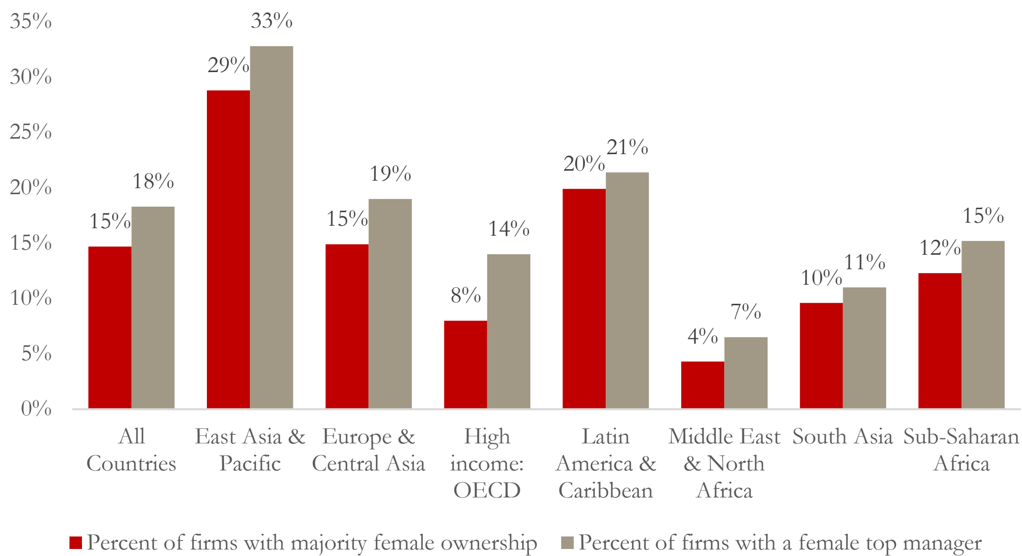
The share of loans to women-led SMEs is below 10 percent and declined since 2017. A key reason for this low number is the overall low share of women-led SMEs in MASSIF countries. However, the share of women-led SMEs in MASSIF client portfolios appears low even when benchmarked to the overall prevalence of women-led SMEs. Based on World Bank data, the average share of female-led SMEs worldwide is 15-18 percent (Figure 6.6), but this is lower in Sub-Saharan Africa (12-15 percent), South Asia (10-11 percent), and especially in the Middle East and North Africa (4-7 percent). Reliable country-level benchmarks need to be developed in order to assess whether MASSIF clients are truly underperforming on average with respect to serving women-led SMEs in their countries. With regard to depositors, a similar exercise could be conducted, but only a select number of MASSIF FI clients have reported on their share of female depositors (See Figure 6.7).

Figure 6.5 The share of loans to women-owned SMEs is low and has declined since 2017.



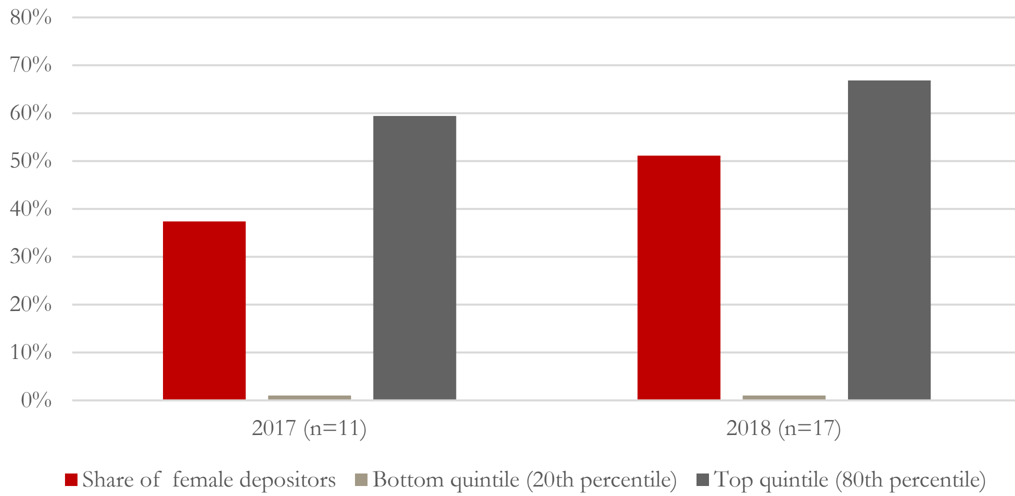
Source: SEO Amsterdam Economics, based on FMO Impact data for 49 clients reporting (at least once) on loans to women-owned SMEs. Investment years 2012-2019, audit years 2017-2019. Not all clients have provided data for all five years. Figures are not corrected for differences in size between clients. 2019 not displayed, only four observations available thus far.

Figure 6.6 The benchmark share of women-led SMEs averages 15-18 percent



Source: World bank Enterprise Surveys. Date? Results based on 161.000 surveyed firms in 144 countries.

Figure 6.7 Not many MASSIF clients supplied data on the share of female depositors

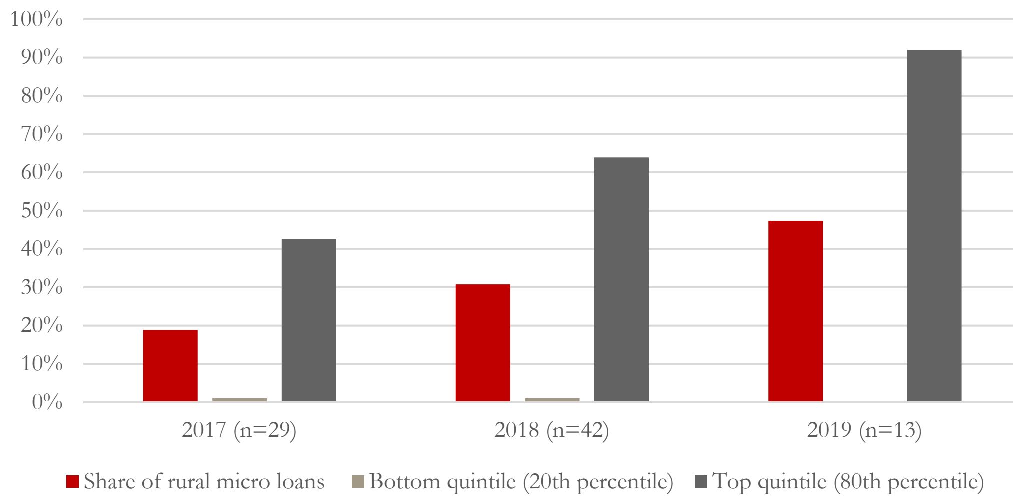


Source: SEO Amsterdam Economics, based on FMO Impact data for 20 clients reporting (at least once) on female depositors. Investment years 2012-2019, audit years 2017-2019. Not all clients have provided data for all five years. Figures are not corrected for differences in size between clients. 2019 is not displayed, as only four observations were available thus far.

6.2.4 Access to finance for rural borrowers

The share of rural microloans appears to have increased significantly since the new MASSIF strategy. In 2017, MASSIF clients reported a share of rural microloans (in percent of their total portfolio) just under 20 percent. This increased to 30 percent on average in 2018, and nearly 50 percent in 2019. However, the number of reporting MASSIF clients for 2019 was quite low (13), meaning that the data for 2019 should be interpreted with caution. However, the data strongly suggests a continued increase into 2019 in the share of loans to rural clients. Ideally, trends should be benchmarked to national statistics on the share of rural borrowers, or at a minimum the rural share of the population, per country.

Figure 6.8 The share of rural microloans appears to have increased significantly since 2017.



Source: SEO Amsterdam Economics, based on FMO Impact data for 2017-2019. Not all clients have provided data for all years. Figures are not corrected for differences in size between clients.

6.2.5 Case study findings on improving access to finance

The Financial Proposals reviewed by the evaluation team as part of its 20 case studies often did not include an in-depth assessment of the access to finance situation for specific target groups in the country. The FPs usually did include limited information about the extent to which target groups were considered underserved.[134] In general, little quantitative information was available in FPs or Impact Cards to assess access to finance gaps (*ex-ante*) or improvements in access to finance relative to the original gap (*ex-post*) for specific target groups, unless a previous in-depth evaluation had been carried out. In our case studies, the evaluation team therefore attempted to collect its own secondary data or had to use qualitative or anecdotal information to assess access to finance gaps.

[134] The new FP template requires some information on client segments, but does not explicitly ask to provide an analysis of the available finance for specific target groups: "Discuss current banking penetration and possibilities for the FI to grow (in line with market or capturing market share). Mention critical success factors. Mention the client segments (corporate, SME, retail etc.), revenue/portfolio distribution, products offered and nr. of employees and branches. Based on the CPP analysis, provide your conclusion on the business environment (e.g. competitive situation and level of over-indebtedness in the market) and business model (e.g. growth strategy) of the client."

Table 6.2 Overview of impact on end-beneficiaries per case study

	Name client	Access to finance	End-beneficiary outcomes	Strength of evidence for end-beneficiary outcomes			
				Employment	Income	Access to goods and services	Gender equality
1	Client 1	High	Moderate	✓✓	✓✓	N/A	No impact
2	Client 2	High	Unknown	✓✓	✓✓	N/A	No impact
3	Client 3	High	Moderate	✓	✓	N/A	✓
4	Client 4	Moderate	Moderate	✓	✓✓	✓✓	N/A
5	Client 5	Moderate	Moderate	N/A	✓✓	N/A	✓✓
6	Client 6	Moderate	Moderate	✓✓	No impact	N/A	No impact
7	Client 7	High	High	✓✓	✓✓	✓✓	✓✓
8	Client 8	High	High	✓✓	N/A	N/A	✓✓
9	Client 9	Moderate	Moderate	✓✓	N/A	N/A	✓✓
10	Client 10	High	High	✓✓	XX	✓	XX
11	Client 11	High	Unknown	N/A	N/A	N/A	✓✓
12	Client 12	Moderate	Unknown	N/A	N/A	N/A	✓
13	Client 13	High	High	✓✓	N/A	✓✓	N/A
14	Client 14	High	Moderate	N/A	N/A	N/A	XX
15	Client 15	High	Moderate	✓✓	N/A	N/A	XX
16	Client 16	High	Moderate	✓✓	✓✓	✓✓	N/A
17	Client 17	Moderate	Unknown	N/A	✓✓	N/A	✓
18	Client 18	Moderate	Moderate	N/A	N/A	N/A	N/A
19	Client 19	High	Moderate	✓✓	✓✓	N/A	No impact
20	Client 20	Moderate	Unknown	✓	N/A	N/A	N/A

Source: SEO Amsterdam Economics, based on case study reports. "✓" denotes a positive impact, while "X" denotes a negative impact reported in case studies. One symbol means that it is qualitatively measured, while two symbols mean that it is quantitatively measured. "N/A" means that data is not available.

Excluding MFIs, case studies suggest that MASSIF was generally successful in improving access to finance to end-beneficiaries: in 9 out of 13 non-MFI case studies, we rated this impact as high. Having a high impact in this area means that the MASSIF investment allows the FI to better serve an un(der)served segment of the market, either by: (a) starting operations in an underserved segment; (b) expanding its current operations to this underserved segment (e.g., increasing the number of clients, the volume of lending, or volume of equity investments); or (c) by introducing new financial products or services.

- **Example 1**: In East Africa, early-stage, pre-profit businesses are greatly underserved in risk capital, due to risks inherent to them, leading to a lack of new business initiatives materialising in the region. Client 13 started targeting this market segment in 2014. By funding early-stage businesses and financing them throughout their initial growth path, Client 13 has enabled this segment to become progressively less underserved. Indeed, Client 13's investees have subsequently been able to raise capital from banks, private and impact investors or DFIs.
- **Example 2:** Client 16 has been able to reach a previously un(der)served segment of its domestic market (SMEs) with its innovative 'peer-to-peer' lending platform that connects SMEs with local retail investors and partnering banks via an online marketplace.

Four cases received a "moderate" and none received a "low" rating for improving access to finance. Limited improvement in access to finance occurred when, for example, the market segment already had an initial level of access to finance (e.g. clients that already had obtained finance), or because external factors limited the FI's effect on access to finance (as in example 1).

- **Example 1:** The significant foreign exchange risks resulting from Sub-Saharan Africa Country 5's economic crisis have restrained Client 18's ability to improve access to finance for SMEs, its target group. Due to hyperinflation and currency depreciation, end-beneficiaries lost their trust in financial institutions and Client 18 was unable to provide new SME loans for a certain period.
- **Example 2**: Client 4's excessively complex credit terms, deemed too difficult to understand for a share of its relatively illiterate and innumerate client base, hampered client access to its services, and led to a feeling among farmers that Client 4 deceived them. About a quarter of all farmers perceive Client 4's loan terms as not clear at all. Note that since Client 4 is not a FI but a provider of products and services, we are not discussing access to finance *per se,* rather access to services.

Overall, MASSIF-funded MFIs had a moderately to highly positive impact on access to finance for end-beneficiaries. Out of the 7 MFI investments in our case study sample, 3 were rated with a high impact on end-beneficiaries' access to finance, and 4 with a moderate impact. Overall, access to finance impact appeared largest whenever domestic competition in the microfinance market was lowest. In these cases, MASSIF MFI investments had a large, additional impact on underserved groups' access to credit, and cross-borrowing among end-beneficiaries was lowest (MASSIF-funded MFIs were their clients' only creditor). MASSIF-funded MFIs for which impact was moderate either had a small market share (because of high domestic competition or simply because of a relatively small size), or a small share of their portfolio in underserved groups (e.g. women-led microenterprises). Rates of cross-borrowing were also highest among them, meaning that their clients had alternative sources of finance.

- **Example 1 (high):** In the 2016-2020 period, Client 7's operations expanded considerably owing to MASSIF investments. Its client base tripled, and its portfolio significantly increased in size. Owing to this growth, Client 7 successfully contributed to improving its clients' access to formal finance, the total amount of finance available to them, and proved instrumental in providing them with cheaper financing options.
- **Example 2 (high):** Access to private credit in Latin America Country 1 was very low, with only 11 percent of the population borrowing from financial institutions. In this context, Client 11's impact on improving access to finance for its target group was high. Most of its clients were exclusive (Client 11 was their only creditor), and Client 11 provided them with relatively large loans, owing to strong client-creditor relationships built over the years.
- **Example 3 (moderate):** While Client 17 contributed to financial inclusion in Southeast Asia Country 1 in the past, the MFI market in this country had become more saturated in recent years and competition among MFIs increased. The number of MFI branches operating in the region where Client 17's operations were concentrated increased significantly. As a result, multiple borrowing and over-indebtedness became common, but Client 17's strong CPP policies limited over-indebtedness risks.
- **Example 4 (moderate):** A MASSIF loan enabled Client 9 to provide loans to at least 295 MSMEs, representing about 44 percent of Client 9's additional borrowers. As such, it has helped improve access to finance to Sub-Saharan Africa Country 2's missing middle.

Nonetheless, Client 9 did not expand at all in the 2015-2019 period, and has provided a relatively low share of loans to women (10 percent of the MFI's micro-loan portfolio).

These results are consistent with the empirical literature on the impact of microfinance on end-beneficiaries' access to finance. Seven large RCTs on the impact of microfinance (see Table 6.3) all found that microfinance increases access to credit for end-beneficiaries, which is consistent with our findings.

Table 6.3 Seven large RCTs found that microfinance increases access to credit

Authors (year)	Country	Sample	Type of Loan
Karlan and Zinman (2011)	Philippines	1,601 individuals in urban areas	Men & women, individual liability microloans, $110 - $550, > 60% APR.
Angelucci, Karlan, Zinmann (2015)	Mexico	1,823 respondents in north-central Sonora, Mexico (rural and urban)	Women only, group liability, $450, 110% APR
Attanasio, Augsburg, De Haas, Fitzsimons, Harmgart (2015)	Mongolia	1,148 relatively poor women in 40 villages across five rural provinces in Mongolia	Women only, individual & group loans, $700, 27% APR
Augsburg, De Haas, Harmgart, Meghir (2015)	Bosnia and Herzegovina	1,196 of these marginal loan applicants	Men & women, individual loans, $1800, 22% APR
Banerjee, Duflo, Glennerster, Kinnan (2015)	India	6,850 households from 52 (of the 104) poor neighbourhoods in the city of Hyderabad.	Women only, group liability, $600, 24% APR
Crépon, Duflo, Devoto, Pariente (2015)	Morocco	5,551 households in rural Morocco	Men & women, group liability, $1100, 15% APR
Tarozzi, Desai, Johnson (2015)	Ethiopia	3,284 households in rural western Ethiopia, spread over 133 peasant associations (PAs) from two 'zones' of the Oromiya region and two zones in the Amhara region.	Men & women, group liability, $600, 24% APR

6.3 Impact on end-beneficiary clients

6.3.1 Outcome data coverage

Outcome data collected using Impact Cards are typically at the level of the MASSIF client, not at the level of its end-beneficiaries. As such, most of these indicators should be considered as short-term outcomes (outputs for the FI) rather than as 'impact' indicators. For example, when the Impact Cards suggest a growing gross microfinance loan portfolio, we still do not know what impact these loans have had on the business performance and quality of life of the end-beneficiaries. While the latter type of question can only be answered on a case study basis (which is being done as part of external evaluations commissioned by FMO), it is worth considering whether the Impact Cards should also include more outcome-level monitoring data for all MASSIF investments, e.g. on SME revenues and employment.

The outcome data for private equity funds is even more limited than for financial institutions, both in scope and in quality. While some indirect employment data are available at the level of fund investees, these investees often report sudden jumps: employment in the first year may be 1,100, drop to 200 in the second year, and then slowly increase in the years after. Some companies report to have exactly 100 employees for three years in a row or show spectacular growth, adding 9,000 employees over three years. Some of these may reflect actual increases or decreases, but others are likely to be the result of inconsistent or incomplete reporting. There is a dataset of 48 MASSIF equity fund clients that in turn had invested in about 400 unique companies.[135] This appeared promising, and the evaluation team spent considerable time trying to clean up and analyse this dataset, but eventually could not include it due to the risk of drawing inaccurate conclusions.

Interviews and case studies revealed that only a few MASSIF clients, usually the larger FIs or PE funds, have a well-developed M&E system to measure and report end-beneficiary impact. Impact reporting is sometimes required by another investor., Sometimes a MASSIF client is thoroughly evaluated, either commissioned by MASSIF itself or by another investor in the same client. Some investment funds (including DGGF) also require 'systematic reporting on certain outcome indicators such as employment (both jobs supported and jobs created) at the level of SMEs, or the number of female- and youth-owned SMEs.

6.3.2 Employment impact

While the employment impact of MASSIF investments is an important part of its Theory of Change (ToC), current employment indicators for FI clients only capture direct employment at the FI itself. This is in line with what was agreed upon with MFA, which confirmed that they had not asked MASSIF to also measure indirect employment at the end-beneficiary level (e.g., at the MSME clients of an FI), in part because of concerns that this would burden MASSIF clients too much, and in part because attribution of indirect jobs to MASSIF is complicated. While the evaluation team acknowledges these arguments, the indirect employment created at the end-beneficiary level is arguably a more relevant statistic, based on the ToC.

There are currently three ways in which FMO captures indirect employment:

1. Indirect employment effects at the MSME level are often studied on a case study basis, as part of in-depth evaluation externally commissioned by FMO.
2. Indirect employment data are available for private equity clients, at the level of fund investees. Given the limited number of investees per equity fund, this is more feasible to collect than employment data for the clients of a financial institution with tens of thousands of clients. However, as discussed above, this data is currently of poor quality and could not be analysed.
3. A proxy for aggregate indirect employment effects may be derived through the Joint Impact Model developed for FMO and a number of other DFIs (see Box 6.1). In principle, this model could also be used to obtain a proxy for MASSIF's indirect employment effects, based on the amount of finance provided, which would not require MASSIF clients to provide additional data. However, the current model still requires significant manual inputs. At the time of this

[135] The data also includes over a hundred 'investments' in companies for which the name is not filled out.

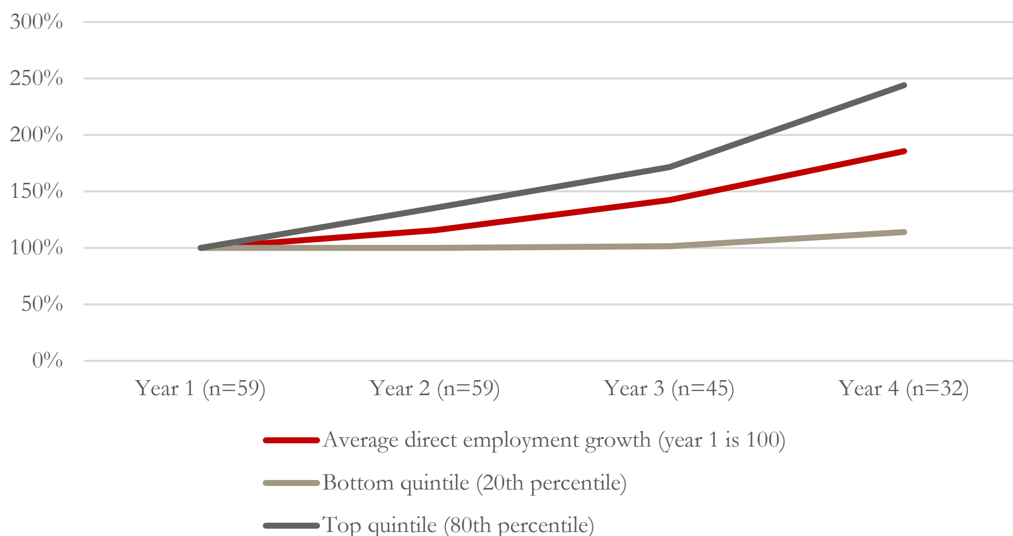
evaluation, FMO was still working on implementation and automation of this model for FMO-A and could not yet supply the evaluation team with results for MASSIF. FMO confirmed that it is possible to provide estimates for MASSIF, but had not yet had the time to re-run the model with MASSIF investment data. The remainder of this section therefore focuses on the direct employment data available for MASSIF clients.

Box 6.1 Joint impact model

Since 2015, FMO has used a so-called Impact Model to estimate the indirect effects of its investments. Over the years, other development finance institutions started to use a similar model. In January 2019, Proparco, CDC and FMO agreed with Steward Redqueen, the consultancy providing the methodology, to harmonise their methodologies on indirect employment measurement, as a result of which a new 'Joint Impact Model' (JIM) was developed. BIO, the African Development Bank and FinDev Canada joined the project at a later stage and the six institutions have closely worked together for the past year and a half. The model has been made open access and is now being tested by 15 institutions (EDFIs, MDBs and private impact investors). The model is based on an input-output methodology that estimates economy-wide jobs via financial services. Indirect jobs arise due to lending to businesses and individuals.

The available impact data show that direct employment at the client level (in operations or maintenance) typically increases rapidly in the years following a MASSIF investment. MASSIF clients report a 15 percent increase in staff in the second year, and a 50 percent increase in the third year. Clients with four or five available data points report on average a doubling in staff. Some clients employ fewer employees as time goes by, whereas others see their organisation grow exponentially. In one case, the number of employees even increased tenfold in five years.

Figure 6.9 Direct employment at client nearly doubles in four years' time, on average



Source: SEO Amsterdam Economics, based on FMO Impact data for 59 clients with between two and four data points for the investment years 2012-2019 (audit years 2013-2019). Not all clients provided data for all four years. Figures are not corrected for differences in size between clients.

Significant employment growth at the MASSIF client level does not necessarily imply that all of this employment growth is due to MASSIF. On the one hand, it is logical that a MASSIF capital injection or loan allows for, or even demands, scaling up FI operations, particularly as MASSIF investments are often relatively large with respect to client size. On the other hand, the number of jobs that could be attributed to MASSIF depends on the MASSIF investment size

relative to other funding sources. Unfortunately, the available data on other investments are currently too scattered to calculate other funding sources.

MASSIF clients report that between 40 and 50 percent of their staff are women (Figure 6.8). For some clients, this percentage is above 80 percent, whereas others indicate that less than 10 percent of their employees are women. This gender indicator was added (as part of the new strategy) to the Impact Cards in 2017. Thus far, MFA is not requiring MASSIF to report this indicator and has not set any targets for female jobs supported.

MASSIF clients on average have a larger share of female employees than an ILO benchmark for the share of women in the workforce. To construct this benchmark, we used data from the ILO World Employment Social Outlook report 2018 on labour force participation at the regional level.[136] These data are displayed in Table 6.4.and are weighted with the share of total MASSIF investments in each of these regions. Based on these data, we calculate that the average share of women in the workforce in the regions where MASSIF is active is 36 percent (weighted for MASSIF investments). Given that MASSIF clients report female employment shares between 42 and 48 percent, they on average outperform this benchmark.

Since female participation rates can differ substantially between countries and sectors, a gender benchmark should ideally be constructed for each country, and preferably by sector. A first step could be to calculate regional benchmarks, based on the average share of women in the workforce by continent in Table 6.4. Ideally country-specific benchmarks are constructed based on national statistics, and preferably by sector. Given the importance of the financial sector for MASSIF, obtaining data for female employment shares in the financial sector would be particularly useful. The construction of national benchmarks is beyond the scope of this evaluation, but we include this as a recommendation for MASSIF.

Figure 6.10 MASSIF clients report on average between 40 and 50 percent female employees

136 Country-level data is not available for all MASSIF countries.

Source: SEO Amsterdam Economics, based on FMO Impact data for 69 clients who reported (at least once) on female employees. Investment years 2012-2019, audit years 2017-2019. Not all clients have provided data for all years. Figures are not corrected for differences in size between clients.

Table 6.4 The average labour force participation of women in MASSIF regions is 36 percent

Labour force participation rate:	Men	Women	Share of women in the workforce*
AFRICA: Northern Africa	71.9%	21.9%	23%
AFRICA: Sub-Saharan Africa	74%	64.7%	47%
LAC: Latin America and the Caribbean	77.1%	51.5%	40%
Europe and Central Asia: Arab States	77.2%	18.9%	20%
ASIA: East Asia	74.7%	59.1%	44%
ASIA: South East Asia	79.4%	56.5%	42%
ASIA: Southern Asia	79%	27.6%	26%
Europe and Central Asia: Eastern Europe	67%	51.8%	44%
Europe and Central Asia: Central and Western Asia	73.5%	45.1%	38%
GLOBAL: Emerging countries	76.1%	45.6%	37%
Weighted average for MASSIF investment regions (Figure 3.4)			36%

Source: SEO Amsterdam Economics, based on ILO World Employment Social Outlook report 2018. *Calculated based on an assumed 50 percent share of women in the population of each continent.

6.3.3 Case study findings on improving end-beneficiary outcomes

Given the limited monitoring of indicators relevant to end-beneficiaries, it was difficult for the evaluation team to assess the longer-term impact of MASSIF. As noted above, MASSIF itself does not require much in terms of reporting on end-beneficiary impact, as the Impact Cards are mostly about short-term outcome indicators (such as volume of loans to specific target groups) rather than longer term outcome indicators (such as employment, incomes, access to goods and services, improvements in quality of life). Yet it is these longer-term outcome indicators that are important to assess when evaluating MASSIF's Theory of Change.

Our case studies illustrate that data availability on longer-term impact indicators varies between MASSIF clients and in the way it is measured. The availability of indicators on end-beneficiary outcomes depends on the presence of earlier (external) evaluations and MASSIF clients' own motivation to report on impact indicators. Some clients reported very little (e.g. Client 18) whereas others tracked their development impact extensively (e.g. Client 16 uses an Input-Output model to extrapolate the impact from its interventions).

A high positive impact on end-beneficiary lives was reported in only four case studies, in part because of insufficient data for other cases. We were only able to conclude high impact when there was sufficient information available, e.g. when these clients had a previous in-depth evaluation (e.g. Client 7, Client 13) or because the client itself has a solid impact measurement framework in place (e.g. Client 8 and again Client 13).

Case studies revealed that FIs often report data on employment at the level of their customers. The Impact Cards collected by FMO only measure direct employment at the MASSIF

client, sometimes by gender.[137] Nevertheless, the FIs in our case studies often had some data available on their customers' number of employees, and sometimes even attempted to estimate 'jobs created'. In addition, data on employment were sometimes collected by an external evaluator (e.g., in case of Client 7, it was estimated through a large survey conducted by SEO and a survey company).

One limitation of client-reported data on employment is that the methodology varies. Some clients report on jobs 'created', either directly (e.g. Client 8) or indirectly (e.g. Client 10, Client 19, and again Client 8). Others report on jobs 'sustained' or 'supported' (e.g. Client 16) which is typically simply the total number of people that are employed at cooperating institutions. This makes it difficult to make a comparison between MASSIF clients. Nevertheless, not using MASSIF client employment data would be a missed opportunity.

Where quantitative data is available, case studies demonstrate that MASSIF was usually successful in improving the incomes of end-beneficiaries. In 8 out of 20 case studies, we found a positive estimate on revenue, profits or income. However, these quantitative estimates were rarely part of the reporting and monitoring system, but were usually the result of an evaluation conducted by an external party (e.g. SEO, IDinsight or Dalberg). In two other cases, we were also able to draw a conclusion based on quantitative data: Client 10's impact data show a decrease in their borrowers' annual return, whilst Client 6's quarterly report states that their clients' profits have stagnated. Based on qualitative information sources, we were also able to conclude that MASSIF had a positive effect on end-beneficiary income based on one more case study (Client 3).

In the nine remaining cases, information on income effects was not available at all; neither quantitatively nor qualitatively. However, in four of these nine cases the evaluation team found a positive effect on employment based on quantitative information sources, making it somewhat plausible that the effects on total income were also positive. For the other five cases, information on income (or business performance in general) was so limited that we were not able to draw any conclusion at all.

- **Example 1:** A 2019 Client 1 annual E&S performance report mentioned a 58 percent increase in end-beneficiary income as a result of their investment, which had grown from a total of USD 9.25mln to USD 14.63 million.
- **Example 2:** Quantitative data provided by Client 10 shows a relative decline in the average annual return per borrower in the 2015-2019 time period, going from USD 394.21 in 2015-16 to USD 349.97 in 2018-19, which represents an 11.22 percent decrease.
- **Example 3:** Client 6 quantitatively tracks the developmental impact of its activities on its investees, but does not provide any estimates on supplier-level income effects. The quantitative data provided by Client 6 show a 50 percent increase in turnover, whilst also creating 1,424 and supporting 4,429 jobs.

Very little is known about MASSIF's role in improving the access to basic goods and services for BoP individuals. By improving access to finance for end-beneficiaries, MASSIF enables BoP individuals to finance the purchase of basic and productive goods and services (i.e. the direct approach, as mentioned in the New Strategy, focusing on the demand side). Similarly,

137 As noted earlier, indirect employment at the level of the clients of MASSIF investees is collected only for Private Equity Funds but these data are highly incomplete (not sufficiently useful to be used for analysis).

improved access to finance for SMEs that develop new basic and productive goods and services is likely to contribute to more innovation (i.e. the indirect approach, as mentioned in the New Strategy, focusing on the supply side). However, very little information is available on whether the SMEs served by MASSIF's clients have actually developed new goods and services over time. By investing in clients that provide goods and services to their clients directly rather than financing (like Client 4), MASSIF can also contribute to the supply of productive goods and services. However, clients like Client 4 account for only a small share of the MASSIF portfolio (and only one out of our twenty case studies). Lastly, MASSIF can spur innovation through its investments in fintech companies. However, given that MASSIF generally does not invest during the client's seed capital phase, MASSIF does not contribute to the development of new financial products and services. Rather MASSIF contributes to the expansions of its clients, making the goods or services developed during the seed-phase (sooner) available to more BoP individuals.

The impact of MASSIF's clients on 'gender equality' (part of the MASSIF Theory of Change) is inconclusive given the limited data on gender indicators. As noted above, Impact Cards include three gender indicators.[138] However, in more than half of our cases Impact Cards did not contain data on these gender indicators. In these cases, no focus on women (and therefore no impact) was claimed by the FI or FMO. Approximately one third of case studies reported a 'focus on women', but these were mostly cases targeting small entrepreneurs; a segment often characterised by the presence of women (and youth). Some FI clients (e.g. Client 7, Client 3,[139] Client 2) explicitly targeted women or underserved groups (e.g., Client 3 also targeted refugees), but many others did not explicitly aim to reduce the gender gap relative to a benchmark (e.g. Client 20, Client 15).

In three cases, the share of women in the client's staff or its loan portfolio was lower than a benchmark.

- **Example 1:** Client 10, a company in South Asia, had a female staff share of only 5.7 percent, according to a June 2018 Client 10 Impact Report. Furthermore, its portfolio contained a mere 0.17 percent of outstanding loans to women-led SMEs, which is probably related to the low proportion of female clients in this market segment in South Asia Country 2. Both at the client and the end-beneficiary level, the relative share of women was so low that it is highly unlikely that FMO contributed to a better position for women.
- **Example 2:** Client 15 also scored poorly on gender indicators, with female staff members comprising only 23 percent of total staff. Indeed, this number is relatively low for Central Asia Country 2, where the female-to-male labour force participation rate ratio is significantly higher. A better benchmark would be the female-to-male labour force participation rate in the country's banking sector, which is likely lower than the average, but the evaluation team was not able to find such benchmark data (yet).
- **Example 3:** According to an third-party independent evaluation, the share of women in Client 4's client base was only 3 percent. At the same time, Client 4 strives to reach women through an innovative programme. Since those clients served through the programme are not officially counted as Client 4 "members" and therefore not included in the aforementioned metric, the

[138] Direct employment for women; Volume of micro enterprise loans for women; and Volume of loans for women-owned SMEs.

[139] Women are the main target group for Client 3 and constitute the majority of the portfolio. But there is no specific credit line for women.

proportion of women effectively reached by Client 4's services is probably higher than 3 percent, but still relatively low.

The four MASSIF-funded investments in MFIs with end-beneficiary outcome data reveals that impact was generally moderate. For three MFIs, impact on end-beneficiary outcomes was moderate; only in one case was impact considered high.

- **Example 1 (moderate):** Prior to recent crises in MENA Country 1, Client 3 clients reported high client satisfaction, the proportion of non-performing loans was low, and MSMEs reported positive growth owing to Client 3's credit provision. Interviews and portfolio data also suggested that Client 3 loans had a positive impact on female entrepreneurs. Moreover, Client 3-financed businesses indicated generating local jobs and increasing women entrepreneurs' incomes. However, recent economic fluctuations in MENA Country 1 meant that the dollar-denominated loans provided by Client 3 increased its clients' liabilities significantly. If Client 3 and its clients had been willing to take local currency loans at a higher interest rate, this negative impact could have been reduced.
- **Example 2 (moderate):** According to an impact study conducted by Client 5, 95 percent of its microfinance clients realised higher incomes owing to their access to credit. However, only a third reported a "significant" increase in earnings, while two-thirds realised merely a "slight" improvement, as the increased income was spent on bills, household expenses, and debt repayment.
- **Example 3 (high):** According to a large survey conducted by SEO and Myanmar Survey Research for an in-depth evaluation of four MASSIF investments in Myanmar MFIs, the impact of these MFIs on end-beneficiary outcomes was high. In total, over 90 percent of around 1,200 respondents (consisting of the clients of four MFIs in Myanmar) reported that they had been able to buy more inputs, hire new employees, produce more output, generate more revenues and profit, and buy more goods and services. The MFI clients attributed these results to the loans provided by these MFIs.[140]

While these case study results suggest that MASSIF-supported MFIs do increase incomes for end-beneficiaries, more data would be required to validate this conclusion. MASSIF-funded MFIs in our small sample did seem to contribute to improving their customers' income levels. In general, customers seem to use their credit for capital expenses, leading to increased business growth. Nevertheless, due to data limitations in the remaining MFI case studies, it is not possible to draw conclusions about MASSIF as a whole.

The empirical literature offers indications on the impact of microfinance on end-beneficiary outcomes. Table 6.5 summarises the results of seven rigorous randomised control trials (RCT) conducted in Mexico, Mongolia, Bosnia and Herzegovina, India, Morocco and Ethiopia. These RCTs analysed the impact of access to microcredit on total income, business expansion and creation and credit access. They generally did not find statistically significant effects on incomes or consumption, but did find positive effects on the composition of income sources

[140] For more detailed results, see SEO Amsterdam Economics (2020), "Evaluation of FMO-MASSIF investments in four microfinance institutions in Myanmar," forthcoming on www.seo.nl

(increase in income from self-employment) and composition of consumption (decrease in 'impulse' consumption).[141]

Table 6.5 Impact of microcredit on end-beneficiaries', based on seven large-scale RCTs

Positive impact found	No significant impact found
• **Improved freedom in earnings sources:** Households with access to microcredit report enjoying greater freedom with regards to the manner with which they earn their money. In general, microcredit appears to enable borrowers to increase their income from self-employment relative to their labour wages, although this result is not entirely statistically robust across countries. • **Improved composition of consumption.** There is considerable evidence that access to microcredit decreases non-essential or 'impulse' consumption (of e.g. alcohol and tobacco) in favour of other, generally more productive spending and investment priorities. • **Microfinance acts as an insurance:** In the Philippines and Mexico, microcredit functioned as an insurance against income shocks and a means to better manage risk. • **Improved trust in the community:** Borrowers' trust in their neighbourhoods was found to be increased as a result of microcredit provision. This is thought to be due to the community aspect of the lending process, which usually takes place in groups.	• **No significant impact on incomes or consumption:** In the short- to medium-term (1-3 years after taking out a loan), microcredit did not lead to a significant increase in end-borrowers' income levels. Consistent with this result, no significant impact on per capita consumption or monthly nondurable consumption was found. • **No impact on profit or self-employment income:** Through borrowers' business expenses and investments increased in multiple countries, there is no significant average treatment effect on business profits, nor on income from self-employment. • **No significant impact on female empowerment:** Three out of four RCTs found no impact on female decision power or female independence. Only one RCT (for Mexico) found a small significant increase in female decision-making power.

Source: SEO Amsterdam Economics, based on Karlan and Zinman, 2011; Angelucci, Karlan, and Zinman, 2015; Attanasio et al. 2015; Augsburg et al. 2015; Banerjee, et al., 2015; Crépon, et al., 2015; Tarozzi, Desai, Johnson 2015.

141 More detailed analysis is included in the SEO evaluation of MFI investments in Myanmar cited in the previous footnote.

7 Conclusions and recommendations

7.1 MASSIF mandate and strategy

- **MASSIF is operating largely in line with its mandate.** The MASSIF investment criteria are generally implemented correctly and are sufficiently different from the FMO-A investment criteria.
- **Since 2017, MASSIF investments have been in line with its new strategy.** Within the portfolio of MASSIF investments between 2017-2019, all four themes were well addressed, with a reasonable distribution[142] across target groups:
  - 45 percent of MASSIF investments targeted the "'unbanked";
  - 27.5 percent targeted agri and rural SMEs;
  - 30 percent targeted women-owned SMEs;
  - 36 percent targeted innovative corporates that are developing new basic or productive goods and services for Bottom of the Pyramid individuals.
- **MASSIF also performed well on its geographic targets:**
  - Of the total committed portfolio, 39 percent of investments were in Africa (target was 40 percent) and 25 percent in Asia (maximum was 25 percent).
  - The remaining 36 percent were global investments or investments in either Europe & Central Asia or in Latin America & The Caribbean.
  - India was the country with the largest committed amount (EUR 32 million).
- **MASSIF helped its clients reduce risks by itself taking more risk than a commercial fund would have done.** It did so in part through equity investments (which comprised around 60 percent of the MASSIF portfolio) and in part through local currency loans (comprising around 40 percent of total loans, but only 13 percent of the total committed portfolio). It also took more risk by investing in clients with a limited track record or who had not yet reached profitability.
- **However, MASSIF took only marginally more country risk than FMO-A:**
  - As much as 78 percent of all MASSIF investments were in countries with F13 to F16 country risk scores, while this share for FMO-A was virtually identical (77 percent).
  - The least risky countries in which MASSIF invested were Indonesia, the Philippines (F9), India (F10) and South Africa (F11), while FMO-A did invest in lower-risk countries (F5 and F8).
  - MASSIF had slightly more investments than FMO-A in high-risk countries such as Zimbabwe (F18) and Lebanon (F19).
  - However, around 40 percent of the MASSIF portfolio consisted of equity investments in F14 and F15 countries (such as Kenya, Jordan, Myanmar or Nicaragua), compared with just over 10 percent for FMO-A.

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142 Note that these numbers do not add up to 100 percent, as most investments were categorised under more than one pillar, and 10 percent was not categorised under any pillar. Moreover, these numbers are based only on MASSIF's own classification of each investment and are not based on the actual share of loans going to target groups. The latter is discussed in more detail under 'impact.'

7.2 Efficiency and financial performance

7.2.1 Conclusions on efficiency and financial performance

- **MASSIF is run efficiently and its operating costs are broadly in line with its peers.** MASSIF's operating expenses were just above 2 percent of its total assets in 2018 and 2019. This was above the operating expenses of the Belgian development bank (BIO) and the Norwegian Investment Fund for developing countries (Norfund), but below those of the Swedish DFI (Swedfund) and the Danish development bank (IFU).
- **FMO has sufficient incentives to ensure that MASSIF will not finance investments that FMO-A could finance out of its own capital.** Incentives to finance commercially viable FMO-A projects with FMO-A funding are strong because FMO itself will then earn a return on the investment. As such, one would not expect FMO to carry out FMO-A eligible investments through MASSIF. This is in line with what we observed during case studies (with one or two possible exceptions).
- **MASSIF funds more risky investments than FMO-A, but this mostly reflects higher client risk rather than higher country risk.** Like MASSIF, FMO-A funds investments in higher-risk countries. However, MASSIF funds significantly more equity investments than FMO-A, and our case studies suggest that the additionality of MASSIF relative to FMO-A is nearly always well justified.
- **Due to its higher risk profile, MASSIF's performance is more volatile than FMO-A.** This is primarily due to its equity exposures and currency risks resulting from unhedged local currency transactions.
- **The financial performance of MASSIF is highly dependent on individual investments.** A small number of (equity) investments is responsible for most of the return. While typical for this type of high-risk equity investments, it also means that it is difficult or even impossible to accurately predict or steer the fund's financial performance (e.g. revolvability).
- **MASSIF's revolvability was close to 100 percent during the 2015-2019 evaluation period.** The overall 'cumulative' revolvability was 140 percent, but this was driven by well-performing equity investments in the 2006-2014 period. It is not the result of returns during the evaluation period. Moreover, revolvability has worsened as a result of COVID-19. In general, FMO has sufficient incentives to ensure (at least) 100 percent revolvability of the MASSIF portfolio.
- **Having two similar ODA funds, MASSIF and DGGF, could be inefficient for the Dutch government, although it could sometimes be effective e.g. in helping funds reach minimal size.** (See the Chapter on Additionality for a more detailed discussion.) The main inefficiencies are as follows:
  - Both funds have to do their own separate due diligence, monitoring and risk management. While this could reduce risks, it comes at a cost, as larger funds are generally able to operate with lower operating expenses as a percentage of assets managed.
  - Having two separate funds only makes sense if both funds truly have their own investment strategy involving distinct risk tolerance and developmental aims including investment criteria and impact objectives. Significant overlap in investments between DGGF and MASSIF over the past five years suggests that this has not always been the case, although most of the overlap occurred during the early years of DGGF when DGGF was building its portfolio (as noted in Section 5.1.5).

7.2.2 Recommendations to improve efficiency and financial performance

- **MFA should maintain MASSIF's overall revolvability requirement of 100 percent.** If it were set higher, MASSIF's risk-taking incentives would decrease and MASSIF's additionality relative to FMO-A would be questionable. If it were set lower, this would effectively mean a subsidy, as the Dutch government would be funding MASSIF investments that have an expected negative rate of return from the outset. Such an implicit subsidy could risk being 'market distorting' but could potentially be justified in cases where market access is very limited, especially when the expected development impact (including catalytic/demonstration effects) is high. Even in these cases special funds or facilities to stimulate such investments may be preferable than an across-the-board lowering of the revolvability target. (See recommendation on improving impact).
- **MFA should engage with both MASSIF and DGGF (track 2) managers to discuss how to define and demarcate their respective target markets better, avoid overlap, and improve complementarities and cooperation.** The combined amount of ODA for these two funds is needed given the continued gaps in access to finance across the world, which have been exacerbated by COVID-19. However, efficiency improvements are possible by reducing overlap between the two funds. At the moment, the investment criteria and risk-return profiles (risk tolerance) of both DGGF and MASSIF are not sufficiently different and lead to both funds selecting the same clients. As DGGF already has a separate Seed Capital & Business Development fund, it might be logical to let DGGF target the more experimental and risky investment funds, while MASSIF could focus more on providing MSME loans for specific target groups through inclusive financial institutions. Where MASSIF and DGGF do continue to invest in the same clients, the two teams should be encouraged to conduct shared due diligence and monitoring processes to reduce inefficiencies for MFA.

7.3 Financial additionality

7.3.1 Conclusions on financial additionality

- **FMO's own analysis of additionality in the Financial Proposal could be improved.** The section on additionality in the FPs we reviewed was often "argument-light" and sometimes appeared to be deal driven. The justification for being additional was often very short and sometimes nearly identical to that of other deals.
- **Our case studies revealed that nearly all MASSIF investments were fully or moderately financially additional.**
  - Nearly all MASSIF investments contributed to closing the **funding gap** for un(der)served clients, including SMEs.
  - In several cases, MASSIF funding was **necessary to establish a viable fund or financial institution**, provide support through its initial years, or prevent collapse.
  - MASSIF investments often added value by offering **longer maturities, local currency financing or additional risk coverage**, relative to other financiers.
- **<u>Relative to the commercial and private market,</u> MASSIF was nearly always additional in our case studies.** In most cases, access to private or commercial financing was impossible or limited in size and product offering, making MASSIF's financing highly additional. Furthermore, in cases where clients had already accessed commercial capital or impact

investor's funds, MASSIF was still welcome since it provided capital for its FI clients to grow and expand into the SME market segment. Yet, MASSIF's additionality was less clear-cut in a few cases where the client could have comfortably obtained adequate funding from private institutions. However, in some of those cases, MASSIF still had a significant non-financial added value for its clients.

- **MASSIF was also additional relative to other DFIs.** This type of additionality is not formally assessed by FMO in Financial Proposals (let alone the important distinction between ODA-funded and non-ODA funded DFI investments) but it is assessed informally during screen processes, and in more detail in our case studies. In eight cases, MASSIF was the first investor of any size, hence highly additional. In the other cases MASSIF invested alongside some or many other DFIs. This often took the form of organised (consortium) finance, whereby DFIs were jointly additional. In only one instance, the MASSIF investee could have easily obtained other DFI funding, making MASSIF clearly not additional to the DFI market.
- **Relative to FMO-A, MASSIF was nearly always additional.** All case studies confirmed that FMO deal teams thoroughly assessed whether their potential clients could have been suitable for FMO-A funding. In all cases except one (Client 5), the evaluation team concluded that these MASSIF transactions could not have been made through FMO-A, as they did not fulfil FMO-A's risk criteria.
- **Relative to private impact investors, MASSIF is frequently additional.** Although MASSIF regularly coinvests with commercial financiers and private impact investors, these are generally 'bit players' investing only small amounts, and not invested in a future partnership. Impact investors are very good at launching early stage initiatives, while (local) banks can help small MFIs. Once operations scale up, however, DFIs are often the first port of call.
- **In cases where financial additionality was low, clients valued MASSIF's non-financial additionality or potential catalytic effects.** In particular, MASSIF clients valued access to know how and capacity development, the potential of a long-term funding partnership with FMO, and the 'stamp of approval' attached to FMO's name. Indeed, our case studies showed that MASSIF and FMO-A often participated in follow-up financing and often mobilised investments from other investors (including for fund investees).

7.3.2 Recommendations to improve financial additionality

Short-term recommendations ('quick wins'):

- **Expand the new FP template by requiring a deeper analysis of financial additionality.** This analysis may already be conducted during due diligence and FP preparation stages, but also needs to be reflected in FPs. Prior to an investment approval, there should be a clearer analysis of MASSIF's position versus other parties that might be willing to invest, including arguments as to why MASSIF must engage and a review of the counterfactual situation ("what if MASSIF did not invest"?).
- **The FP section on financial additionality should include categories that are important to MFA.** In particular, a checklist could be developed to provide a better understanding of MASSIF's additionality:
  a. Additionality relative to fully commercial capital (e.g., banks).
  b. Additionality relative to DFI investments funded from core (non-ODA) capital (this excludes the ODA funds of DFIs, or impact investment funds with similar risk appetite as MASSIF)

c. Additionality relative to FMO(-A).

- **The FP template should distinguish between ODA and non-ODA when assessing the additionality of MASSIF investments to other DFIs.** While ODA reporting practice is not always transparent, MASSIF deal teams should always try to assess whether (co-)investing DFIs or impact investors are funded from ODA sources, or are operating on terms similar to ODA. If the latter is the case, there is less need for MASSIF to be additional to these funds. In case of FMO-A investments, this distinction is irrelevant since FMO-A does not need to be additional to other DFIs (as both are non-ODA).

Medium-term recommendations

- **Develop clearer guidelines on handling and assessing MASSIF's additionality relative to private impact investors.** Some private impact investors (e.g. ResponsAbility Investments) are very similar to purely commercial investors, but may be too small to make a difference in terms of filling a funding gap. Others, like Blue Orchard and Triodos Funds, are similar to non-subsidised DFI funds like FMO-A in terms of risk appetite and social impact goals. Yet others are similar to ODA funds like MASSIF (e.g., Triodos Hivos fund) with a high risk tolerance and stronger social impact goals. In our view, there is no need to require MASSIF to be additional to the third category. In other words, there is no need to be additional to ODA funds, as long as ODA funds themselves are additional to non-ODA funds.
- **Consider more co-funding arrangements with other ODA funds (and impact investors with similar risk appetite and social targets) so as to improve synergies and reduce unnecessary competition.** This is particularly important when exploring new regions or market segments where FMO previously had limited exposure.

7.4 Catalytic and demonstration effects

7.4.1 Conclusions on catalytic and demonstration effects

- **In nearly half of case studies, the MASSIF investment was a first and necessary step to access international funding, including institutional finance**. There were also cases where immediate financial additionality was low, but catalytic effects were important.
- **In the majority of case studies, MASSIF had catalytic effects related to ex-post mobilisation of other investors, by reducing investees' perceived or actual risks.** In at least half of all cases, MASSIF had a strongly positive signalling effect on the market, reducing perceived risks by its presence as a trusted investor. Moreover, FMO's investments and CD contributed to improvements in clients' fundamentals, leading to a reduction in actual risks. This naturally generated a higher supply of finance from the rest of the market.
- **Catalytic effects related to ex-ante mobilisation were clearest in the case of investment funds.** In such funds, MASSIF and other investors (often other DFIs) tend to act in unison and are often co-dependent in helping a fund reach first close. In one case, MASSIF acted individually as an anchor investor, investing in a risky, early-stage fund. In doing so, it directly supported the fund manager in raising capital. In other cases, MASSIF invested jointly with other investors. As a consortium, they then catalysed additional investors in subsequent funding rounds.

- **Four cases suggest MASSIF was successful in catalysing FMO-A.** MASSIF's involvement, and the resulting development of the client, sufficiently reduced clients' risks for them to fulfil FMO-A's risk criteria.
- **While our case studies and independent evaluations commissioned by FMO point to the existence of demonstration effects at various levels, FMO itself does not systematically analyse such effects.** MFA confirmed that demonstration effects are seen as 'positive side effects' that MASSIF should strive for, but cannot be held accountable for. However, as shown in our reconstructed Theory of Change, demonstration effects are important as they are ways to multiply MASSIF's impact.

7.4.2 Recommendations to improve catalytic and demonstration effects

Short-term recommendation ('quick win'):

- **If there is potential for MASSIF to have catalytic effects (including demonstration effects), a MASSIF investment could be justified despite otherwise low financial additionality.** Having funds like MASSIF as a catalyser is particularly important for fast-growing, capital-hungry FIs and equity funds that need to source the international capital market sooner or later. As long as MASSIF is not distorting the market or crowding out other investors, a MASSIF investment with low financial additionality could therefore still be acceptable if it satisfies the following conditions:
    a. MASSIF has high potential for mobilising additional investments into the same client from FMO-A, other DFIs, or commercial investors;
    b. MASSIF has high potential for mobilising additional investments into similar companies from FMO-A, other DFIs, or commercial investors (demonstration effects at the investor level);
    c. The client has high expected demonstration effects on other similar companies in its sector or segment (for example, as it is the first to offer certain products in its market).

Medium-term recommendation:

- **Measure and report demonstration effects of MASSIF investments more systematically.** MASSIF aims for impact on the financial sector, but this is currently not measured nor reported. For example, when MASSIF or its clients introduce new financial instruments or innovative products or standards with the potential to be copied by others, impact can be wider and more systemic at the level of the investment community and/or the financial sector.
- **Report demonstration effects of CD.** For example, through CD projects MASSIF clients may set new sectoral standards by improving E&S standards, CG standards, or CPP policies. CD could then indirectly have demonstration effects on other FIs that may adopt similar standards. Based on examples from other DFIs (e.g. EBRD, IFC) we suggest that this can be measured in two ways:
    - **Ex ante:** assess potential demonstration effects, i.e. the extent to which CD or investment would lead to introducing new standards, products or services to the sector or segment and therefore have the potential to be copied by others (this could be included in the FP template, both for investments and for CD).
    - **Ex post**: assess actual demonstration effects. This could be done regularly through, for example a survey sent to CD beneficiaries one year after completing the CD, or could be done more thoroughly through externally commissioned in-depth evaluations.

7.5 Non-financial and ESG additionality

7.5.1 Conclusions on nonfinancial additionality

- **Our 20 case studies suggest that MASSIF has had four key channels of non-financial additionality:** (1) advice provided through seats in Boards or Advisory Committees (ACs); (2) CD provided to investees; (3) CD provided to clients of investees; and (4) CD for sector-wide initiatives.
- **The CD offered by MASSIF appears to add significant nonfinancial value.** Many case studies described CD's positive impact on MASSIF's clients and end-beneficiaries, either via client-specific CD projects or sector-wide projects, such as the organisation of conferences, staff exchanges, and other events.
- **However, CD was sometimes not provided even if a need had been identified.** For example, in the case of Client 5, FMO officers conducting a CPP risk screening had recommended CD to improve CPP policies, but this was not followed up on for unclear reasons. Similarly, a CD project provided to Client 9 in 2015 was not followed up by additional support despite the client's various challenges. MASSIF should use the CD channel more to achieve greater impact.
- **The impact of CD on MASSIF clients is not systematically reported.** Our separate evaluation of the B-CD fund reveals this as a general issue for CD. According to a CD team representative, three reasons are:
    a. **The CD team has limited human resource capacity**. Since monitoring and reporting the impact of CD projects requires additional resources, the CD team lacks the incentive. Nonetheless, FMO is currently developing a framework for improving the monitoring and reporting of CD.
    b. **The different nature of CD projects makes it difficult to monitor them using standardised impact indicators.** CD projects are quite heterogenous, and do not allow for the use of 'universal' indicators used by FMO for impact monitoring (e.g. jobs created, GHG emissions, and other more specific indicators).
    c. **Attributing results to CD is difficult.** Just as for MASSIF investments, it is complicated to establish a causal relationship between the provision of CD and developmental results.[143] The impact of CD is complex and relates to changes in habits and paradigms, and thus requires hybrid methodological approaches that are not yet fully developed.[144] Moreover, FMO's general policy is to remain cautious and modest about reporting its own impact.

7.5.2 Conclusions on ESG

- **MASSIF's ESG risk rating methodology appears generally sound.** ESG risk measurement and monitoring is conducted seriously and FMO usually ensures that its client

[143] Their impact usually depends on factors related to the specific circumstances in which CD is given (e.g. are other CD projects given at the same time by other donors?), the organisational structure of the receiving client (e.g., how well will CD knowledge given to top management staff, for instance through an FMOxChange programme, trickle down to the rest of the staff?), and other contextual factors.

[144] B. Vallejo, U. Wehn (2016). "Capacity Development Evaluation: The Challenge of the Results Agenda and Measuring Return on Investment in the Global South". *World Development*, Vol. 79, pp. 1-13.

can manage E&S risks themselves. While our case studies revealed a few cases where indirect E&S risks (the E&S risks pertaining to MASSIF client's own clients) were not sufficiently accounted for in the risk rating, the evaluation team did not encounter any instances where an ESG issue arose that could be attributed to FMO's own negligence in screening. In some cases, however, as a result of FMO's risk rating being low, the deal team did not actively monitor ESG issues.

- **FMO-nominated Board or AC members can have a positive impact on client ESG policies and procedures, but this impact channel could likely be used more effectively.** In at least three cases, Board nominees or AC members had either a direct positive impact, by pushing for changes in the firm's governance during Board or AC meetings, or a more indirect positive impact, e.g. when their arrival created a positive change in the firm's governance structure by diversifying the shareholder representation. However, in at least one case, the effectiveness of an FMO Board nominee was limited due to poor nominee selection from FMO's part and a firm owner's oversized influence.
- **CD on improving CPP was sometimes highly beneficial, but for clients who already exhibited strong CPP standards, the benefits of obtaining CPP Smart Campaign certification did not outweigh the costs.** For some clients, the process of being introduced to industry CPP standards or obtaining a Smart Campaign certification was highly beneficial. Yet for clients who already had strong CPP standards, the Smart Campaign certification that MASSIF sometimes pushed for was often perceived as an unnecessary burden. Moreover, there was a case where FMO arguably did not sufficiently assess CPP risks that could arise due to transparency issues during the risk screening phase.

7.5.3 Recommendations to improve non-financial & ESG additionality

<u>**Short-term recommendations ('quick wins'):**</u>

- **Allocate more time and resources towards improving impact measurement for CD.** It appears that the CD team is already under-resourced for the large number of projects they manage (with only 9 CD officers and up to 40 CD projects per CD officer). Given these capacity constraints it is understandable that monitoring and reporting is currently not a priority. However, we understand that the CD team is currently working with the evaluation and impact teams at FMO to jointly develop a better framework for measuring the impact of CD, and that the CD budget has been increasing over the recent years.
- **Further improve the linkages between CD and ESG teams with respect to (a) identification of CD needs aimed at reducing ESG risks; (b) measurement of the impact of CD in terms of reducing ESG risks.** As we have seen, in every case study where CD was implemented to tackle E&S issues, clients welcomed CD. In order to better prioritise the high demand for CD on ESG issues, ESG teams and the CD team should work more closely together so that opportunities can be better identified and implemented. We understand that FMO has already taken steps in this vein; its E&S, CG and CD teams have been housed in the same department for about one year now, which should facilitate communication.
- **FMO should not insist on formal CPP certification if clients already have good CPP policies, as our case studies showed that the benefits in such cases may not exceed the costs.** Therefore, employing conditions enshrined in the contract terms to get a client to obtain Smart CPP certification should be done only in cases where doing so does not generate

excessive operational costs for the client. Moreover, when conditionality is employed, FMO should ensure that it does not impose an undue burden on the client at that point in time.

Medium-term recommendations:

- **Improve the measurement of CD project impact with respect to reducing ESG risks (E&S, CG, CPP).** Since MASSIF-funded CD projects are managed like other CD projects, this is our general recommendation for the CD programme. FMO is currently working on a new Sustainability Information System (SIS) in which each client has a "sustainability information card", where ESG risks and implementation of E&S action plans are to be tracked over time. We also understand that an expansion of the SIS to incorporate CD is being considered. We believe that this is a valuable opportunity to systematically identify CD needs, and track whether CD was provided to address E&S risks (by developing impact indicators at the CD level). This system could then also be used to assess whether E&S risk ratings were lowered (or E&S actions implemented) as a result of the CD provided.
- **FMO may wish to review and improve its procedures for identifying and selecting effective Supervisory Board or Advisory Committee members of its equity investees, as well as their implementation.** In order to generate and maximise the developmental impact of equity investments, it is important that a sufficient amount of time and effort is devoted towards choosing Board members with the linguistic knowledge and technical abilities required to be effective through the Board channel. We understand that FMO has a detailed nominee recruitment policy, but it has been the case that FMO nominated Board members with insufficient abilities to add value; thus, processes and procedures and how well these are followed up on by deal teams should be carefully examined.
- **Where potential indirect E&S risks (pertaining to MASSIF client's own clients) are identified, clients should be encouraged or required to assess such risks seriously.** MASSIF clients having a complex end-client portfolio of their own can generate substantial indirect E&S risks, which are effectively borne by FMO itself. Such risks should therefore be taken seriously, and clients could be required to adopt rigorous risk assessment and management policies and procedures, or implement a fully developed E&S management system.

Long-term recommendations:

- **Measuring and monitoring the impact of CD should be done more systematically.** While CD projects can be quite heterogeneous and have different type of impacts that are difficult to capture in standardised indicators, we can see several areas for improvement. Based on our evaluation of the B-CD fund, and our experience with measuring the impact of other CD programmes in other development organisations (e.g. IMF, ATAF), we recommend the following:
  a. **The short-term impact of CD on improving knowledge and skills** could be measured using simple pre-CD and post-CD evaluation forms, to be developed by CD providers themselves, in coordination with the FMO evaluation team who could develop templates for this.
  b. **The medium-term impact of CD** could be measured with a short CD beneficiary survey among CD recipients after 1 year. This survey could measure e.g. (a) to what extent the improved knowledge/skills were still there; (b) if CD participants were still in their job, had been promoted, or left the company; (c) how the improved knowledge or skills had been

applied; (d) whether the CD had generated any changes at the organizational level (e.g. changes in policies, standards, products or services); and (e) expected impact of changes at the organizational level. This survey could also be used to identify follow-up CD needs.

c. **The 'catalytic effects' of CD** (on making investments from FMO or other investments possible, e.g. by reducing certain risks) could also be measured and reported, e.g. in a short impact report 1 year after the CD has been completed. This question could be included in:
   - the CD beneficiary survey after 1 year (to capture possible catalytic effects on other DFIs)
   - the FP template, requiring FMO itself to make a judgment on the extent to which any CD had been instrumental for the proposed investment (e.g. on a scale of 1-5);
   - the terms of reference for future evaluations of CD or investment projects.

7.6 Impact

7.6.1 Conclusions on impact measurement

- **The number of impact indicators that MFA requires MASSIF to report is limited.** MFA requires MASSIF to report on four indicators. In practice, MASSIF reports on only three out of those four indicators (plus three additional ones). Moreover, MFA has not set any specific targets for these indicators. Given that MASSIF's Next Frontier strategy aims to reach specific target groups (including 'the unbanked', 'agri/rural' and women-owned MSMEs), it is somewhat surprising that MFA does not require more reporting on the actual outreach and impact on these target groups. MFA only requires a classification of MASSIF investments based on whether an investment is seen as being 'focused' on one of these groups.
- **The tools applied by FMO to describe the outputs and outcomes of MASSIF investments are not always consistent or integrated**. The tools include Impact Cards, labels (SDGs), externally commissioned evaluations, strategy documents (e.g. the 2017 strategy) and the new FP templates. What is missing is a centralised organisation of these tools.
- **Many steering mechanisms of the portfolio are ex ante.** For example, the strategic pillars and SDG-labels are never updated nor actively monitored. FMO expects to start monitoring these labels ex-post from 2021 onwards. During the evaluation period, the labels were a way to categorise investments ex ante. This allows for statements such as "25 percent of investments is focused on gender inclusivity", which does not yet say much about the actual gender impact. Moreover, the Impact Cards that are used for monitoring purposes were until very recently never analysed at portfolio level. As such, they do not contain a feedback loop back to portfolio management.
- **Knowledge relevant to impact measurement is quite fragmented.** Various types of impact data are collected and reported by different groups: Investment Officers, CD officers, E&S officers, CG officers, Evaluation officers, the MASSIF management team, and the recently formed Impact Measurement and Integrated Reporting team (IMIR). Retrieving the information needed to properly measure and report impact may take a long time. Currently FMO is in the process of improving coordination and synergies between the different groups. The entire measurement system is expected to be updated in Q1 2021.
- **While some relevant impact indicators are already being collected per target group, information available at higher impact levels is limited.** Although currently not required

by MFA, the Impact Card template for MASSIF investments do contain data on e.g. the number and volume of FI loans provided to specific target groups; direct jobs supported by target group. However, they do not contain information on higher level outcomes such as employment, incomes, and access to goods and services at the end-beneficiary level. While such outcome data is more difficult and burdensome to collect, some other investors do collect these data (e.g. DGGF collects indicators on indirect employment) and some FI clients themselves already collect such data.

- **Data quality of the Financial Institution Impact Cards is suboptimal.** Oftentimes observations for certain years or certain indicators are missing, or the data shows large unexplained deviations over time. FMO acknowledges that this is work in progress.
- **Data based on the equity fund Impact Cards proved unusable.** This data is provided by the portfolio companies of the funds and does not appear to be subject to quality control., Many missing values and unexplained deviations over time suggest that the reporting entity itself or the definitions used have changed dramatically.

7.6.2 Conclusions on end-beneficiary access to finance

- **Portfolio data suggest that access to finance for MSMEs and rural micro-entrepreneurs improved since the new strategy was adopted in 2017.** Based on client MSME portfolio data, the volume and share of MSME loans increased over time, with nearly half of all MASSIF client portfolios (on which data are available) consisting of microfinance loans. The share of rural microloans in particular appeared to have increased significantly, increasing from just below 20 percent in 2017 to 30 percent in 2018 and nearly 50 percent in 2019 (although the average for 2019 is based on a low number of observations).
- **The impact of MASSIF on improving access to finance for women seemed more limited, but was difficult to assess given limited data coverage and absence of a benchmark.** Although not required by MFA, FMO's Impact Card template includes indicators on the share of microloans and SME loans provided to women. These data suggest that the share of microloans to women increased, while the share of loans to women-led SMEs declined and seemed low compared to country averages. The number of observations is however still too limited to draw solid conclusions. In more than half of our case studies, no data was provided on these indicators.
- **The Financial Proposals reviewed as part of our case studies contained limited analysis to assess the expected impact of potential MASSIF clients on improving access to finance for specific target groups**. The absence of such a rigorous analysis is surprising given the key objective of MASSIF to improve access to finance for underserved target groups, and the fact that primary and secondary data are generally available on various access to finance indicators.
- **Our analysis of 20 case studies suggests that MASSIF was successful in improving access to finance: in 12 out of 20 case studies we rated this impact as high**. **In the other 8 instances impact was rated a moderate.** A high impact means that the MASSIF investment allows the FI to better serve an un(der)served segment of the market, either by (a) starting operations in an underserved segment; (b) expanding its current operations to this underserved segment (e.g., increasing the number of clients, the volume of lending, or volume of equity investments), or (c) by introducing new financial products or services.

7.6.3 Conclusions on end-beneficiary outcomes

- **The Financial Proposals reviewed for our case studies offered limited analysis on the expected impact of MASSIF investments.** While the FP template has recently been improved, most FPs studied for this evaluation contained little analysis of how FMO determines the expected impact on end-beneficiary outcomes. It was generally assumed that improving access to finance will automatically improve end-beneficiary outcomes. The new FP template does require IOs to provide a short 'impact rationale' for the investment, outlining the outcomes and impact expected to be achieved based on the indicators collected for MASSIF (which cover more than what was agreed with MFA). However, what is still missing is a comparison to benchmarks, for example on access to finance and employment rates for target groups.
- **The available impact data show that direct employment at the client level (in operations or maintenance) typically increases rapidly in the years following a MASSIF investment.** MASSIF clients report a 15 percent increase in staff in the second year, and a 50 percent increase in the third year. The clients for whom four or five data points are available report on average a doubling in staff.
- **MASSIF clients on average have a larger share of female employees than an ILO benchmark for women in the workforce.** MASSIF clients report female employment shares between 42 and 48 percent, while the average share of women in the workforce in the regions where MASSIF is active is 36 percent (weighted for MASSIF investments). This benchmark analysis however would ideally need to be conducted at the country level (and where possible, the sector level).
- **Data on indirect employment at the end-beneficiary level is too limited for conclusions.** Many MASSIF clients did not report any impact data on end-beneficiary employment. In theory, FMO's Joint Impact Model could estimate indirect jobs created by MASSIF based on the funding provided. However, this was not yet done in practice at the time of the evaluation.
- **Impact on end-beneficiary access to (new) goods and services is measured only ad hoc in investment evaluations commissioned by FMO, even though this is part of MASSIF's ToC.** Case studies indicated that only where FIs explicitly focus on providing production inputs directly (e.g. Client 4) or indirectly (e.g. Client 13), a claim could be made about the impact of (new) goods and services.
- **Eight out of the 20 case studies found an improvement in revenue, profits or income.** Quantitative estimates of such effects were often produced by an external evaluator (e.g. SEO, IDinsight or Dalberg). In two cases, an analysis was conducted but did not show an increase in incomes: Client 10's impact data showed a decrease in their borrowers' annual return, whilst Client 6's quarterly report stated that their clients' profits had stagnated. In one case, income effects were assessed to be positive on the basis of qualitative methods (interviews and focus group discussions). In the nine remaining cases, information on income effects was not available at all; neither quantitatively nor qualitatively.

7.6.4 Recommendations to improve impact measurement

<u>**Short-term recommendations ('quick wins'):**</u>

- **Further improve MASSIF's Theory of Change and results framework**. The current ToC for MASSIF could be improved fairly quickly, by including clear impact pathways for different impact levels (as described in Chapter 2), clearer causal linkages ('arrows' between boxes to

indicate hypotheses to be tested), and more consistent linkages between (monitored) indicators and the ToC. The ToC in Appendix A could serve as a starting point to expand.

- **Further improve output and outcome measurements in the FP template by developing country-level benchmarks, at least for access to finance and employment.** While some improvements were already made in the new FP template, further improvements are possible, notably with respect to the measurement of impact on access to finance and end-beneficiary outcomes (employment, income, access to goods and services). A practically feasible step is to develop a database of national benchmarks (gaps) which could help to estimate expected impact (where high gaps mean high expected impact). Two concrete suggestions are as follows:
  - **Develop a database of access to finance indicators to estimate and benchmark access to finance impact by target group.** While this would require some investment in data collection, access to finance indicators are already available from a variety of sources.[145] Using existing indicators as benchmarks, access to finance indicators for MASSIF countries (e.g., total amount of MASSIF funding going to certain countries) and MASSIF clients (e.g. their share of loans going to specific target groups) can then be compared to existing access to finance gaps. For example, if MASSIF invests in an FI that targets women-led SMEs in rural regions, it should be compared to access to finance indicators for women-led SMEs in these rural regions, or at a minimum compare with averages for women-led SMEs or rural SMEs in the country.
  - **Similarly, develop a database of employment indicators in order to estimate and benchmark employment impact by target group.** FMO is already collecting data on direct employment by gender and should consider including indirect employment (unless too burdensome for the client). However, since female participation rates can differ substantially between countries and sectors, any impact data on female employment should be benchmarked against national/regional averages, and where possible sectoral averages.[146] Such benchmark data on employment should be available for most if not all MASSIF countries from national statistics bureaus, ILO, or the World Bank.
- **Once a database with benchmarks is developed, it can improve both expected impact measurement (in FPs) and actual impact measurement.** For example, classifying countries (and possibly specific segments within countries) into different levels of access to finance or unemployment (e.g., low/medium/high) can help to assess whether MASSIF is targeting the right countries or segments. Moreover, the same can be done by target group. For example, if the share of female FI clients or female jobs supported by MASSIF clients outperforms the national or sectoral benchmark, the MASSIF client could then be said to have a high (expected) impact on improving access to finance or employment for women. Such an analysis could be conducted both ex ante (in FPs)[147] and ex post (when reporting on access to finance impact or employment impact).

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[145] For example, IFC already estimates access to finance gaps by country, based on World Bank Enterprise Survey data which are often also available by sector and by gender: https://www.smefinanceforum.org/data-sites/ifc-enterprise-finance-gap-0.

[146] For example, if MASSIF invests in a client that reports a female employment share of 30 percent (either direct employment or indirect employment at the end-beneficiary level, if available), this can then be compared to the average share of women working in the country or sector before one can judge whether 30 is a lot or a little.

[147] For example, in a country with a low female employment rate, one can already say *ex ante* that the expected impact of investing in a MASSIF client that targets women is higher than in a country with a higher female employment rate.

Medium-term recommendations:

- **Further improve output and outcome measurements reported on Impact Cards.**
  - **Coverage and harmonisation:** where possible, expand Impact Cards with additional indicators more focused on end-beneficiary impact. When MASSIF is the only party requesting certain indicators, clients may be unduly burdened. In order to reduce the costs of collecting such additional data (both for the client and for MASSIF), we recommend aligning and harmonising indicators with other DFIs, and collect relevant indicators that are already used by clients themselves.
  - **Timelines:** make sure all clients deliver all requested indicators on time;
  - **Quality:** perform checks on data quality (e.g. validate questionable values with clients) and provide guidance on how indicators should be measured.
  - **Integration**: continue current efforts (e.g. IMIR) to integrate and optimise monitoring processes and disseminate the resulting insights, both on investment level and on portfolio level. Moreover, include the evaluation department in these efforts.
- **Further improve the measurement of (expected) inclusion impact by developing a full database of 'inclusion gaps'.** This can be done in a similar way as described above for access to finance impact and employment impact, where 'inclusion impact' could include gender impact, rural impact, and youth impact. A further development of this approach could be based on the inclusion impact methodology used by EBRD, which is seen as the leading DFI when it comes to measuring inclusion gaps and inclusion impact.[148] For example, EBRD also scores investment proposals on the basis of their expected inclusion impact, and uses such scores as part of is investment approval process (along with other expected impact indicators such as expected demonstration effects).[149]
- **Continue the good practice of (externally) evaluating individual investments, and do so over a longer time period.** Independent in-depth evaluations are the only way to rigorously assess ex-post mobilisation effects, demonstration effects, and end-beneficiary impact. In-depth evaluations could also be commissioned to assess the effectiveness of certain types of investments, for example SME mezzanine finance. Several case studies and previous experience by the evaluation team suggested that the business model of providing direct loans with mezzanine elements to the "missing middle" is challenging, as these funds need to expend a lot of effort to make relatively small and risky loans in multiple jurisdictions. It could therefore be interesting to commission a separate evaluation to assess whether this missing middle is "missing" for good reason. Such a 'negative' lesson could be valuable to SME finance practitioners as it could help them avoid future failures.

7.6.5 Recommendations to improve impact

Short-term recommendations ('quick wins'):

- **Use MASSIF's successful track record and high revolvability as a comfortable buffer for mitigating the impact of COVID-19 on MASSIF clients**. This buffer should be effectively used by MASSIF, as it already is, to support both existing and new clients during this difficult period. If revolvability declines as a result, this can be justified given the extraordinary needs

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148 For example, EBRD estimates gender gaps, regional gaps, and youth gaps for every ERBD country of operation: https://www.ebrd.com/what-we-do/projects-and-sectors/economic-inclusion.html. We would recommend MASSIF and MFA to further study this inclusion gap methodology to see whether a similar methodology could be used for MASSIF.

149 See https://www.ebrd.com/what-we-do/economic-research-and-data/transition-impact.html

faced by clients and the very low probability of distortionary effects in markets where alternative funding has dried up.

- **Expand the CD team's capacity to use CD more often:**
  - **Use CD more often during the pre-investment stages** to increase the potential bankability of clients that are not yet ready for MASSIF but could become ready with a little support. The CD instrument could be used more often in higher risk countries or sectors where FMO's risk appetite is less than the actual risk on the ground (e.g. fragile states, MENA, South Sudan, Chad, Mali). According to a senior manager at FMO, "these are very difficult, but this is one of the reasons FMO is here".
  - **Use CD more often for sector-wide initiatives** such as pre-investment engagement in specific a sector or country, for example by conducting market studies, supporting regulators, or associations. Sector-wide CD has been previously provided on a small scale, but could be provided more often to help MASSIF reach new markets and countries where it is currently difficult to find projects.

Medium-term recommendations:

- **Further improve the inclusion impact of MASSIF by linking the improved measurement of inclusion gaps to business development and approval processes for MASSIF investments and CD.** A relatively straightforward way to measure expected inclusion impact is to compare impact indicators to existing access to finance gaps, employment gaps, and other inclusion gaps for specific target groups (e.g. women, youth, and rural households). This expected inclusion impact (which is higher in countries with large gender gaps, rural gaps, or youth gaps) could then help inform business development (e.g., the MASSIF could look more actively for projects in countries/sectors with higher gaps) and could also be linked to investment approval processes. For example, investment proposals as well as CD proposals could be scored on the basis of their expected inclusion impact and projects with a higher expected inclusion impact would then have a higher chance of being approved (all else equal). The same could be done for expected demonstration effects.
- **Consider setting up a special sub-fund for MASSIF investments that have high expected impact and high potential to mobilise commercial funding in the future, but that are currently considered too risky even for MASSIF.** By not requiring such high-risk investments to have an upfront positive expected return, a higher subsidy element could effectively be provided for such investments. This could be done e.g. for specific countries (e.g. fragile states, Sahel region, countries worse hit by COVID-19) or for specific target groups (e.g., remote rural areas, refugees) where the potential impact is high and where the risk of market distortion is very low, as they are still far from being commercially viable. Some DFIs have such funds for specific countries or specific sectors, which could serve as an example.[150] In case the overhead costs of setting up a separate legal entity are considered too high, an alternative is to use a more internally labelled version which would apply modified investment criteria to eligible investments but otherwise would follow the same approval and monitoring processes as MASSIF.
- **Similarly, a local currency fund could be set up to encourage local currency investments in countries where the FX hedging cost would otherwise be prohibitive (i.e., no market**

[150] For example, EBRD mobilised donor funding for its "Early Transition Countries Initiative" to allow it to accept higher risks in the projects it finances in countries with the most significant 'transition challenges': https://www.ebrd.com/what-we-do/sectors-and-topics/early-transition-countries-initiative.html

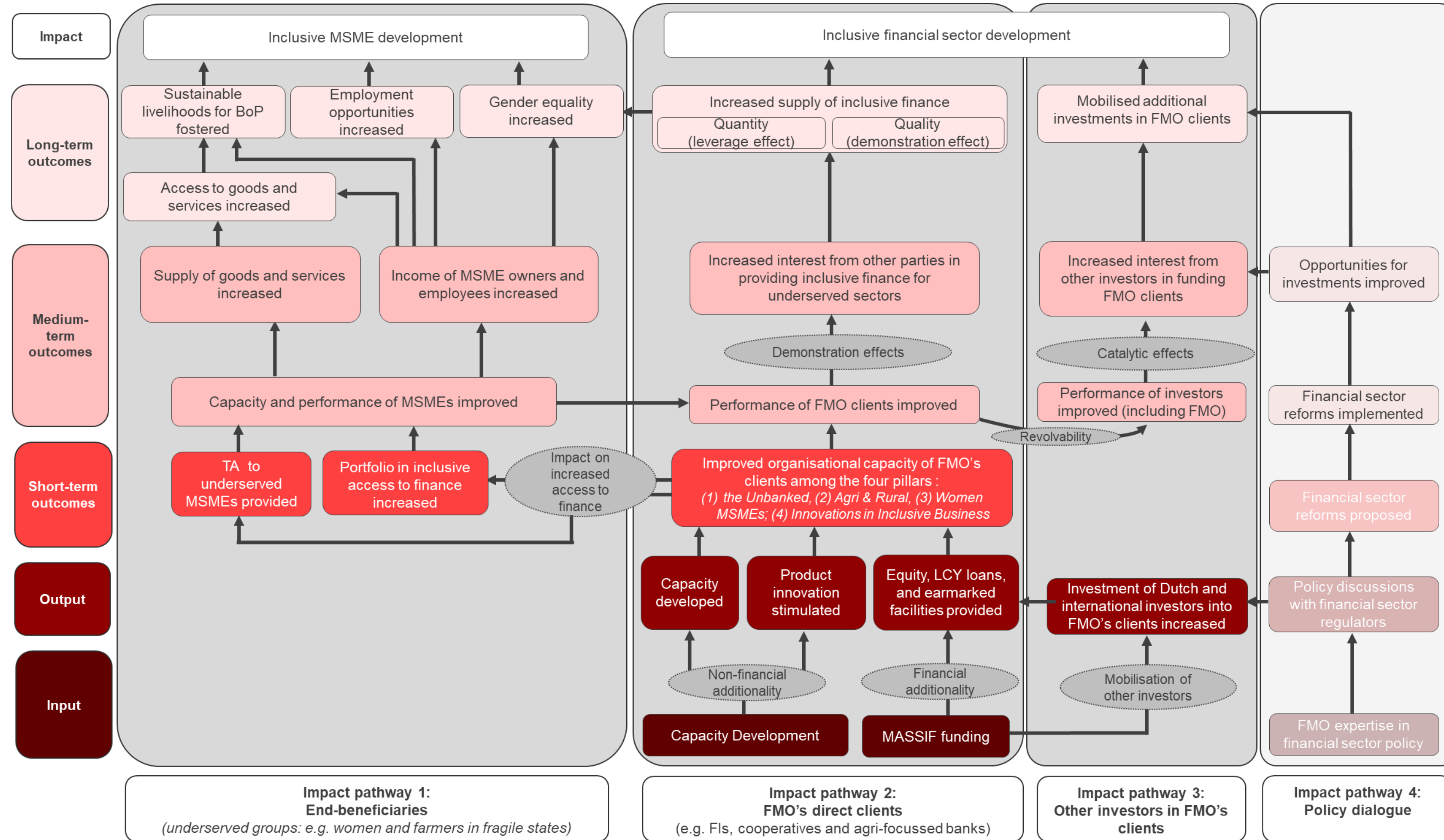
for FX hedging exists). Such a local currency fund could be similar to EBRD's SME Local Currency Programme, to which EBRD donors like the U.S. Treasury, Switzerland and Japan contributed risk-sharing funds that has allowed EBRD to reduce interest rates on its local currency loans.[151] Effectively, such a fund would then subsidise TCX hedging costs (or the credit risk resulting from exposing end-clients to currency risks), which could then allow MASSIF to do more local currency debt financing in countries with high exchange rate volatility. This in turn could substantially improve the impact of MASSIF investments in countries like Lebanon or Zimbabwe where borrowers faced very high exchange rate risks but preferred FX loans simply because of the high cost of hedging.

Long-term recommendation:

- **Improving impact measurement in the medium term will allow for better decisions in the long term on how to further improve MASSIF's design.** When more and better information becomes available at the portfolio level, analysis can reveal in which areas (countries, sectors, instruments, target groups) MASSIF is most impactful.

[151] See: https://www.ebrd.com/what-we-do/sectors-and-topics/sme-local-currency-programmes.html

Appendix A Reconstructed Theory of Change for MASSIF



Appendix B Case study selection

Criteria used for selecting a sample of 20 representative MASSIF investments:

1. Combined total of at least 20 MASSIF investments
2. Combined minimum value of EUR 100 million.
3. About 67 percent active investments 33 percent inactive investments. (not necessarily an even spread over the years 2015-2019)
4. About 67 percent debt, 33 percent equity investments.
5. A representative spread across the four pillars of MASSIF (or at least two investments in each pillar):
   - the unbanked
   - agriculture and rural livelihoods
   - women-owned (M)SMEs;
   - innovations in inclusive business.
6. The size distribution of the selected sample should broadly match the current (and anticipated future) size distribution of the entire MASSIF portfolio:
   - Median investment size of around EUR 4.5 million.
   - Include at least two large investments (> 10million)
   - Include at least two small investments (< 2 million).
7. Since the anticipated size distribution of MASSIF investments is expected to increasingly contain more smaller investments, smaller investments may be overrepresented in the sample
8. Up to 5 out of 20 case study investments could include multi-country fund investments, given that about 25 percent of MASSIF investments concern fund investments.
9. The selected sample of 20 investments should include:
   - a few MASSIF investments that 'graduated' in that they were followed up with investments by FMO-A, other FMO funds, or commercial funding.
   - a few investments that did not graduate (while noting that some were never expected to graduate)
10. The sample distribution should mimic the portfolio spread in terms of risk profiles, for example as measured by the "F profile" (financial risk, particularly related to country risk and company risk). In particular, care should be taken to ensure a sufficient number of fragile states (high country risk)
11. The sample distribution should include at least one investment in Special Operations (the unit that deals with NPLs).

The final selected sample of 20 case studies is presented at the end of Chapter 2.

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