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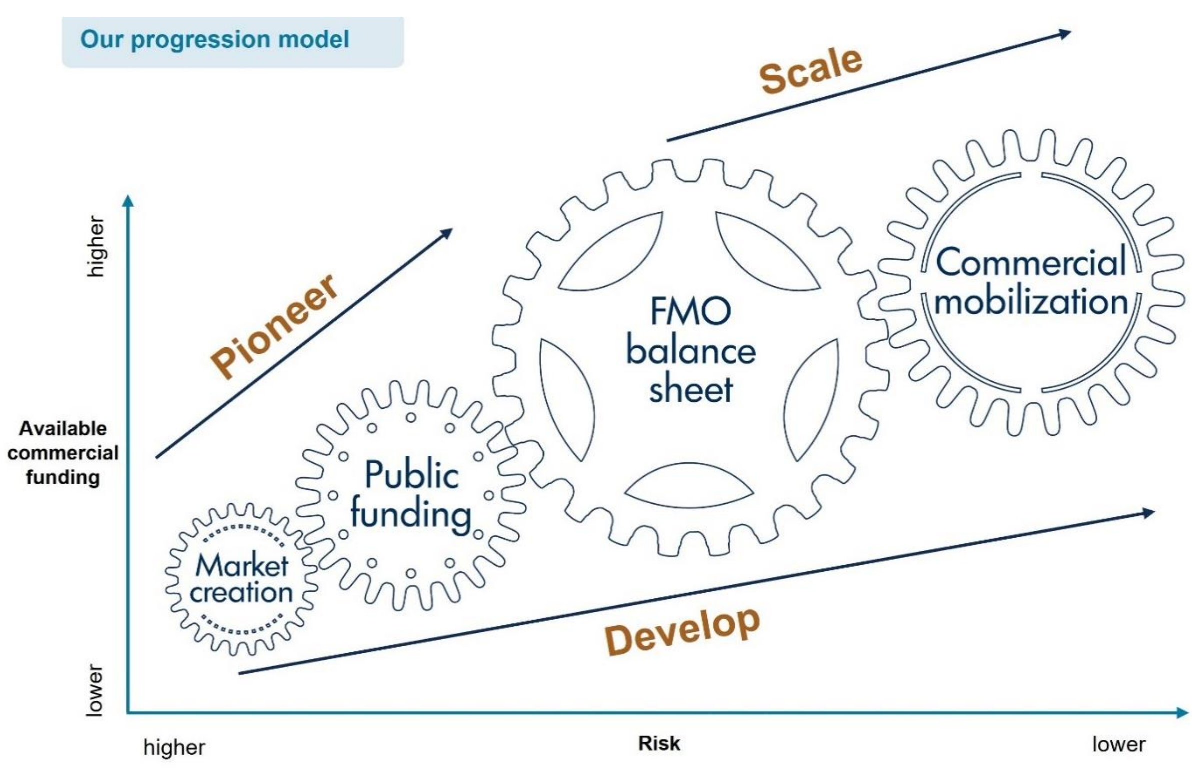
External Management Response to the Progression Model Evaluation

Progress towards achieving the Sustainable Development Goals (SDGs) is lagging worldwide: inequality is rising while the climate crisis continues to unfold. We need sufficient resources to tackle these issues, especially for lower- and middle-income countries. Yet, we cannot entirely depend on government resources, as they are not sufficiently available, and we cannot place our hopes in the private sector spontaneously multiplying their investments. In short, there is an SDG funding gap. This is why the Progression Model is at the heart of FMO's Strategy 2030 Pioneer-Develop-Scale, where we move opportunities from market creation and public funds, through our own balance sheet, to commercial mobilization. The model not only focuses on helping our customers get ready for commercial funding, but also on deploying concessional resources where they are needed the most. A model in which progression serves as a means to an end, where scaling impact is our ultimate goal.

The progression model is a simple reflection of the complex reality that our customers face. In fact, progression is influenced by many variables, some of which can be directly influenced and others not. At the same time, we recognize that the development finance architecture needs to accelerate progression to maximize its impact. This is why FMO commissioned Dalberg to carry out a progression model evaluation (on behalf of the Dutch government's financed programs Massif, AEF, and BP). This research is valuable for FMO, as it helps us to better understand these specific parts of the progression model. In its research, Dalberg focuses on the progression of FMO customers financed via public funds (concessional finance) towards financing via FMO's own balance sheet and onward to commercial mobilization. This evaluation, however, did not cover all progression elements, such as FMO's contribution to the progression of sectors and markets, or customers' progression to commercial funding that is not mobilized by FMO.

Progression reality



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FMO deploys market creation and public funding where risks are high and where available commercial financing is scarce. When risks decrease, we can deploy our own balance sheet resources, and when commercial appetite increases, FMO can mobilize commercial resources for its impact agenda. The evaluation demonstrates that progression is influenced by a number of factors, ranging from market-specific factors to company-specific factors. Some of these can be influenced by FMO while others cannot. From a market perspective, progression is influenced by (among others) (i) stable economic growth, (ii) sector maturity and stability, (iii) country risk rating, and (iv) history of conflict. From a company perspective, progression is influenced by, for instance, (i) proper corporate governance, (ii) E&S performance, (iii) impact label contributions (green financing), and (iv) business model and financial health.

The progression variables will all impact the customers' ability to progress its business. Some of the variables are entirely outside the scope of control of the customer and FMO. Therefore, we do not focus on how many customers progress to the next level but on the parts of the progression that we can influence, which differ for each customer. Where one customer needs additional support for ESG management, another needs to focus on financial performance.

We also perceive that progression is often a gradual process. Where a customer will usually depend on concessional resources for equity participation for a relatively long period, the customer might be able to attract medium-term loans from more commercial resources and easily attract short-term loans or trade finance from purely commercial resources. To complete the puzzle, FMO's financial and non-financial activities contribute to the progression of sectors and markets, which is not considered by the Dalberg evaluation. This is especially important in our sector initiatives, such as Invest for Impact Nepal.

Evaluation results

We are pleased to see that the evaluation shows a significant number of customers have progressed. Considering that the evaluation does not cover the full progression story, we view this outcome as a baseline. Even more importantly, Dalberg has confirmed that progression is taking place in line with our progression model and reinforced our progression assumptions, showing that we focus on the right progression-enabling elements. These elements include FMO's investment strategy, our financial offering (e.g., concessional finance terms, a mix of financial instruments, and risk-sharing mechanisms), and our non-financial support (e.g., technical assistance and ESG advisory). At the same time, we recognize Dalberg's finding that some customers face challenges in moving quickly from the public funding stage to the (partly) private stage, especially those in the agricultural sector or in challenging (socio-political) environments. These challenges are often beyond our control, but we remain committed to investing in these customers due to our significant added value and the impact achieved at the customer level as a result of our financial and non-financial support. Our focus is not on easy-to-progress customers but on designing interventions to accelerate progression, even if difficult. Dalberg's recommendations will assist us in this effort.

The progression model is integral to our strategy and impact ambitions, serving as a framework within which we provide funding and other services. In other words, it is a means to scale impact rather than an end in itself. We therefore support Dalberg's recommendation to clearly articulate this role of the progression model. We also see the benefit of raising awareness and promoting progression opportunities and initiatives. It is especially important to recognize that public funding, ESG improvement plans, and technical assistance are key drivers for customer progression.

We view progression as essential for achieving development impact, but it is not an isolated variable. Hence, progression is part of our Theory of Change, and part of our Measurement, Evaluation, and Learning (MEL) tools aimed at assessing and maximizing impact. Thus, we will not create a separate MEL strategy for progression or develop steering metrics, as proposed by Dalberg. Isolating this variable can lead to a perverse incentive and favor interventions that do not maximize development impact.

We believe that the development finance architecture would indeed benefit from an improved understanding of best practices that accelerate progression. Most importantly, we believe that we, as DFIs and IFIs, must avoid practices that slow down progression, such as investing concessional resources in ways that keep customers reliant on concessional terms for too long. In this regard, we emphasize the importance of the *DFI-enhanced blended finance principles.*

We thank Dalberg for conducting the evaluation, helping us better understand progression, and sharing insights to optimize our progression efforts. These steps are essential for scaling impact and directing more investment towards the SDGs and climate finance