Centre for Development
Finance Studies

The CDFS Short Read – May 2023

# Measurement and Reporting in a Time of Mobilisation

## This CDFS Short Read in Brief

**As the development finance system of institutions scrambles to mobilise capital markets, accurately assessing progress is necessary to develop an understanding of what the most effective strategies and instruments are, and what simply does not work. The adoption of methodologies delivering an overly optimistic picture of current achievements conversely presents a direct threat to the ability of the system to deliver on the objectives set by shareholders. Corrective measures are needed, and it seems necessary to push for the adoption of a single measurement system. This should introduce dimensions too often overlooked in the debate: time, risk, and funding strategies. Self-assessment is, absent an independent verification mechanism, perhaps not an advisable route to the measurement of capital mobilisation by DFIs and MDBs.**

This CDFS Short Read provides a brief initial analysis of two existing frameworks for the measurement of private sector capital by development finance actors: the OECD's DAC methodologies, and the methodology developed by a group of MDBs and DFIs.

Each approach has its relative merits. Both agree however that, to various extents, every dollar fortuitously found in the same room as development finance funding is a dollar mobilised. The MDB methodology does at least recognise that not every dollar can be claimed as mobilised with the same level of self-congratulation. Where the DAC methodology concedes something of that nature, it is merely to apportion the glory amongst the development finance actors crowding the room.

These arrangements unsurprisingly result in development finance actors already being able to claim impressive mobilisation numbers. Whenever a system designed to measure the progress of a dynamic that is generally deemed to need considerable acceleration instantaneously finds that the entities whose work is being assessed are in fact already acting satisfactorily, a healthy level of scepticism is advisable. Whenever this system happens to have been designed or informed by these same entities, double the healthy level.

In addition to correcting some of the more questionable assumptions and formulae, it may be useful to make acceleration the focus of measurement efforts, rather than current flow. The current readings of the latter would then constitute a baseline.

A measurement system that solely focuses on adding numbers may tell us whether or not we are successful, but it will not tell us why. Beyond measuring aggregate numbers, monitoring ratios pertaining to the efficiency of different mobilisation instruments would help adjust strategies and allocate resources.

The observable, if hitherto modest, multiplication of measurement methodologies is in itself a threat to the sector's ability to accurately measure its progress, and therefore the effectiveness and efficiency of its initiatives. Comparing the mobilisation levels across institutions is necessary to develop an understanding of the dynamics. Using a different, ideally homebuilt measuring tape is a time-honoured way to escape the scrutiny and the potential embarrassment associated with publicly available comparable data. This is not to say that individual efforts to develop measurement models are unwelcome. They are in fact much needed. Improvements to a mutually accepted common framework would just be more useful.

In a sector that has traditionally been focussed on self-liquidating instruments such as loans and private equity limited partnerships, and that has placed co-investment - whether pari-passu or through a blended finance structure - at the core of its mobilisation theory of change, it is not surprising to notice that almost all mobilisation measurement methodologies are focussed on the time at which the initial investment is made.

The private sector refinancing of an infrastructure project, the sale of an equity stake, secondary issues of shares following a development finance-enabled IPO are all mobilisation events that, should the *sine qua non* role of the original public sector funding be demonstrable, should be accounted for. The fact that they happen at a different time may make their recording more difficult, and less instantly rewarding, but recorded they should be.

They in fact underpin the important concept that the differentiated nature of development finance actors should mean that they are likely to be more successful in their mobilisation as first movers than as conveners.

Equally, transferring risk from MDB balance sheets to capital markets, or indeed issuing bonds to fund financing activities are equally worthy of consideration.

The continued absence of a centralised external, independent audit mechanism is an impediment to the opportunity for the development finance system to learn, and to share learnings. Whilst this observation equally applies to other measurable aspects of development finance, the debate surrounding the measurement of private sector capital mobilisation is at a relatively early stage.

It has been said (by many) that 'the chains of habit are too light to be felt until they are too heavy to be broken' The opportunity to prevent their formation is worth seizing.

# 1. A House Divided

**The DAC methodologies and the competing MDB framework provide a solid if divided foundation to build on. Once a few scenarios have been reviewed to compare and comment, it is worth interrogating some of the assumptions underpinning this tale of two methodologies.**

## 1.1. Housekeeping

This brief analysis was conducted based on the latest publicly available depictions of the respective methodologies. Latest does not in this instance rhyme with recent. The DAC methodologies latest available draft was published in 2020[1] and the MDB group last described its own approach in June 2018[2]. The latest joint report itself was published in 2021 but looks at 2019 data.

Mobilisation measurement does seem to result from the combination of a rear-view mirror and ornithology-grade binoculars. It is fully expected that updates might have taken place since, but notwithstanding the lack of public knowledge of such improvements, the principles underpinning these methodologies have not materially changed.

A significant difference between the two methodologies is that the MDB approach introduces a split between private direct mobilisation ('PDM') and private indirect mobilisation ('PIM'). A seemingly robust test is applied to the ability of the reporting DFI or MDB to prove that it played an 'active and direct' role in securing the commitment of private capital.

This is absent from the DAC methodologies. On the other hand, the latter is as will be seen rather less generous than the former in claiming components of a transaction's capital structure not directly linked to the DFI/MDB intervention.

The MDB approach does however solely attribute mobilisation credits to institutions contributing to its joint report, meaning that other public investors in the transactions concerned are largely ignored.

## 1.2. Guarantees

The measurement of private capital mobilisation brought about by commercial risk guarantees is a useful starting point. The first assumption of the DAC methodologies sets the mood:

*'The implicit assumption is that the private investor would not have provided the loan, equity or other finance without the official guarantee. The amount mobilised by a guarantee is the face value of the instrument covered by the guarantee, irrespective of the exposure value of the guarantee.'*

The full face value of the instrument benefiting from the guarantee is therefore recognised as having been mobilised. In the case of commercial guarantees, the MDB methodology does categorise the portion of the loan that is covered by the guarantee as a commitment from the MDB, and therefore only recognises the rest of the loan as PDM.

As can be seen in Table 1, this results in a higher reading of private capital mobilised (orange ovals) by the DAC methodology compared to the MDB's PDM (orange ovals). The MDB approach does not however stop at the loan being guaranteed. It further considers that '100% of the private sponsor's investment' is attributable as PIM (blue ovals).

[1] https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/DAC-Methodologies-on-Mobilisation.pdfGuarantees

[2] https://documents1.worldbank.org/curated/en/495061492543870701/pdf/114403-REVISED-June25-DocumentsPrivInvestMob-Draft-Ref-Guide-Master-June2018-v4.pdf

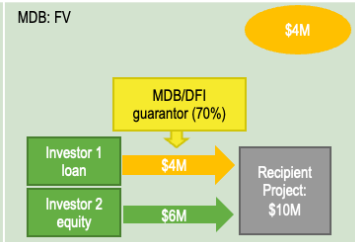
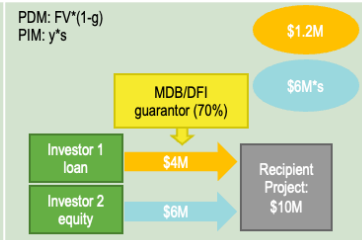
| Instrument | Definitions | DAC Methodologies | MDB Methodology |
|---|---|---|---|
| Commercial Risk Guarantee | FV = face value of instrument covered by guarantee<br>g = percentage of the FV guaranteed by MDB/DFI<br>y = other private investments (not covered by guarantee)<br>s = MDB/DFI's share of total MD/DFI commitment |  |  |

Table 1: Guarantees

The divergence in the treatment of the guaranteed loan is an early indicator of the issues inherent to a cash-based measurement system applied to a finance scenario. Whilst the private investors making the loan do indeed provide its full face value in cash, they are only exposed to the risk of the portion of the loan not covered by the guarantee. The MDB methodology value makes more sense from this standpoint but still fails to recognise that the quantum of the risk will not, depending on the terms of the guarantee, represent 30% of the aggregate risk.

In a project finance context and keeping in mind that this specific asset class is the historical bread and butter of MDBs, the mobilisation claim to the sponsor's equity is defensible. The same could of course not be said in a corporate lending context.

For the sake of completeness, it is worth noting that both sets of methodologies recognise the full face value of a loan to which a non-commercial risk guarantee is applied. Here again, the MDB approach claims the private sponsors' investments as PIM.

## 1.3. Syndicated Loans

Whereas in both approaches there is an implied assumption that there is a single guarantor in the scenarios described above, the methodologies applied to syndicated loans do – rather satisfactorily given the prevalence of inter-DFI/MDB syndication – allow for the presence of multiple development finance lenders.

Where private lenders have managed to squeeze in, the OECD asymmetrically attributes the mobilised private capital between the MDB arranger and other development finance lenders, whereas the MDB methodology attributes all of the private lending to the MDB arranger and claims the equity contributed by the project's sponsor as PIM.

The syndicated loan scenario does present several simplification advantages. Where a development finance actor plays the role of arranger, it does clearly play an 'active and direct role'. The pari-passu nature of the structure does in addition make for an alignment between cash and risk.

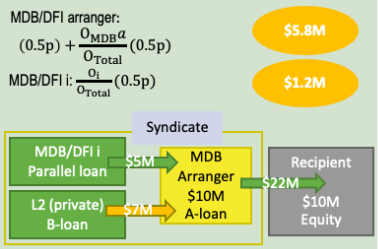
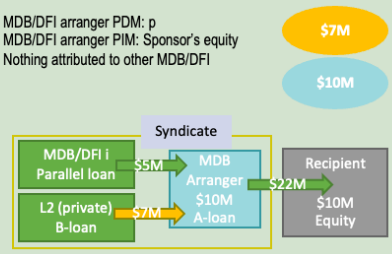
| Instrument | Definitions | DAC Methodologies | MDB Methodology |
|---|---|---|---|
| Syndicated loan (MDB/DFI arranger) | p = volume of private lending<br>o = volume of MDB/DFI lending | MDB/DFI arranger: $(0.5p) + \frac{O_{MDB}a}{O_{Total}}(0.5p)$<br>MDB/DFI i: $\frac{O_i}{O_{Total}}(0.5p)$<br>  | MDB/DFI arranger PDM: p<br>MDB/DFI arranger PIM: Sponsor's equity<br>Nothing attributed to other MDB/DFI<br>  |

Table 2: Syndicated loans

The case where the loan syndication is conducted by a private arranger is not included in Table 2. It is however worth noting that the DAC methodologies assume that 'private investors (including the arranger) would not have invested without the presence of official participants in the syndication'. This is highly questionable and serves to highlight the risk of oversimplification for the credibility and the utility of mobilisation measurement and reporting.

| Instrument | Definitions | DAC Methodologies | MDB Methodology |
|---|---|---|---|
| Collective Investment Vehicles (CIV) | P = volume of private investment<br>T = total value of MDB/DFI Investment<br>n = number of MDB/DFIs in riskiest tranche<br>x = investment from specific MDB/DFI | MDB/DFIs, riskiest tranche:<br>$\frac{0.5P}{n} + \frac{x_i}{T}(0.5P)$<br>Other MDB/DFIs | P = PIM, unless MDB acts as GP, in which case P = PDM |

Table 3: Collective Investment Vehicles

## 1.4. Fund Investments

The DAC methodologies pertaining to investments made in collective investment schemes do provide an interesting case study in the treatment of blended finance structures with investments made by public and private actors alike at different points in time.

Whilst every dollar of the private capital present is still deemed mobilised, the attribution favours those investors committing earlier and to more junior components of the vehicle's capital structure.

There was at the time of writing no publicly available information about the treatment of non-flat structured funds by the MDB methodologies. Unless an MDB plays the role of general partner – i.e. fund manager – there is no recognition of any PDM, but all commitments from private investors are counted as PIM. This aspect of the methodologies asks some important questions. Rewarding early-stage anchor commitments makes sense since these demonstrably embolden private investors. Higher levels of attributions for junior positions that essentially amount to the subsidisation of private investments are however more problematic than it may seem.

This is once again linked to the fact that cash is not the sole, in fact arguably not the primary, concept in matters financial.

The objective of mobilisation is to have private investors shoulder more of the risk associated with the financing of sustainable development. It can be argued that a development finance actor taking a higher share of the risk to entice private investors can lead to these investors gaining familiarity with the underlying assets and eventually to their making investments without the need for further subsidisation. Absent evidence to back this theory, however,

this approach to measurement risks incentivising DFIs and MDBs to inefficiently 'buy' mobilisation cash with taxpayer risk.

If key performance indicators and incentivization systems were to shift their focus from deployment targets to mobilisation objectives this may result in transactions where development finance actors shoulder an unnecessarily large amount of risk to lure private investors. There is no intention here to cast aspersions on the dedication of DFI teams to their mission, but incentive schemes are renowned for their unintended consequences.

## 1.5. Synthesis

It is readily observable, even on the basis of what is publicly available, that the OECD's DAC methodologies have evolved over time, including additional methodologies for additional instruments and contexts. The MDB approach seems to constitute an attempt to circumvent the need for a wide array of scenario-specific formulae by applying a more principle-based approach.

It should be stressed that whilst the nature of this CDFS Short Read means that it is focussed on constructive criticism, these two approaches form a solid basis on which to build.

### Has Anyone Asked the Mobilised?

The DAC methodologies for each instrument share a common assumption: that 100% of the private investor capital present in any transaction involving development finance can and should be counted towards mobilisation numbers.

This is clearly at least an oversimplification. Whilst it is of course impractical to interview private sector investors to assess whether they would have invested regardless of development finance participation, it does seem that the 100% assumption is hard to defend in cases where the deal is not originated by a development finance actor. It would at any rate be instructive to conduct a sample-based series of case studies to gather informative if not necessarily statistically representative factual evidence.

The DAC methodologies do seem to be more concerned with the attribution of mobilisation across DFIs than with the validity of the 100% assumption. This is, of course, important in the context of a comparison between institutions, but of little value in assessing progress, let alone identifying the most effective instruments.

The MDB approach does make a valuable attempt at verifying whether the MDB claiming mobilisation credit does indeed play an 'active and direct' role in bringing private capital into the transaction. The PDM measure does as a result seem to paint a more realistic picture. Somewhat predictably however, the Joint Report uses the combined PDM and PIM as its headline number, and one must plough through to page 20 of the 2021 Joint Report[3] featuring 2019 numbers before being told that only 32% of this number is of a PDM nature.

### Negative Mobilisation

There is in addition the rather sensitive matter of negative mobilisation. There are persistent rumours in some segments of the market suggesting that development finance actors sometimes compete away private sector financing. There is little doubt that the relatively low cost of capital enjoyed by development finance actors affords them the opportunity to do so. Daniel Zelikow, chairman of the governing board of J.P. Morgan's Development Finance Institution is for example quoted in a rare development finance focussed article published in March 2023 by The Banker[4] as suggesting that:

*"Sometimes the availability of funding from official lenders, whether multilateral or bilateral, drives down the spread available to private sector investors. This may be good for borrowers, but it can also discourage private*

[3] https://publications.iadb.org/en/2021-mdb-joint-report

[4] https://www.thebanker.com/World/Americas/Cover-story-Redefining-development-banks-purpose-in-Latam

*investors involvement rather than 'crowd in' private money."*

It could be argued that no system designed to measure the quantum of the private capital mobilised can be complete without at least some effort being dedicated to ascertaining whether there are instances in which development finance has a negative mobilisation effect.

## Can the Mobilised be Mobilisers?

In addition to the doubts expressed earlier about the wisdom of incentivising blended-finance-based subsidisation, the DAC approach, on which one must pick, absent information pertaining to the MDB's views on the question, attributes some of the private capital mobilised in a blended finance fund to DFIs investing later than and in tranches senior to those of other DFIs. Can a DFI that is effectively de-risked by another, and that failed even to take a leadership role in a specific transaction seriously claim any mobilisation credit? Let it be permitted to suggest that such an approach only serves the reporting needs of official actors, not those of sustainable development.

# 2. Adding Dimensions

**The current mobilisation measurement methodologies are effectively solely focussed on private capital mobilised at the single transaction level, and at or around the time at which the transaction takes place. No amount of granularity will make up for the fact that this is bound to deliver a woefully incomplete account of the role played by privately held capital.**

## 2.1. Time, the Great Mobiliser

As discussed above, both measurement frameworks share a built-in focus on the point in time at which development finance funding is committed or deployed. Whilst this reflects a core tenet of the hitherto prevailing mobilisation theory, this approach will invariably fail to capture the very real potential for mobilisation *over time*.

Let us conjure a couple of practical examples.

If an MDB single-handedly funds the development and the construction phases of an infrastructure project which is subsequently entirely refinanced by the private sector, does it not constitute mobilisation? The project would demonstrably never have seen the light of day without development finance. It is now sourcing the financing it requires to operate from the private sector. The only difference is that the two sources of funding intervened at different times.

If a DFI injects equity capital into a fledgling financial inclusion business, and helps it achieve the scale and commercial viability it requires to attract private sector shareholders, and subsequently sells its stake to an institutional investor, is that investor's capital not legitimately mobilised?

At the risk of stating the obvious, the nature, structure and mandate of development finance actors do allow them to intervene in a manner that is differentiated from private sector investors. Blended finance is based on this principle. The DAC methodologies do integrate the concept of asymmetric risk investments. It is therefore bewildering that the much simpler concept of the time-continuum of development should not be recognised. The conversation does seem to be at an inflexion point, and the 'pathways' described in a recent BII discussion paper[5] suggest the need for further thinking is not exclusively held by 'outsiders'.

## 2.2. Risk Transfer

Risk transfer is at the core of modern financial markets.

Though it is not our purpose here to dive into the technicalities of the instruments of risk transfer, whether they be securitisation or credit risk insurance markets, the key concept is that it is possible for DFIs and MDBs to transfer some or all of the risk of existing investments from their balance sheet to private sector actors. This can of course be done by selling these assets. It can also be done by purchasing 'insurance' against the risk exposure generated by these investments. This frees up risk budget, enabling the development finance actor to invest in new projects.

The origination, repackaging and transfer of risk by DFIs and MDBs holds great potential, and should therefore be included in measurement frameworks.

## 2.3. The Game is Bonds

The most surprising omission currently observable in mobilisation measurement frameworks is arguably the issuance of bonds by MDBs and DFIs. Bonds issuance programmes are of course a key feature of MDB funding models but are also at play with a some of the larger bilateral DFIs. The growth in Green, Social, Sustainability and Sustainability-linked ('GSSS') bond issuance

[5] https://assets.bii.co.uk/wp-content/uploads/2023/03/13125506/Understanding_Mobilisation.pdf

adds to the relevance of this mobilisation model.

If 70% of an institution's balance sheet is funded through debt sourced from capital markets, there should be no argument that it has successfully mobilised private sector funds. The reality is of course that this results in the leveraging of the equity held by public sector shareholders, and that the risk of the institution's portfolio is asymmetrically shared. A measurement methodology developed to bring this route to mobilisation into the fold should therefore account for its higher risk cost.

## 2.4. Complexity Ahead

Adding dimensions to measurement frameworks will undoubtedly lead to a much higher level of complexity. This is particularly true because, to allow for a comparative analysis of the effectiveness and efficiency of each instrument, it will be necessary to understand the cost of mobilisation. What is the cost in terms of risk to taxpayer equity of issuing bonds? Is paying credit risk insurance premia a cost-effective way of mobilising private capital to free up risk budget? What of the risk exposure created by the provision of a first loss tranche to a private equity fund?

There is thankfully much one can draw from the body of knowledge built over decades by financial institutions that found it necessary to answer these same questions, if for very different reasons.

# 3. The Importance of being Earnest

**The real value of an accurate, multi-dimensional, independently verified measurement system lies not in the painting of a perfect picture, but in the learnings that can be transcribed into tangible actions accelerating our common journey towards sustainable development.**

One should take pause at regular intervals to sympathise with the plight of development finance professionals. No sooner are they asked to alter decades-old models to mobilise capital markets than they are asked to spend significant amounts of time and creativity to report on what are admittedly complex dynamics.

Given the scarcity of these resources, it is important to establish that this additional effort is not solely justified by an insatiable but potentially unproductive appetite for transparency on the part of external stakeholders.

As has been argued above, the mobilisation of private capital is a complex and multidimensional endeavour. It can be achieved through an array of instruments that go far beyond simple co-investment.

To ensure that the collective efforts of development finance institutions are optimally efficient it is therefore crucial to establish which strategies are most effective, and which instruments deliver the biggest capital market bang per buck of development finance risk.

The core purpose of the measurement of capital markets mobilisation simply cannot be to satisfy our collective addiction to the announcement of large numbers on the podium circuit, but the acquisition of reliable knowledge to drive informed decision-making.

A first obvious step towards delivering this value should be the merger of the two main measurement models described above. The OECD has over the past six decades built considerable capacity and expertise in the field of statistical measurement. It has specifically dedicated resources to the development of the DAC methodologies. It seems well-positioned to manage this process, thereby freeing up precious resources at MDBs and DFIs. Whereas self-assessment is necessary in the banking world given the vast universe of actors, the development finance system of institutions has relatively few members, and frequent co-investment among them means that there is value in a centralised measurement process.

It seems equally clear however that this is not solely a statistical matter.

***An independent body should be convened to ensure that the best available capital markets expertise informs the methodologies and ensures that they are keeping pace with innovation and market shifts.***

And because we cannot hope to alter human and institutional nature in anything like a relevant timeframe, this body should also include transparency experts, the kind of people that know what a closet looks like when it contains a skeleton.

The system born out of the combination of the OECD's capabilities and an independent steering committee would be positioned to equip the shareholders and the management of development finance actors with actionable, analysed data rather than with impressive but ultimately strategically irrelevant statistics.

As the development finance system of institutions seeks to implement, inter alia, the recommendations of the G20´s Capital Adequacy Framework Report, the importance of generating fit-for-purpose, actionable knowledge cannot, and must not be underestimated.

# 4. Risk-Weighted Capital Mobilisation

As briefly discussed above, cash is only one component of any investment and of any financial instrument. Without some sort of recognition of risk, any attempt at measuring the extent to which the development finance system of institutions is successfully mobilising private capital to deliver sustainable development will paint a distorted picture.

This is particularly relevant if additional instruments or events are being introduced into mobilisation measurement methodologies. The resulting inflation in reported mobilisation numbers is unlikely to be effectively addressed by stronger tests of the actual mobilisation role played by the reporting institution largely relying on self-assessment.

It is crucial that, whilst the very real mobilisation delivered by the issuance of bonds by DFIs is worthy of recognition by measurement methodologies, the fact that the risk taken on by the investors buying these bonds is relatively low should be considered. Where risk transfer is concerned, the thickness of the tranche of a portfolio being transferred matters, but so does its position.

It is riskier to address the shortage of equity capital for SMEs than it is to lend to large corporates. It is riskier to invest in LDCs than it is to do so in MICs. Intuitively, capital mobilised to take more risk is worth more to development. Mobilisation measurement methodologies should reflect this.

Thankfully, as was discussed in the context of the modernisation of the DAC Statistical System for the measurement of ODA in the previous CDFS Short Read, assigning risk weights to assets is not precisely a new concept. The development finance system of institutions should here again resist the temptation to engage in wheel reinvention.

***Where the DAC statistical system seeks to measure the donor effort resulting from the use of private sector instruments ('PSIs'), methodologies designed to measure mobilization should seek to measure the private sector effort. In both instances, they should look to measure effort on a risk-weighted basis.***

***Beyond solving for the measurement of mobilisation in a format that yields knowledge that can be built upon, there is a real opportunity to align the measurement of the effort consented by both the official and the private sector.***

***An opportunity to build a measurement system that makes sense.***

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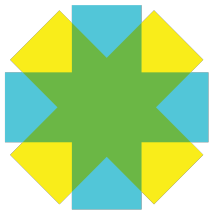

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Please contact the CDFS at info@thecdfs.org with any comments or questions about this Short Read.

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