**Asiana: Asiana Investments Fund I, LLP**

***Introduction***

Cynthia Leung was perplexed. As an Independent Evaluation Specialist, she had been assigned to review the expanded project supervision report for the Asiana Investments Fund I (“the Fund”). The Fund was a closed-end, 7-year, private-equity fund in the country of Asiana. She had to prepare an evaluative note, or EvNote, to cover the standard categories of rating indicators for the project, the UN investment, and UN’s work quality, indicating where she and UNDP agreed or disagreed with the UN SELF-EVALUATION REPORT Team’s ratings for each of these indicators. She also had to make sure that the lessons the SELF-EVALUATION REPORT had drawn about this project were the right ones.

She had been in her position at UNDP for a little over a year. During that time Cynthia had reviewed twelve SELF-EVALUATION REPORTs, with this one being the thirteenth. She was beginning to see a recurring anomaly. More than half of the SELF-EVALUATION REPORTs she had reviewed thus far, had assigned the project a low rating (indicating some shortcomings) in terms of the indicators affecting overall Development Outcome. These composite indicators were: Project Business Success (“PBS”), Economic Sustainability (“ES”), Environment & Social Effects (“E&S”), and Private Sector Development (“PSD”). She also noted that those same projects had all been assigned mostly Satisfactory ratings (and some ratings of Excellent) with respect to UN work-quality indicators. The latter indicators were: Screening, Appraisal & Structuring (“SAS”), Supervision & Administration (“S&A”) and Role & Contribution (“R&C”). The indicators pertaining to UN’s Investment Outcome, being more quantitative with specific rules for assigning ratings, provided somewhat less latitude for applying qualitative “texture” during evaluation.

Cynthia was impressed by the candor with which SELF-EVALUATION REPORT Teams had identified and analyzed problems associated with, as well as the mistakes made by, the client companies, their sponsors and the projects’ management teams being reviewed. She felt that when it came to UN rating its own work quality, however, that there was a tendency to overemphasize the positive aspects and to downplay or even obscure the possible mistakes that had been made. For example, in this case, although the SELF-EVALUATION REPORT recognized deficiencies with respect to PBS (ES, E&S, and PSD were all rated Satisfactory), it rated SAS as Excellent while rating both S&A and R&C as Satisfactory. From this, it seemed that the SELF-EVALUATION REPORT was inferring that there was little if any room for improvement on UN’s part.

Since the evaluation exercise was considered important for UN’s own institutional learning, to help staff avoid mistakes of the past, she was concerned by what she perceived as this evaluation imbalance. Having been an Investment Officer prior to her time at UNDP, she knew the challenges involved in striking an acceptable *ex ante* balance between risk and prospective return in an investment transaction. She did not want to be unfairly critical. Yet she felt strongly that if the evaluation exercise was to add value, the right lessons needed to be learned. And if the UN work components were rated as either Satisfactory or Excellent, then any attempts to record in the Lessons section of the SELF-EVALUATION REPORT or the EvNote the things UN could have done better without reflecting those shortcomings in the associated ratings would unavoidably produce an apparent inconsistency. To the extent that UN self-rating erred on the side of being generous, then avoiding such an inconsistency generally resulted in the loss of a valuable learning opportunity. After reviewing the materials, Cynthia was concluding that a more useful and balanced evaluation of the Fund would require greater focus on UN’s work quality.

***The Fund – Description and Objectives***

The fund’s target was to raise US$75 million in Asiana, an IDA country.

It raised US$64 million in two closings.

UN made a US$7 million investment commitment, disbursing US6.7 million by the date of the evaluation, representing UN’s first PE investment in the country. UN also secured the rights to appoint a representative to the Fund’s Advisory Committee, which it was unable to do (instead, contributing via the supervision function).

With a 7-year life, the Fund departed from the more common 10-year life found among similar funds. Based on UNDP’s methodology for selecting SELF-EVALUATION REPORT candidate projects, evaluation of the Fund commenced in year 6 of its life. The Fund made 14 major investments and 4 minor listed-equity investments in sectors as diverse as media, logistics, tourism, IT, real estate, financial services and manufacturing. The Fund made two complete exits and one partial exit at evaluation with a net loss of US$250,000.

The Fund Manager (“the FM”), although a first-time manager, comprised individuals who were returning and previously-expatriate Asiana nationals with solid finance, entrepreneurial and company-operation backgrounds.

The FM successfully negotiated an annual management fee at a rate of 2.5% of assets under management (“AUM”). This was acknowledged to be above the average rate paid to comparator funds (which was closer to 2% of AUM per annum). But the principals’ strong resumes, despite their lack of prior fund experience, were offered as justification for the higher management fee. No information was provided in the SELF-EVALUATION REPORT regarding the “carry”.

The Fund was focused on supporting mid to late-stage private equity in SMEs and state-owned enterprises slated for privatization by providing, in addition to funding, hands-on value-adding operational assistance.

Despite the strategy presented in the UN Board Report, the SELF-EVALUATION REPORT revealed that, in fact, about 30% of the Fund’s ultimate investment portfolio comprised investments in publicly-traded companies listed on the Asiana Stock Exchange.

The fund’s objectives, as stated in the UN Board Report, were to:

1. Support UN’s overall expansion in IDA countries
2. Cultivate a true private-equity manager in a country with weak NBFIs
3. Indirectly support real-sector growth by investing in underfunded sectors
4. Promote fast-growing SMEs with 30-50% of portfolio to be in private SMEs constrained by financing

Goals or targets for fund returns were set as percentiles with respect to a reference group of somewhat similar funds.

Overall, the Fund’s performance had been mixed with two star performers (a travel agency and a media company) registering significant value appreciation with valuations for the rest of the portfolio underperforming (at least 7 investee companies’ valuations were below cost at the time of UN evaluation). The main cause of underperformance was cited as being mainly the slump in the local equity markets and the local real estate market. The Fund’s return (IRR) at evaluation was 4.5%, compared with an UN Board Report projection of 7.65% (this was the figure for pooled returns for Asia private equity and venture capital funds of vintage 2007). Moreover, the Fund’s 4.5% return was calculated primarily on the basis of unrealized fund investments. Upon digging into the SELF-EVALUATION REPORT and IDOCS, Cynthia found adequate detail on the investee companies’ operational and financial performance but virtually nothing regarding the Fund’s and its investee companies’ contributions to other developmental objectives. After perusing the legal documents, Cynthia concluded there were no legal obligations requiring the FM to provide this information.

Cynthia noted that the SELF-EVALUATION REPORT rated the Development Outcome as Mostly Successful on the grounds that the Fund had achieved two important objectives: (1) it had established successfully a local private equity fund manager; and (2) the FM had succeeded in raising a US$175 million follow-on fund with more commercial investor participation than in the first Fund (including an Asia-based fund-of-funds, several family investment offices, local DFIs, the FM, as well as CDC and DEG). Although the SELF-EVALUATION REPORT conceded that the Project Business Success was Partly Unsatisfactory (mainly due to the disappointing IRR), it rated the Project as Satisfactory on each of Economic Sustainability (“ES”), Environmental & Social Effects (“ESE”), and Private Sector Development (“PSD”). Regarding ES, the SELF-EVALUATION REPORT cited the satisfactory contribution made by the Fund to government tax revenue and employment generation. With respect to PSD, it cited the positive contributions made by the FM to the two-star investee companies about formulating and executing business strategy, knowledge transfer, recruitment, enhanced private sector ownership and support of new technology and innovation. After considerable review and analysis, Cynthia downgraded UNDP’s ratings for ES and PSD to Partly Unsatisfactory, which also resulted in a downgrade of the synthesis indicator Development Outcome to Mostly Unsatisfactory.

***Questions***

1. From the information at hand, what may have been reasons why Cynthia downgraded ES, PSD and thus DO?
2. Do you have any observations on Fund strategy (should it have been more VC-oriented? PE-oriented? Market-oriented?) and implications for FM structure/skill sets as well as the Fund’s geographical and sector scope?
3. What is your opinion of the decision, which departed significantly from the investment thesis presented to UN’s Board, to invest 30% of the Fund’s capital in publicly-listed companies in terms of:
	1. The Fund’s apparent or presumed investment strategy, especially regarding hands-on advice?
	2. The objective of providing scarce capital to SMEs and public-sector companies ready for privatization?
	3. The claims regarding the Fund’s contribution to employment?
4. From a DO perspective, can you identify any key differences between what can be reasonably expected between listed investee companies and privately-held ones?
5. Where a case might be made for some portion of fund investments being channeled to publicly-listed companies, what should UN be looking for as preconditions?
6. From the information provided in this case example, what do you think can be said (or alternatively, how far should claims go) regarding the Fund’s distributional (income and wealth) contributions to UN’s broader developmental objectives? What would be needed to strengthen this aspect while retaining a strong commercial focus for the Fund?
7. Why do you think so few investments had been sold by the 6th year of a 7-year fund?
8. What else would you want to know about the FM?
9. What do you feel might be essential or important design features of a suitable FM remuneration package?
10. How credible was the FM principals’ experience and presumed value addition, given the diversity of the investment portfolio? Do you think UN was naïve (remiss?) in overpaying the FM?
11. How important in your opinion was UN’s inability to place someone on the Fund’s Advisory Committee? Why? How good a substitute (including relative benefits and risks) for this do you think is UN’s portfolio supervision role?
12. From the information provided, how would you rate (1) UN Screening, Appraisal & Structuring? (2) UN Supervision & Administration? And (3) UN Role & Contribution?
13. From an UN supervision perspective what are the pros and cons of tasking CFN and CGF with this responsibility? Which do you think it should have been?