III. CHALLENGES

3.1 The call for IFC to help create opportunity so that people can escape poverty and improve their lives is greater than ever. With its strong financial position, high-quality and motivated staff and record of achievements, it has become clearer that the key constraint for IFC to scale up its development impact is the measured pace of resource expansion which is being outpaced by increases in demand. An increase in budgetary resources would of course have implications on human resource management. Whilst IFC Management is confident about the implementation of its strategy, there are challenges:

- IFC is aiming to have more systemic impact in developing countries, which will require significant resources, as will the push to do more projects in the most challenging environments.
- Fluctuations in emerging market economies, and the resulting need for IFC to resume a counter-cyclical role, could have an impact on IFC's growth plans and financial position.
- IFC is moving to become a more decentralized institution to enhance its development impact and become more responsive to its clients, and human resources management will be critical in ensuring effective decentralization.
- Decentralization will require effective management and dissemination of IFC's global knowledge so that large and small clients in all regions can benefit.
- In terms of risk management and financial capacity, whilst IFC is currently in a strong position, it needs to conserve resources in order to maintain its AAA rating whilst remaining able to (i) accommodate downturns and crises in its member countries through its countercyclical role; and (ii) pursue innovations that may initially entail more risk but have the potential for significant development impact and additionality.
- There are information technology implications of growth and decentralization, particularly in light of the proposed delegation of decision-making to the field.
- In all its activities, IFC needs to balance the imperatives of delivering development impact and providing additionality to its projects, and at the same time growing and remaining profitable.

3.2 IFC's strengths as an institution, its management structure and focus on measuring and learning from results give it the tools to address these challenges and to be a leader in the delivery of development impact where it is most needed.

HUMAN RESOURCES

3.3 As IFC strengthens its client focus, its human resource (HR) strategy has evolved to support a decentralized business model with the objective of enhancing IFC's impact on the ground. Since FY99, IFC's HR strategic direction has been centered on building a high-performance, merit-based organization that can effectively and efficiently help the Corporation achieve its business goals. There are three pillars to the HR strategy: (i) differentiation of staff based on performance; (ii) accountability of managers for people management and results; and (iii) recognition of behaviors that model excellence, teamwork, integrity and commitment to IFC's mandate.

3.4 Whilst the HR strategic direction remains constant, the strategic challenges have evolved and are becoming more pronounced. These challenges, which directly affect IFC's ability to achieve its business goals, define the HR strategic priorities: (i) recruitment to grow the business and enhance impact; (ii) compensation and incentives to attract and retain talent; and (iii) measurement and recognition of teams and individuals who achieve results.

3.5 **Recruitment: Attracting Talent in a Decentralized Business Model.** Recruitment of diverse talent has been a key factor in growing IFC's business. As of January 31, 2007, IFC's workforce totaled 3,031 staff, reflecting a 55% increase since FY01. The most significant increase in staffing numbers is in country offices. The total country-office based staff is 1,507 (50% of all IFC staff) compared to 626 (32%) in FY01. Whilst the majority of the growth in country staff has come in advisory services (which grew from 170 staff in FY01 to 806 staff today), staffing in investment operations has also grown in the field from 462 staff in FY01 to 701 staff today. Since July 2005, IFC has hired 948 new staff, including 643 staff (or 68% of the total) in country offices.

3.6 As IFC operations move closer to clients, it is critical that the right people be located in the right place. Therefore, to achieve greater development impact and improve client responsiveness, recruitment will focus on hiring people with skills that are relatively scarce in today's workforce: (i) experienced staff with client relationship management skills in the regions; (ii) seasoned industry and product specialists, primarily in Washington; and (iii) junior staff globally, rather than centered in Washington, to build the future core of IFC operations.

3.7 Whilst the recruitment strategy is clear, a major challenge facing IFC is the highly competitive employment market worldwide for finance and investment professionals. Based on market data and on rejection of offers from IFC, finance/investment professionals, particularly those with expertise in emerging markets, have never commanded salary packages more competitive than today. For example, Investment Officers (at Grades G and above) are consistently offered total compensation packages outside equivalent to three to four times their IFC salaries. In addition, turnover for Investment Officers has averaged around 8% over the last two years, compared to 3.6% for the period FY01-FY05. Turnover is particularly high for those investment officers who have 5-9 years of experience, with 39% of those staff having left IFC. IFC is losing core staff just as they become more productive as team leaders. IFC is also experiencing a higher rate of offer rejections than in recent years: about 15% of the offers to finance/investment professionals were rejected in FY07 (excluding another 15% based on verbal offers) compared to less than 8% of offers rejected over the previous five years. A concern is the impact of uncompetitive packages to recruit talent that would add greater diversity to the workforce; for example, IFC has experienced a larger number of rejections from countries whose currencies have appreciated over the last few years against the U.S. dollar.

3.8 **Compensation.** The comprehensive review of the World Bank Group's compensation framework provides an opportunity to implement a more performance-based and market-based approach, which could help IFC mitigate its staffing challenges. Within a decentralized business model, IFC has a business imperative to ensure that its core talent pool is deployed effectively across regions, with equal standards for staff quality regardless of location. As a result, IFC endorses the elimination of the current international versus local World Bank Group employment framework for staff, and the implementation of some flexibility to enable the use of "global" salaries in different country offices. As importantly, the implementation of differentiated functional pay among distinct career streams, an approach already used by organizations such as European Bank of Reconstruction and Development (EBRD), is critical to recruit and retain top talent. IFC has already implemented a number of initiatives that differentiate staff based on market and performance (such as the Long Term Performance Awards program, only available for investment staff) and experience shows that such tools can be effective when managed systematically and with discipline. The use of such approaches is driven by business imperatives – for example, the market for investment/finance professionals with African experience/backgrounds is particularly at a premium, and constraints to hire and retain such talent limit IFC's ability to operate and deliver effectively in Africa.

3.9 The global compensation market for investment/finance professionals has changed substantially in the last two years. In the past, peaks in compensation for finance/investment professionals were limited to "bubbles" in the major financial centers (London, New York, Singapore, Hong Kong). Today, a global "pay-line" for experienced finance/investment professionals has emerged, with salaries closely within range in cities such as Moscow, Delhi, Johannesburg and Sao Paolo – all key areas for IFC's business. Given the existing World Bank Group compensation framework, IFC is severely limited in its ability to attract and retain these core professionals. Based on current reality, IFC is therefore giving serious consideration to the implementation of a global pay-line for seasoned finance/investment professionals.

3.10 **Aligning Incentives to Reward Superior Performance.** IFC currently has in place four programs to measure and reward performance, which together, provide incentives to staff: (i) an annual performance, evaluation, and planning process linked to annual salary increases; (ii) a competency-based career framework that provides staff with clear guidelines on what it takes to progress at IFC; (iii) a Performance Awards program to reward and recognize annual results at the corporate, departmental and staff level; and (iv) a Long Term Performance Awards program to reward staff for actual, long-term results. All programs reward both team and individual performance.

3.11 In order to support a client-centered strategy, IFC is considering a number of enhancements to the existing performance award programs. One foreseeable enhancement, rooted in external best practice, would be to link awards more closely to the achievement of collective results. In addition, IFC is considering using the full funding authorized by the Board for the Long Term Performance Awards program, based on the market premium for the investment stream (please refer to Board report IFC/R2004-0007 and PC2007-0004). Such an approach would enable IFC to reward its superior performers and would further accentuate development impact indicators in the award programs.

3.12 **Measuring Results and Developing Staff Globally.** IFC has enhanced its performance management framework to strengthen the alignment of corporate objectives with management and staff goals. This year, IFC adopted a cascading approach to manage organizational and staff performance. The Management Group is responsible for developing strategic corporate goals, reflected in the Corporate Scorecard and then incorporated into objectives for department directors. The Department Scorecards and new director scorecards are a means towards building vertical alignment of strategic priorities within IFC, and the larger World Bank Group, as well as horizontal integration of performance objectives across IFC departments. Completing the performance cascade, directors evaluate managers in alignment with departmental scorecards, and managers, in turn, develop staff objectives to meet unit goals.

3.13 *Global Career Framework*. A final priority is to design a new Global Career Framework, to enable equal professional growth and development opportunities for all staff, whether hired in a country office or in Washington. Staff hired in any location would be able to progress to senior jobs within their own region and/or may relocate to other regions. In addition, to groom high potential staff, existing corporate leadership programs will be enhanced to provide development opportunities. New career and staff development frameworks will also be developed for core staff in advisory services, and for all administrative client support (ACS) staff worldwide. A robust career and development framework, coupled with appropriate tools to attract and retain high performing talent, would substantially help IFC deliver its development mandate more effectively.

RISK MANAGEMENT AND FINANCIAL CAPACITY

3.14 As IFC scales up its activities and decentralizes further, management of risk, including maintenance of a sound financial structure and appropriate risk management practices, will become an even more critical issue.

3.15 **Risk Management**. As part of the decentralization initiative, the Risk Management function will be transformed to facilitate improved client service and efficiency whilst retaining appropriate checks and balances on decentralized decision-making. Steps in this direction include: (i) the ongoing Business Process Review to streamline, and at the same time strengthen, operational procedures; (ii) shifting credit review and, eventually, most aspects of risk management decision-making to the field to parallel the decentralization of business decision-making to the field; (iii) enhanced corporate tools for risk management including economic capital allocation, improved risk rating systems and associated principles that allow for greater decentralization and accountability for pricing, performance measurement and portfolio management; (iv) integration of development impact metrics with financial risk-return metrics; (v) enhanced reporting of all metrics; and (vi) strengthening of information technology (IT) hardware, including bandwidth suited to the various field office needs and IT infrastructure for more efficient and effective document processing and management. The various elements of this new framework are in the process of being developed and will be brought to the Audit Committee and/or the Board in due course.

3.16 IFC is piloting and using the Capital Pricing and Risk (CAPRI) economic capital approach for capital adequacy, capital allocation and internal risk management purposes and potentially for setting loan loss general reserves. This approach brings IFC in line with industry best practice in the measurement of risk and has been discussed previously with the rating agencies and the Audit Committee[16]. The rating agencies have endorsed this approach for capital adequacy. In this regard, a paper proposing changes in capital adequacy and financial polices will be brought to the Audit Committee in the coming months. Information systems needed for this approach are currently being constructed and/or implemented.

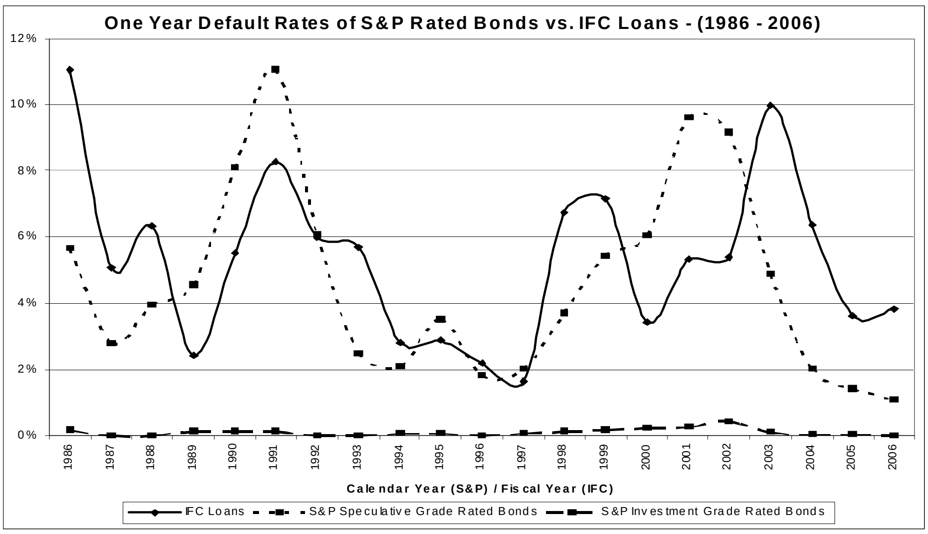
---

[16] AC2005-0029: Review of, and Potential Enhancements to, IFC's Capital Adequacy and Risk Management Framework, April 5, 2005 as well as various prior technical briefings and papers cited in this paper.

3.17 **International Financial Reporting Standards.** As discussed with the Audit Committee on February 14, 2007, IFC has set a revised target date of FY10 to resume presentation of its financial statements using International Financial Reporting Standards (IFRS). In the interim, IFC's FY07-09 financial statements will be prepared using accounting principles generally accepted in the United States. Amongst other changes, this will require the Corporation to make expanded use of fair value accounting, principally in equity investments, and derivatives associated with the loan and equity portfolios. This will imply significantly greater volatility in net income reporting, including the possibility of sizeable net losses due to market downturns. Given the operating and financial results so far, and the revised program commitment target ranges provided in this Strategic Directions Paper, IFC estimates that its current capital position would allow it to accommodate a shock in two of its high exposure countries and continue to meet its countercyclical role, whilst still being able to allocate about $750 - $800 million for special initiatives or for other uses that the Board assesses to be appropriate. However, given the uncertainties in many of its markets, including some high exposure countries, and the future volatility of its net income, IFC is proposing a conservative approach to the designation of retained earnings. These issues will be discussed further in the Annual Report on Financial Risk Management, which will be presented to the Board before the end of the fiscal year.

3.18 **Financial Capacity**. IFC is by its nature and mandate a risk-taking institution. Economic theory postulates that there is a direct link between risk and reward and IFC's experience bears out this relationship: it has traditionally made some of its largest returns in investments considered amongst the most risky at the time. As an indication of the significant risks inherent in its portfolio, an analysis of IFC's one year default rates shows that they are comparable to Standard and Poor's speculative ("junk") grade default rates (Chart III-1). IFC makes this risk transformation of investing in riskier assets whilst maintaining its AAA credit rating by: (i) diversification in its investments, giving it exposure to a range of risk profiles; (ii) maintaining a strong financial structure and capital base; (iii) being a long-term investor particularly for its equity investments; and (iv) rigorous due diligence, accumulated knowledge and experience in developing countries and sophisticated risk management practices.

Chart III-1: IFC and S&P One Year Default Rates (FY86 – FY06)



STRATEGIC COMMUNICATIONS

3.19 **A Broader Approach to Communications.** IFC needs a broader approach to communications for several reasons: (i) the Corporation's growth strategy and plans to become much more decentralized by 2010; (ii) IFC's leadership role in key areas, particularly environmental and social standards, which brings increased attention to IFC's projects, especially in politically contentious environments; (iii) the commitments that the Corporation has made to assess and report on its development impact as well as to improve its public disclosure and handling of community relations; (iv) the need to educate and assimilate large numbers of new staff in a more global and decentralized organization; and (v) the greater market leverage gained by integrating investments and advisory services under a single brand.

3.20 **Enhanced Communications Function**. In light of the above challenges, IFC is putting in place an enhanced communications function in order to support IFC's role and growth strategy more effectively. This will be approached on several fronts: (i) realigning communications strategy and the structure supporting it to promote and support IFC's business plans; (ii) developing and implementing a corporate brand strategy; (iii) developing communications strategies for all major corporate initiatives as well as complex or visible projects; (iv) improving internal communications across the Corporation, helping staff understand corporate strategies, objectives, and priorities and contributing to positive culture change; and (v) developing an external stakeholder outreach program, to increase awareness and value for IFC's brand among relevant groups.

3.21 **"Creating Opportunities"**. The overarching theme of IFC's communications effort during 2007 is "Creating Opportunities." This will be reflected in the communications support for IFC's business plans and major corporate initiatives, the leadership on the brand strategy, and the integration of IFC's external reporting into a single annual product, with emphasis on the development impact of the Corporation's portfolio as well as new business activities during the fiscal year.

INFORMATION TECHNOLOGY

3.22 The alignment of information technology (IT) with IFC's strategic directions is an important part of IFC's strategy implementation, and meeting the IFC's client-centered business goals will certainly require a significant IT component over and above the support of current systems and infrastructure.

3.23 As decentralization results in changes to IFC's organizational structure, physical locations, and business processes, IT must be ready to respond with an infrastructure that provides accessibility and mobility and with application architectures that are flexible and responsive to change. New classes of tools to facilitate collaboration and expertise sharing will also be required. With these elements in place, IT will play a critical role in expanding and streamlining the flow of information and business processes to enhance effectiveness of IFC in delivering results to its clients.

3.24 Integrating the demands, priorities, and challenges of an extensive IT program that addresses IFC's further decentralization, as well as maintenance, support, and enhancement of existing infrastructure and systems, will be carefully considered in close coordination with significant stakeholders, including ISG. This strategy and work program formulation exercise is underway, and the resulting IT budget will be included in the forthcoming Business Plan and Budget Board Paper.