

HOW WE MEASURE IFC'S PERFORMANCE

INTRODUCING DOTS

IFC has a long-term commitment to measuring results. The World Bank Group's Independent Evaluation Group has a well-established role in evaluating IFC's development impact for representative samples of mature projects, and its approach is considered the best among its peers.

To enhance our measurement of the development effectiveness of our investment and advisory work, IFC launched the Development Outcome Tracking System in October 2005. The new system is consistent with the ongoing work of IEG but differs in permitting contemporaneous monitoring of development results throughout a project's life cycle. This earlier feedback gives IFC an ability to make mid-course corrections in investment operations and advisory work. It enables us to capture more systematically the developmental reach of our engagements—for example, how they help create jobs or expand critical services. Information captured in DOTS also informs IFC's incentive system at the corporate, departmental, and individual levels, and it feeds into the formulation of strategy.

Some 2,300 IFC staff have received DOTS training, and the system now covers IFC's entire active investment portfolio and all advisory projects.

APPLYING DOTS TO IFC INVESTMENTS

DOTS enables ongoing tracking of the good practice standards applied by IEG in its evaluations. We distinguish four areas of performance: financial performance, broader economic performance, social and environmental performance, and private sector development impacts.

- ▶ For financial success, which measures return to the financiers, we compare returns to our client companies' cost of capital.
- ▶ For economic returns, which measure returns to society as a whole, we compare benefits against a benchmark of 10 percent annually, plus inflation.
- ▶ To assess social and environmental performance, we look at compliance with IFC's performance standards.
- ▶ To assess private sector development impacts, we look at how investments contribute to private sector development beyond the client company.

We use an aggregate index, based on these four components, to measure overall development success. Results from DOTS are proving consistent, overall, with evaluations by IEG.

The most meaningful measure of financial performance is the market test. To be a commercial success, a company has to outperform the competition and beat market benchmarks to continue to attract private funding. In a market environment, only about half of all projects succeed, and this has also been IFC's experience in terms of financial performance.

Unlike with financial performance, there is no simple number to measure how IFC's investments contribute to private sector development beyond the client company. Sometimes an investment has demonstration effects—when it shows how the private sector can succeed in a difficult country environment; when it improves environmental, social, or corporate governance standards; or when it uses new technologies. Sometimes the added impact comes from links to the local economy: for example, our manufacturing and services clients alone purchased over \$24 billion of goods and services locally in 2006. Sometimes IFC investments help bring changes in the business environment, particularly when we combine them with advisory services: for example, IFC helps governments revise laws and regulations to allow leasing and is also able to help firms enter this new market. Financial performance and development results are closely aligned: IFC's profits are a reliable indicator that we are achieving our mission.

IEG 2007 REPORT: RESULTS, LESSONS, AND IMPLICATIONS FROM 10 YEARS OF PRIVATE SECTOR DEVELOPMENT EVALUATION

This year, a new IEG report looked back on 10 years of evaluating IFC's development results. The review found a good overall result, that 59 percent of investments (65 percent by volume) evaluated between 1996 and 2006 achieved high development ratings—they were, on balance, delivering sustainable results across financial, economic, environmental, and social performance, as well as contributing to private sector development generally. The report underscores that profitability and development impact usually go hand in hand, and that our development impact is further enhanced when we work with repeat clients. It also underlines the critical importance the quality of IFC's own project execution and supervision (particularly of environmental and social effects) for our development results.

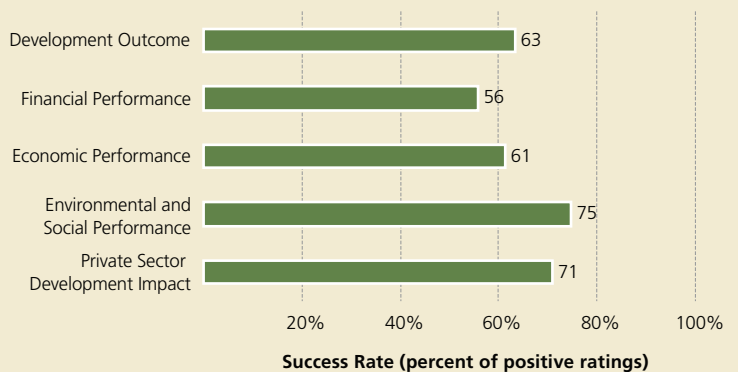
The report generally endorses IFC's strategic directions, but also provides guidance for coming years. It recommends that IFC adopt more tailored, sharply focused country strategies, especially for middle-income countries, as well as strengthen cooperation with the World Bank in key areas such as business environment and financial sector work, infrastructure development, and environmental and social impact.

WHICH INVESTMENTS DOES DOTS COVER?

The DOTS results reported here are for investment projects that IFC started between 1998 and 2003 and that are still active in our portfolio. We do not report on newer investments, since they are too immature for us to be able to judge their success reliably. We also do not report success rates on older investments, since they are less relevant for today's operations, and because many of them are already closed.

Historically, as evaluated by IEG, about 60 percent of IFC's investments have managed to meet the combined conditions of success described above. As of June 30, 2007, DOTS showed that 63 percent of our mature investment portfolio had high development outcome ratings, similar to success rates reported by IEG. Some 75 percent of these investments had successful environmental and social performance, while 71 percent had significant private sector development

IFC'S DEVELOPMENT RESULTS FOR INVESTMENTS



DOTS data as of June 30, 2007, for projects approved in calendar 1998-2003.

impacts, such as positive demonstration effects or an improved business environment. Aid agencies that focus on activities for which clear market benchmarks do not exist can evaluate success only by comparing stated intentions with achievements, not whether the activity did better than competitors. Hence they typically report success rates at or exceeding 80 percent, but these ratings are subjective.

HOW WE MEASURE IFC'S PERFORMANCE

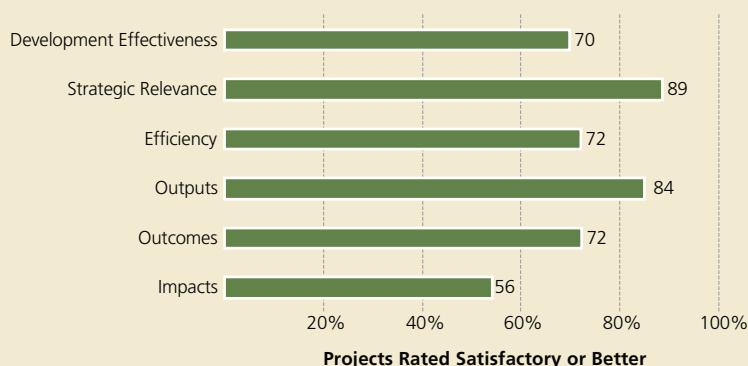
APPLYING DOTS TO IFC ADVISORY PROJECTS

For advisory projects and programs, DOTS enables ongoing monitoring of key measures of performance against objectives. All projects are required to specify objectives with output, outcome, and impact indicators, as well as targets for these indicators. These are monitored during the life of the project, and they are compared at project completion to achieved results. DOTS, like IEG, looks at five dimensions of advisory project performance, which are synthesized into an overall rating of development effectiveness:

- ▶ Immediate deliverables, or *outputs*.
- ▶ Medium-term *outcomes*, measured in terms of changes in knowledge, behavior, or performance.
- ▶ Longer-term *impacts*, such as higher productivity, higher income, and growth.
- ▶ Strategic relevance, and the fit of the advisory service engagement to the issues at hand.
- ▶ The efficiency of the engagement: project costs in relation to potential results.

As evaluated by IEG, where calculable, the overall development effectiveness success rate for advisory projects that were completed between July 2004 and December 2006 is 70 percent. While outputs can be observed during project implementation, outcomes and impacts tend to come only after a project ends and are thus harder to measure. Hence IFC is putting in place a mechanism to track, for selected projects, longer-term impacts.

IFC'S DEVELOPMENT RESULTS FOR ADVISORY SERVICES



Data based on a random sample of 293 projects evaluated by IFC's Independent Evaluation Group.

Understanding how our investments and advisory work contribute to development goals — and learning how to enhance this contribution — depends on a clear and consistent approach to results monitoring. DOTS is an important upgrade to our capacity, enabling us to monitor results as our projects unfold.



Michael Klein VICE PRESIDENT, FINANCIAL AND PRIVATE SECTOR DEVELOPMENT, AND IFC CHIEF ECONOMIST

OUR SYSTEMS IN CONTEXT

Good practice standards for assessing development results of investment projects have been agreed upon by multilateral development banks. In 2005, a consultant study commissioned by the MDBs found that IFC's evaluation system was the most consistent with these standards. Since then, many institutions have strengthened their results measurement. A subsequent 2007 consultant review found that IFC's results measurement and reporting continues to be at the forefront both for investment and for advisory services, for example by publishing development results of its portfolio, by seeking external assurance for this report, and by innovating through control group experiments.

IFC's private sector investments constitute over 30 percent of the volume among all development finance institutions that provide such financing in emerging markets. IFC leads in terms of profitability, with equity returns double the average of such institutions for almost every year in the past decade. Development results are not comparable across peer institutions, largely due to differences in systems, approaches, and implementation.

ENHANCING OUR RESULTS MEASUREMENT OVER TIME

FOR INVESTMENTS

As we continue to improve our measurements, we gain insights into the impacts of our activities. For investments, one first step was to collect a systematic set of indicators of development reach at the company level. In this report, we have aggregated these indicators by sector and region for the first time to show the reach of IFC clients in developing countries.

We have also started to standardize indicators and to set specific benchmarks for the results we expect them to achieve. Standardizing indicators allows us to compare performance across projects and to aggregate results. This includes aggregating across industries to provide a regional view. However, more work remains in this area.

For our investments, this report also shows how much IFC expects client companies to expand their reach, for example by providing jobs to people, improving access to finance or infrastructure for businesses and households, or paying revenues for governments. It will be some years before we will be able to report on the extent to which these expectations have been fulfilled.

IFC is tracking changes in reach over time. Using the previous year as a baseline, we can see how many new businesses were established or new jobs created. For example, the 99 financial market clients for which we had portfolio data for 2005 and 2006 had increased their portfolios of micro, small, and medium enterprises by 23 percent, adding some 650,000 loans. Investment volumes increased by 33 percent, or over \$6.5 billion.

IFC'S REACH

Reach indicators give an indication of the people touched by IFC's activities.

INVESTMENTS, 2006

Hospital patients treated: 4 million
 Students educated: 350,000
 Electricity customers served: 9.5 million
 Water customers served: 15.3 million
 MSME loans: 5 million
 New phone connections: 53 million
 Local purchases by IFC clients: \$31 billion
 Community development spending by clients: \$250 million

ADVISORY SERVICES, 2002-2006

Assisted 1,768 banks
 Assisted 40,000 entrepreneurs

FOR ADVISORY SERVICES

IFC uses a number of evaluation tools to measure the development outcomes and impacts of our advisory work. These range from cost-benefit analyses to inform decision making at the outset, to before-and-after analyses, to randomized experiments with large-scale data collection efforts.

Randomized experiments are the most advanced method for evaluating results, as they allow us to assess whether the recipients of advisory services are better off than a control group. IFC leads in developing the use of such experiments for advisory work in emerging markets. As of the end of FY07, we are implementing 25 such experimental designs to evaluate advisory programs.

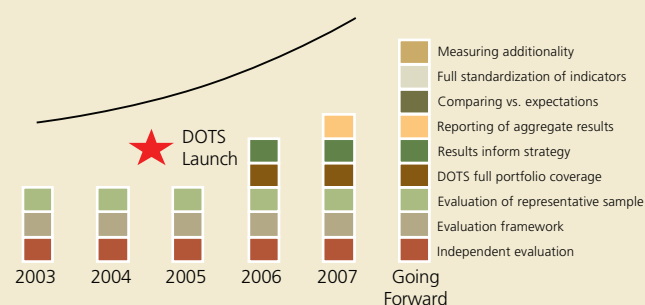
For example, a quasi-experimental evaluation of IFC's alternative dispute resolution program in Serbia showed significant reductions in time and cost as businesses used mediation rather than the court system. By contrast, for a farm forestry program in India and a seaweed farmer cooperative program in Indonesia, randomized trials and quasi-experimental evaluations showed the difficulty of doing better than other market participants, because of the high cost of discovering market information that is relevant to individual farm operations.

The data provided on our advisory services in this year's report reflect our ongoing and evolving work to quantify the outcomes and impacts of these engagements.

BEFORE AND AFTER COMPARISON

New business registrations	Relative to previous three years
El Salvador	Up 100%
FYR Macedonia	Up 78%
Georgia	Up 55%

EVOLUTION OF RESULTS MEASUREMENT



A NEW GLOBAL BENCHMARK

In April 2006, IFC reinforced a long-standing commitment to sustainability by adopting a new policy and performance standards for managing environmental and social risk. We also support the use of our standards by commercial banks, export credit agencies, and other financial institutions. Previous IFC safeguards were adopted as the basis for the Equator Principles in 2003. Today our standards form the basis of a revised set of Equator Principles for financing projects with capital costs above \$10 million. Over 50 leading financial institutions have signed on—including some key players from emerging markets—and the principles are estimated to cover nearly 90 percent of global, cross-border project finance. During FY07, 18 of the Equator institutions provided 46 percent of new loan participations in IFC investments. In June 2007, the Organisation for Economic Co-operation and Development updated the Common Approaches for Export Credit Agencies with references to IFC's performance standards.

IFC INVESTMENT PROJECT CATEGORIES

- A** Expected to have significant adverse social or environmental impacts that are diverse, irreversible, or unprecedented
- B** Expected to have limited adverse social or environmental impacts that can be readily addressed through mitigation measures
- C** Expected to have minimal or no adverse impacts; includes certain financial intermediary projects
- FI** Investments in financial intermediaries that have no adverse social or environmental impacts but that may finance subprojects with potential impacts

STRONGER STANDARDS

IFC's new policy and performance standards for social and environmental sustainability took effect on April 30, 2006. Some 182 new projects have been screened against them as of June 30, 2007, and we have improved procedures and internal monitoring systems to keep pace.

The standards enable our clients to meet environmental and social challenges and IFC to process complex projects more effectively. With the performance standards we are doing more and better deals. Our clients are implementing the standards and meeting IFC's requirements; these include, among other things, comprehensive environmental and social management systems; safe working conditions; avoidance of child labor; free, prior, and informed consultations of affected communities; and mitigation of threats to biodiversity.

The standards apply to all new IFC investments. For a given project or company, certain standards are particularly relevant depending on levels of risk, location, and the nature of the business, and the application of these standards results in specific items that the client is expected to act on.

The new performance standard on Labor and Working Conditions has strengthened IFC's engagement with clients on these issues, including the International Labour Organization's core labor standards. IFC now assesses the client's management systems on labor and working conditions and looks at how these are implemented with the company's employees and contractors, as well as how the company addresses child labor and forced labor among its suppliers. In such industries as agribusiness and global manufacturing and services, we pay particular attention to traceability and monitoring of labor and working conditions across the supply chain.

Our Board expects us to work more quickly, effectively, and without compromising on quality. Initial results indicate that applying the new standards has not significantly increased IFC's cost of doing business or the time we need to process projects. We continue to share our experiences with the rest of the private sector. In May 2007 we convened the first Community of Learning Event for Equator Banks and other bilateral and multilateral financial institutions.

MANAGING ENVIRONMENTAL AND SOCIAL RISK AND PERFORMANCE IN OUR PORTFOLIO

IFC monitors the environmental and social performance of investments and manages associated risks as part of our portfolio management. We have been calculating an environmental and social risk rating (ESRR) for applicable investments since 2000. This rating is given and updated, typically once a year, by our environmental and social specialists and is based on reports provided by clients and on supervision site visits. The frequency of visits depends on an investment's risk rating and how it performs.

With the launch of new performance standards in 2006, IFC introduced an expanded methodology that allows us to disaggregate data on performance and risk components for all projects following the performance standards. We give an ESRR to companies that have some degree of risk in their projects (as reflected by their categorization as A, B, or FI) and that have passed their first reporting period. IFC has environmental and social risk knowledge on 70 percent of the portfolio, including projects with no expected risk (category C) and projects that have not passed their first reporting milestone (normally after 14 months). We do not update ESRRs on projects that have no remaining IFC investment.

IFC's goal is to have an ESRR for all investment projects that have potential adverse environmental and social impacts and have passed their first reporting milestone. Sufficient information for an ESRR is particularly difficult to obtain where companies run into financial or legal difficulties. In these cases, IFC regards these investments as no longer reporting, although from an environmental and social risk management perspective we still seek to assure ourselves that there is not a significant risk to IFC, the environment, or local communities.

The DOTS rating includes IFC's assessment of the extent to which companies in the portfolio are meeting environmental and performance requirements, drawing from the ESRR.

IMPLEMENTATION OF THE STANDARDS

Highlights since April 2006 have included the following:

- ▶ Adopting an environmental and social review procedure that guides staff and formalizes new components in the appraisal and supervision process.
- ▶ Creating a central information management system that consolidates related decision making for all projects.
- ▶ Introducing a new quality assurance system and team to ensure higher standards of supervision and monitoring.
- ▶ Training 1,228 IFC employees, including 532 investment staff, in sessions at headquarters and in the field.
- ▶ Providing additional training on standards related to labor and working conditions and security personnel.
- ▶ Running nine external training sessions for consultants and clients in China, Ghana, India, Indonesia, Kenya, Russia, South Africa, and Turkey.
- ▶ Issuing new versions of the World Bank Group's Environmental, Health and Safety Guidelines on April 30, 2007, which offer technical guidance on pollution prevention and abatement to both public and private sector users.
- ▶ Publishing guidance on lessons of experience from two major oil pipeline projects, BTC and Chad-Cameroon; a handbook on stakeholder engagement; and a guide to applying the International Labour Organization's code regarding indigenous peoples.

ASCERTAINING COMMUNITY SUPPORT FOR COMPLEX PROJECTS

To ensure the support of the local people their projects will affect, IFC's clients are required to undertake free, prior, and informed consultation wherever communities are subject to risks or adverse impacts as the result of a new IFC investment project. In such cases—and before seeking Board approval of the project—IFC verifies that the process has enabled the informed participation of the affected communities and has led to broad community support for the project. Such consultations were required in seven instances during FY07: two category A and five category B projects.