SECTION II: PROGRESS REPORT ON FY08 BUSINESS PLAN AND BUDGET

2.1 In 2005, the Board endorsed IFC's FY05-08 growth plan, which was reaffirmed and extended by the Board in subsequent years, most recently in March, 2008. The scaling-up was guided by IFC's five priorities, which have been in place since 2004 and consistently endorsed by the Board, with some evolution. This year, IFC has included climate change in its third pillar and defined frontier markets more specifically as IDA countries to align better with the World Bank Group priorities. These five priorities are:

i) Strengthening the focus on frontier markets, including small and medium enterprises and agribusiness;
ii) Building long-term partnerships with emerging players in developing countries;
iii) Addressing climate change, and environment and social sustainability activities;
iv) Addressing constraints to private sector growth in infrastructure, health and education; and
v) Developing local financial markets through institution building, the use of innovative financial products and mobilization.

2.2 Together with the six corporate Goals[1] introduced in 2006 to sharpen IFC's focus on the priorities, these provide the necessary framework for IFC to continue its growth and do its part, together with the other members of the World Bank Group, for an inclusive and sustainable world, by creating opportunities for people to continue to escape poverty and improve their lives.

2.3 The following paragraphs provide highlights of IFC's achievements in FY08, which were discussed in depth in *IFC's Road Map FY09-11* and its accompanying *Background Paper.*

PROGRESS REPORT

2.4 **Development Impact.** Achieving strong development impact is at the core of IFC's business. In order to emphasize its importance further, in 2006 IFC made greater development impact its principal corporate Goal (see para 2.1 above). Achievement in this regard is supported by the Development Outcome Tracking System (DOTS), launched in 2005, as well as by the results of the Independent Evaluation Group's (IEG) studies.

2.5 **Corporate Scorecard.** The Corporate Scorecard (introduced in 2004) and the Board-endorsed development impact targets set for achievement by FY08 have enabled Management and the Board to track progress under the five priorities. As shown in Table 2.1 below, IFC will meet or exceed the targets set for FY08. IFC's success in meeting its targets places the Corporation in a strong position to build on the momentum of its

[1] i) Greater development impact; (ii) greater client satisfaction; (iii) disciplined growth, both for IFC's account and mobilization; (iv) greater World Bank Group cooperation; (v) maintenance of sound finances; and (vi) high quality, diverse employees who are motivated and engaged.

achievements, and IFC is proposing new and ambitious targets to be achieved over the next three-year period. These are shown in the Corporate Scorecard in Annex 3.

Table 2.1: Summary of Progress on Key Development Impact Indicators Compared to Targets

Scorecard Item	FY07 Achievements (Actual)	FY08 Achievements (Estimate)	FY08 Board- Endorsed Target/Benchmark (set in 2005)
Ex Post Development Impact Measures			
% satisfactory or better *ex-post* development outcomes (XPSRs) - IEG ratings	56%[1]	63%[2] on projects approved CY00-02	65% on projects committed FY06-08
Development Outcome Tracking System (DOTS) Success Rate	63%[3]	65-72%[4]	-
Ex Ante Development Impact Measures			
Commitments in Sub-Saharan Africa	$1,379m	$1,380-1,590m	$735-857m
Commitments in MSME[5]	$2,501m	$2,700-2,900m	$1,100-1,300m
% of IFC total commitments in frontier countries, compared with the frontier share of developing member country GDP[6]	38%:14%	36%-39%:14%	Overweight in Frontier
Commitments in IDA Countries as % of Total Project Count	44%	42% - 47%	-
Commitments in Middle East and North Africa	$1,217m	$1,250–1,600m	-
% New Clients	48%	45-50%	Larger than 50%
Renewable Energy / Energy Efficiency[8] - IFC Commitments in RE/EE Component - Total Cost of RE/EE Component	 $477m $2.0 bn	$600-900m	EIR target for the World Bank Group
Infrastructure; Information and Communications Technologies (ICT), Health & Education Commitments	$1,533m	$2,900-3,800m	$1,500-1,800m
Financial Sector Commitments[9]	$3,374m	$4,500-4,900m	$2,100-2,500m

[1] *FY07 IEG result is based on a three-year rolling average for projects approved during calendar year (CY) 99 to CY01 (projects are typically evaluated 5-6 years after approval)*
[2] *FY08 estimates for IEG results are based on three-year rolling averages for projects approved in CY00-02*
[3] *FY07 DOTS result is based on a rolling average for projects approved in CY98-03.*
[4] *FY08 DOTS estimates are based on rolling averages for projects approved in CY99-04*
[5] *FY07 results include trade finance.*
[6] *Starting FY08, the definition of IFC's Frontier Markets has changed to IDA countries and frontier regions in non-IDA countries in order to align with the World Bank Group strategic priorities.*
[7] *Based on new projects, excluding rights issues, A/B loan increases and secondary commitments*
[8] *In FY07, the total project cost of projects with RE/EE components was $6.2 billion, of which $2.0 billion was invested in RE/EE components. IFC invested $1.1 billion in these projects, of which $477 million was targeted to RE/EE components*
[9] *Not including investments in private equity funds*

2.6 **Development Outcome Tracking System.** DOTS has allowed continuous and contemporaneous tracking of development results for IFC's entire portfolio. It allows more timely feedback into strategy and new operations and also allows IFC to better articulate both results already achieved and the expected development results of new operations, for example in terms of how many people IFC is reaching through its clients. These results, together with IEG's studies feed into strategy formulation and also inform IFC's incentive system at the corporate, department and individual levels. This "cascade effect" helps to ensure that the whole Corporation is focused on development impact.

2.7 DOTS results show that in FY07, 63% of IFC's investment operations (based on rolling average for projects approved in FY98-03) had high development outcomes, meeting or exceeding market, financial, economic, environmental and social, and private sector development performance benchmarks and standards. Results from DOTS as well as independent studies done by IEG also show that in IFC's projects, development impact and financial success are closely interrelated and that there is no trade-off between financial and development results in IFC projects. They also indicate that repeat investments with the same client tend to have better development results.

2.8 Looking to the future, IFC will continue to build on its success in meeting the *ex ante* development targets set out in the Corporate Scorecard as it embarks on its next phase of growth and concentrates on areas where its impact can be greatest, such as frontier markets. IFC's continued decentralization will support the increased emphasis on clients in more difficult markets to maximize IFC's additionality and assessment of development impact. It will better enable a critical mass of staff to focus on the development results of projects through greater understanding of their needs and markets.

2.9 **Additionality**. Starting with the formulation of its Articles, additionality has been fundamental to IFC's role. Over time, IFC's additionality has evolved as IFC has developed new ways to add value in response to changing client needs and market environments, and the Additionality Technical Briefing held in November, 2007 laid out IFC's current thinking.

2.10 As an indication of its additionality, in FY07, 69% of IFC's projects, representing 65% of its volume, were in IDA countries or frontier regions, or targeted MSMEs in non-IDA countries—all areas where IFC's additionality tends to be strongest. IFC is also working increasingly with second-tier clients; for example, they are an important strategic focus of IFC's activities in Latin America and in FY07, 66% of IFC's projects in the region were with these clients, compared to 31% in FY05. When IFC plays its counter-cyclical role, its additionality is particularly strong as it can swiftly provide liquidity and subsequently longer-term financing in situations where no viable financing alternatives exist.

2.11 **Additionality with Advisory Services.** Advisory services are a key component of IFC's value-added in investment activities and are critical to increasing IFC additionality, providing greater reach and impact for the Corporation. The rapid growth of IFC's advisory services business is targeted at areas that increase the Corporation's overall additionality, including programs that leverage key IFC and World Bank expertise, such as in business environment, privatization and public-private partnerships (PPPs), access to finance, and environment, social and corporate governance. Advisory services enable the Corporation to reach locations and sectors where it would be difficult to provide investment services alone. In FY07, advisory services expenditure increased 28% over FY06 and of this 44% was spent in IDA countries.

2.12 **World Bank Group Cooperation.** Enhanced cooperation among World Bank Group members continues to be an important corporate Goal for IFC. Such cooperation is critical to improving development effectiveness, especially where policy and transactions intersect, and plans are underway to further extend the range of collaboration. IFC was closely involved with the Six Themes[2] working groups and its inputs were reflected in the presentations made to the Board. IFC's priorities and activities directly support these World Bank Group Strategic Directions, as was outlined in the IFC Road Map paper. For example, IFC's focus on IDA countries, and new initiatives such as the Africa Health Initiative and InfraVentures, target the Poorest Countries; and IFC's expansion of activities in conflict-affected countries and increased presence in countries such as Democratic Republic of Congo, Lebanon and Liberia reflect the World Bank Group's focus on Fragile and Conflict-Affected Countries.

2.13 Over recent years, steps have been taken to maximize the organizational synergies and effectiveness. These include joint departments working in a number of core sectors (e.g. oil, gas, mining, information and communication technology, subnationals, and finance and private sector development) as well as the recently established IDA/IFC Secretariat, and these joint departments are working well. There is also corporate-level cooperation in a number of important areas such as the World Bank Group-wide implementation of the Governance and Anti-Corruption strategy and regional-level cooperation.

2.14 **Transfer to IDA**. Building on IFC's transfer to the International Development Association (IDA) of $150 million approved by the Board in August 2006, in September 2007 the Board approved the designation of $500 million from IFC's retained earnings for IDA15 to promote private sector development in IDA countries. It also approved an indicative program of up to a further $1.25 billion for IDA15 to be designated as follows: $450 million of retained earnings from the Corporation's fiscal year 2008; $400 million of retained earnings from the Corporation's fiscal year 2009; $400 million of retained earnings from the Corporation's fiscal year 2010, subject to the actual availability of IFC funds. Together with IFC's enhanced focus on investment and advisory activities in IDA countries, and the establishment of the joint IDA-IFC Secretariat, this supports IFC's objective to increase its impact where the needs are greatest and contribute substantively to overall World Bank Group activity in these markets.

HIGHLIGHTS OF PROGRESS ON THE FIVE PRIORITIES.

2.15 **Frontier Markets.** In response to guidance from the Board, IFC has placed increasing emphasis on frontier markets. IFC's alignment of its frontier country definition with IDA countries should further enhance its focus on the areas of greatest need.

- *IDA Countries*. As a result of both favorable market conditions and a shift in focus, between FY05-07, the percentages of IFC investment commitments in IDA countries grew from 21% to 37% ($ commitments) and 32% to 44% (number of projects). In terms of countries served, in FY07, 37 of the 69 countries (54%) in which IFC made investments were IDA countries, compared to 29 of 68 (43%) in FY05.

[2] Poorest Countries; Fragile/Conflict Affected Countries; Middle Income Countries; Global Public Goods; Arab World; and Knowledge and Learning.

- *Frontier Regions.* In addition to IDA countries, IFC is also focusing on frontier regions of non-IDA countries, and if these are included, frontier commitments in FY07 represented 47% of volume and 54% of projects.
- *Agribusiness.* Recognizing its critical role in poverty reduction and environmental and social sustainability, IFC last year made Agribusiness an explicit part of its frontier focus. IFC is aiming to extend its impact beyond individual direct investments (which increased to $628 million in FY07 from $456 million in FY06) both by developing programmatic approaches to investments as well as by using its convening power more broadly. In 2006, IFC's agribusiness portfolio companies reached 538,295 farmers and employed 138,893 workers.

2.16 **Building Long-term Partnerships.** IFC's clients particularly value IFC's ability to accompany them through their business cycles and changing market environments, and to offer them an evolving menu of investment and advisory services to meet their changing needs, as evidenced by IFC's continued growth in South-South business: $1.3 billion committed in South-South projects in FY07 ($673 million in FY06 and $484 million in FY05). Further decentralization is especially important as IFC's clients are increasingly local – 64% in FY07 compared to 51% in FY04 – who look for IFC to deliver its additionality over the course of a long-term relationship, rather than in the context of a one-off project. While development results from both DOTS and IEG indicate that repeat investments with the same client tend to have better development results, IFC aims to achieve a balance between nurturing existing clients and working with new clients, as both offer the potential for significant development impact.

2.17 **Addressing Climate Change, and Environment and Social Sustainability.** IFC continues to have a strong focus on promoting its sustainability agenda and maintaining its sustainability leadership. Sixty banks and financial institutions have now adopted the Equator Principles (51 a year ago), 32 export credit agencies of the OECD countries benchmark private sector projects against the Performance Standards, and MIGA has recently adopted the Performance Standards for its operations. Recognizing the importance of climate change in today's world and the potential impact on its clients, IFC has made climate change one of its areas of strategic focus, and, in collaboration with the World Bank, is formulating a climate change strategy, as outlined in further detail in the Background Paper to the IFC Road Map.

2.18 **Infrastructure, Health and Education.** Over the past three years, IFC's commitments in these sectors have increased steadily, from $880 million in FY05 to more than $1.5 billion in FY07. IFC has recently concluded a number of landmark transactions, and is developing innovative ways to address the significant needs in these sectors. These include the new InfraVentures fund, a $100 million early stage equity fund in IDA countries targeted to projects improving the infrastructure in the poorest communities and the New Africa Healthcare Initiative, for which IFC developed a plan during FY07 and which is further discussed in Section IV. In 2006, IFC's clients delivered power directly to 9.5 million customers, supplied water to 15.3 million customers, and reached almost 4 million patients and 353,000 students.

2.19 **Local Financial Markets Development**. In FY07, financial markets commitments accounted for 37% of IFC's committed portfolio (35% in FY06) and 41% of IFC's new investments (37% in FY06). IFC's investments in MSMEs have also grown: in FY07, total IFC MSME commitments were $2.5 billion ($1.5 billion in FY06 and $1 billion in FY05). In 2006, IFC's clients disbursed an estimated 8.9 million sub-loans totaling $96.5 billion.

STRATEGY DEVELOPMENTS

2.20 IFC's track record and growth in capacity have allowed it to adopt new approaches to help build on its achievements, and thereby scale up its development impact across its five priorities. These approaches were highlighted last year and IFC has continued to build on them: reaching the underserved, programmatic approaches, and becoming more client-centered, in particular through greater decentralization.

2.21 **Reaching the Underserved**. Many people in developing countries have not yet benefited from the overall growth of the private sector in these countries. The needs in the poorest markets are driving IFC's strategy, and in particular the further shift of its business to frontier markets, and IDA countries in particular. Going forward, IFC will seek ways to go beyond commitment volume to emphasize its strategic priorities.

2.22 IDA Countries. IFC has increased its focus on IDA countries by aligning its frontier definition with IDA countries and setting the number of IDA country investments as a key performance indicator in investment department scorecards. IFC is aiming to increase further its investments in IDA countries and is also developing new approaches for private sector development in these countries, such as the proposed SME equity funds for risk capital in IDA countries.

2.23 Frontier Regions. A significant proportion of the world's poor live in the frontier regions of non-IDA countries, and reaching these underserved segments remains an important priority for IFC. As an example, in FY07, 44% of IFC's investments (by number) in China and Russia were targeted at these frontier regions, compared to 28% in FY05. By volume, the figures are 32% and 28% respectively.

2.24 Base of the Pyramid Initiatives. IFC has given considerable thought as to how best to address the needs of the poorest in its markets, and continues to work on developing approaches in this area. Support for microfinance institutions is one element of IFC's strategy, as well as several innovative advisory services projects such as the "Lighting Africa" initiative.

2.25 **Programmatic Approaches**. Programmatic approaches can be implemented in different ways, but all have in common the goal of extending IFC's activities beyond the individual project into a program of projects and advice, often with pre-identified or existing partners. The principal types of programmatic approaches being implemented and under development are: wholesaling and cross-sector approaches, which combine financial sector and industry expertise; country/sector strategies with advisory services, often combining work with the World Bank – strategies for infrastructure, PPPs and the financial sector are the most common sectors to date for these approaches; multiple-project client strategies, including development of South-South programs; and combined advisory/investment programs to bring enhanced value-added to projects, for example investment programs with linkage components.

2.26 **Becoming More Client Centered**. As IFC has targeted more frontier markets and second tier clients, and as a greater proportion of its clients have become local rather than international, the need for increased field presence and a different and more efficient operating model has become clear. As discussed with the Board at the Technical Briefing on decentralization in December 2007, this move to a decentralized model has been an evolving process, intensifying from 2002. IFC has found that being close to clients and better understanding their needs and markets yields not only increased levels of business, but brings other important benefits, such as the ability to engage more effectively with governments and the World Bank, improve monitoring of projects, and offer proactive support to clients.

2.27 IFC has also taken steps to enhance its responsiveness through improvement of its internal business processes. IFC is now looking at the next phase of business process improvements, specifically targeting portfolio supervision processes in FY09.

GROWTH AND PROFITABILITY

2.28 In FY07, IFC's commitment program reached $8.2 billion, and similarly strong performance is expected in FY08. These direct investments raised $1.8 billion through the B Loan program and mobilized another $2.1 billion through structured finance transactions, bringing to a total of $12.1 billion IFC's own account funding and mobilization. The rate of increase in the disbursed portfolio continued to improve: 21% between FY06 and FY07, compared to 9% between FY05 and FY06.

Table 2.2: FY05-08 Commitments by Region

US$ millions

	FY05 Actual*			FY06 Actual*			FY07 Actual*			FY08 Estimate		
	Amount	%	YoY%	Amount	%	YoY%	Amount	%	YoY%	Amount	%	YoY%
Central & Eastern Europe	1,128	21	37	1,092	16	-3	668	8	-39	1,200 - 1,420	12 - 12	80 – 113
East Asia & Pacific	740	14	1	982	15	33	944	11	-4	1,365 - 1,700	14 - 14	45 – 80
Latin America & Caribbean	1,398	26	15	1,747	26	25	1,781	22	2	2,405 - 2,840	24 - 24	35 – 59
Middle East & North Africa	315	6	33	668	10	112	1,217	15	82	1,250 - 1,600	13 - 13	3 – 31
South Asia	443	8	9	507	8	14	1,073	13	112	1,155 - 1,365	12 - 11	8 – 27
Southern Europe & Central Asia	809	15	-4	991	15	22	1,118	14	13	1,175 - 1,420	12 - 12	5 – 27
Sub-Saharan Africa	445	8	10	700	10	57	1,379	17	97	1,380 - 1,590	14 - 13	0 – 15
Total	**5,373**	**100**	**13**	**6,703**	**100**	**25**	**8,220**	**100**	**23**	**10,500 - 12,500**	**100****	**28 – 52**

*Includes commitments for projects officially classified as World projects.
**FY08 percentages are of mathematical totals of low- and high-ends of the ranges for all regions, but do not include world projects.

2.29 While IFC is anticipating another year of strong performance, and has already realized substantial capital gains, the current uncertainties in many of its markets could well have a significant negative impact on its final financial results. IFC's financial position continued to strengthen in FY07, with operating income reaching $2.6 billion

($1.4 billion in FY06 and $2.0 billion in FY05) and IFC's Return on Net Worth up to 21% from 14 % in FY06.

2.30 The quality of the portfolio also continued to improve, as measured by a decrease of the impaired loan portfolio from 3.4% at the end of FY07 to 2.4% at the end of the third quarter FY08. There was also an improvement in the average loan credit risk rating (CRR) from 3.00 to 2.93 (on a 1-best to 7-worst scale).

ANTICIPATED SPENDING IN FY08

2.31 Prudent financial management requires the Corporation to maintain a margin of safety between the authorized budget and the actual level of spending. Unexpected swings in cost items (especially those that are not directly controlled by IFC) could otherwise create the risk of IFC inadvertently overspending the annual budget. For this reason, Management generally aims to keep spending to roughly 3% below total spending authority.

2.32 In order to foster prudent management of resources, the Board has authorized IFC to carryforward any underrun against its annual spending authority up to a maximum of 5% of total budget from one fiscal year to the next.

2.33 In last year's Business Plan and Budget, FY07 administrative expenses were projected to be within a range of 97% to 99% of the total budget, or 94% to 96% of the total budget plus the carry-forward. Actual FY07 total expenses were 95.1% of the total budget plus the carry-forward. This year, FY08, total expenses are projected to be within the same range of 97% to 99% of the total budget, or 94% to 96% of the total budget plus the carry-forward.

SECTION III: FY09-11 BUSINESS PLAN

EXTERNAL ENVIRONMENT

3.1 In the last five years, the global position of many developing countries has changed. Consistent growth, lower poverty levels, and increased trade and investment have been common to a number of countries throughout the developing world in recent years. Yet people in poverty in these and other countries still have very great needs—jobs, access to basic services, sustainable development—and there is much to be done to bring the benefits of growth to all.

3.2 While a strong private sector is now widely recognized as an essential part of the development agenda, it remains weak in many of the neediest countries and its benefits are not reaching large sections of the population, even in the more advanced developing nations. The way international institutions engage with the private sector has also changed—no longer primarily by providing better finance, but rather by providing a mix of finance, knowledge and innovation, standard setting, and policy improvement. In this respect, IFC is committed to provide continued leadership, in close cooperation with all the members of the World Bank Group, to address today's private sector development needs and support the World Bank Group's objectives.

3.3 The Corporation is also being asked to place an increasing effort on addressing global public goods, such as climate change. The extent of IFC's response, however, must be flexible due to current increased market risks, and IFC is already seeing signs in several markets that clients' financing opportunities are being adversely affected. A downturn or adverse event would lead to further demand for IFC to play its counter-cyclical role and to consider adjusting the mix of its business, both in terms of products and clients, in order to be able to do so. IFC is ready to play this role and, learning from past experience, is developing tools to help it do so effectively while also managing its portfolio in affected countries.

PRIORITY AREAS

3.4 IFC will build on its achievements and the comparative advantage of both the Corporation and the whole World Bank Group as it plans for the next three years. It will continue to adjust its business mix towards the focus areas of frontier markets, and IDA countries in particular, and climate change, while standing ready to play its countercyclical role. In order to support IFC's efforts in these important areas, IFC intends to devote resources to strengthening its internal support infrastructure, such as risk and portfolio management. The Corporation will therefore face special challenges in striking the right dynamic balance between competing imperatives and must focus on those key priorities where it provides the greatest impact, while soundly managing the risks it faces. IFC must also become more efficient in order to work effectively in the more resource-intensive frontier markets.

3.5 **IDA countries and Frontier**. IFC is planning to increase further the focus on smaller and more challenging markets, in particular IDA countries, and on reaching the underserved wherever they live. IFC has set itself a stretch target to have 50% of projects in IDA countries by FY11, although this is subject to two caveats: first, that sufficient resources continue to be made available, and second, subject to the implications of IFC's being called upon to play a major countercyclical role, and the countercyclical impact on IFC's own portfolio, which remains unclear at this juncture.

3.6 As IFC reaches further into the frontier, the costs of projects are only likely to increase and the average size of projects, and therefore aspects of IFC's productivity, decrease. IFC must therefore balance the increased costs and risks of these investments with the need to remain financially strong and maintain capacity to respond in an effective countercyclical fashion in other countries.

3.7 By way of illustration of the likely cost implications of IFC's focus on IDA, the average cost of infrastructure projects in IDA countries was almost twice that of projects in non-IDA countries over the FY06-08 period, as illustrated in the table below.

Table 3.1: Average Costs for Infrastructure Projects, FY06-08

US$ '000s

	FY06	**FY07**	**FY08**	**Avg. FY06-08**
IDA Only	510	313	323	382
Non-IDA	319	189	184	231

3.8 In terms of information technology, the typical IDA office support cost can be up to two to three times that for non-IDA office support, on a per capita basis, and more than 20% higher on a per office basis. It should also be noted that the higher cost of doing IDA projects means that additional staff must be hired to do this work.

3.9 **Climate Change**. Recognizing the depth and breadth of the challenges and opportunities climate change poses, and the growing demand from clients and countries, IFC is adding climate change to its priorities, and an increasingly significant amount of business, particularly in middle income countries, may be focusing on this area. This will accelerate a process that was started within the World Bank Group in 2005 in response to the G8 Gleneagles Climate Communiqué. IFC is aiming to double or triple its renewable energy/energy efficiency (RE/EE) investments over the period FY09-11 from $1.1 billion invested over FY05-07. The extent to which IFC can achieve this and mainstream carbon finance support will depend on the availability of sufficient funding resources and strong advisory support.

3.10 **Preparing for Counter-Cyclical Demand.** The current uncertain global economic situation poses challenges and opportunities for IFC. IFC must be ready to play its counter-cyclical role as well as ensure that its portfolio management and internal controls are sufficiently robust to be able to deal with adverse impacts. IFC has been preparing more concerted interventions than in the past and is potentially positioned to play a larger role as a result of the growth strategy of recent years. Should such a counter-cyclical role emerge for IFC, this would probably imply increased demand from non-IDA countries while adverse conditions continued to prevail. IFC would therefore have to balance competing demands in assuming its counter-cyclical role, depending on the timing and magnitude of the downturn, against effects of the downturn on IFC's portfolio and balance sheet.

3.11 **Decentralization**. In order to support its strategy, and in particular reach more markets and strengthen its client relationships, IFC will build on its Asia decentralization pilot by decentralizing further in other regions. While IFC thinks that the benefits of decentralization are significant, there are costs, including, in the current economic environment, the impact of the weak dollar. Decentralization is further discussed in Sections V.

3.12 **Strengthening Internal Infrastructure**. IFC has seen significant growth at a time when markets were particularly favorable. While IFC's portfolio remains strong, the growth has highlighted several areas which need strengthening, particularly in the context of the continuing shifts in business mix, the likelihood of a counter-cyclical situation and IFC's decentralized operations. The areas on which IFC plans to focus more resources over the three-year planning period include: (i) risk management and supporting systems; (ii) portfolio management and systems; (iii) support functions such as legal and environment; (iv) HR systems and tools to ensure that IFC has the desired number and quality of staff in the right places and the incentive and career frameworks to support them; (v) movement of expatriate staff to the field; (vi) security for staff in the field; and (vii) adopting processes to support future growth of, and new types of, business, such as appropriate delegation of authority. Portfolio management is further discussed in Section IV.

3.13 **Commitments**. For FY08, commitments will be in the range of $10.5 to $12.5 billion. This projection is higher than the $10 to $10.5 billion estimated at the time of the *IFC Road Map* largely as a result of several important and large infrastructure projects, as well as increased demand from clients arising from difficulties in their markets. IFC will build on this strong base, and is for now proposing to continue its growth at a more modest rate in terms of commitment volume, as endorsed by the Board during discussion of the *IFC Road Map*, as it focuses on IDA countries and frontier regions where projects tend to be more complex, resource-intensive and smaller. This steady rate of growth will allow IFC to maintain its momentum and deliver significant development impact, while continuing the shift to more frontier markets, although this may impact certain aspects of IFC's productivity, as further discussed in Section VI. However, IFC is now seeing significant increased demand in many countries as a result of market difficulties and the projections for FY09-11 are therefore conservative and actual commitments could be considerably higher. In addressing this increased demand IFC will continue to prioritize in order to maintain its focus on the areas of strategic importance.

Table 3.2: Projected Commitment Volume FY08-FY11

US$ millions

Region	FY08 Cmt Estimates	FY09 Cmt Projections	FY10 Cmt Projections	FY11 Cmt Projections
Central & Eastern Europe	1,200-1,420	950-1,150	950-1,150	950-1,150
East Asia & Pacific	1,365-1,700	1,500-1,700	1,700-1,900	1,800-2,000
Latin America & Caribbean	2,405-2,840	2,200-2,600	2,300-2,700	2,400-2,800
Middle East & North Africa	1,250–1,600	1,600-1,800	1,800-2,000	2,000-2,200
South Asia	1,155-1,365	1,200-1,300	1,300-1,500	1,500-1,700
Southern Europe & Central Asia	1,175-1,420	1,200-1,300	1,250-1,450	1,300-1,500
Sub-Saharan Africa	1,380-1,590	1,600-1,900	1,800-2,200	2,200-2,600
Overall Range*	**10,500-12,500**	**11,000-12,000**	**12,000-13,000**	**13,000-14,000**

* This range represents Management's projection for the Corporation, which may not necessarily be the mathematical totals of the low- and high-ends of the individual regions.

<u>SECTION IV: FY09-11 ADMINISTRATIVE BUDGET</u>

BUDGET FOR FY09

4.1 The Regular Budget is the benchmark used to determine discretionary budget growth, since it excludes items that fluctuate independently of budget allocations (such as contributions to retirement accounts), or items which are the product of previous budget allocations (such as depreciation). In discussion on IFC's Road Map, many Board members signaled that IFC should pursue the 'preferred case' business scenario which called for an increase to the regular budget of 11.5% in real terms. This is what Management now proposes as shown in Table 4.1. The figure of 11.5% represents a balance between the high demand for IFC's services in all regions combined with the more resource-intensive nature of projects in IDA and frontier markets, and slower growth dictated by risk management concerns, in particular the need to strengthen internal support infrastructure, as well as market uncertainties.

Table 4.1: FY09 Budget
US$ millions, in constant FY08 dollars[3]

	FY08 Budget†	**FY09 Proposed Budget**	**FY09 % Increase**
Regional Departments	99.5	110.2	10.8%
Industry Departments & Advisory Services	175.0	183.6	4.9%
Subtotal Operations	**274.4**	**293.8**	**7.1%**
Environment & Social Development	18.3	20.8	13.8%
PSD & IFC Chief Economist	9.4	9.9	5.6%
Risk Management	50.1	55.2	10.2%
Information Technology	11.3	16.8	48.7%
Finance & Treasury	14.9	16.0	7.5%
Human Resources & Communications	12.5	13.8	9.9%
Legal Department	23.3	23.0	-1.3%
Executive Vice President	4.1	2.6	-35.3%
Total Departments	**418.4**	**452.0**	**8.0%**
Corporate Overheads	30.6	48.1	56.9%
Operating Budget	**449.0**	**500.2**	**11.4%**
Corporate Governance	6.0	7.2	21.0%
REGULAR BUDGET	**455.0**	**507.3**	**11.5%**
Other Budget Items	142.9	149.0	4.3%
Total Budget	**597.9**	**656.4**	**9.8%**

† FY08 budget presentation has been adapted to the new organizational set-up. Totals may not add exactly due to rounding.

4.2 While the regular budget will increase by 11.5% overall, the budgets for Information Technology, Corporate Overheads, and Corporate Governance deviate

[3] The price adjustment for FY09 is 2.87% (see Annex 2 for details). It is excluded from the figures in the table. If this inflation adjustment is included, the total budget is $671.9 million.

significantly from this average as shown in Table 4.1. The budget for Information Technology will increase by 48.7% in FY09 to resolve contractor conflict of interest, improve capital budget oversight, increased travel to support decentralization, and the costs to assess new capital projects. The budget increase of 56.9% for Corporate Overheads is discussed in paragraphs 4.51 to 4.56. The budget increase of 21.0% for Corporate Governance is primarily for IFC's growing share of Anticorruption & Fraud and the Conflicts & Evaluations Office.

4.3 As described in IFC's Road Map, the indicative budget increase in real terms is estimated to be 10% in FY10 and 9% in FY11. These indications reflect current medium-term plans, but will be reassessed during FY09 when business and budget planning for FY10 begins. The FY10-11 budgets are provided for the Board's endorsement on an indicative basis, assuming that there are no significant changes to IFC's strategy or external conditions such as a major downturn in market conditions.

NEW STRATEGY AND BUDGET PROCESS

4.4 This year IFC introduced a new more structured process for internal strategy and business planning in order to improve the quality of strategic discussions from the Corporate through to the Department and Unit level for both of IFC's core lines of business – Investment Operations and Advisory Services. The process also resulted in better alignment of the strategy formulation and corresponding budget process, achieved through two main phases: Phase 1 entailed the determination of strategic plans for FY09-11 linked to IFC's Strategic Priorities and the six themes of the World Bank Group and resulted in the 'preferred case' (one of three scenarios) as detailed in IFC's Road Map. Phase 2 entailed the detailed formulation of the associated budget for the 'preferred case.'

4.5 **The Process.** All discussions relate back to IFC's Vision that 'People should have the opportunity to escape poverty and to improve their lives'. The process starts with the Outside-In perspective, looking at the external environment in the markets in which IFC operates, the clients' needs, IFC's role within the World Bank Group, as well as stakeholder and other relevant aspects. There is then discussion of internal strengths and weaknesses, challenges and opportunities, leading to formulation of Goals and then specific Activities needed to achieve the Goals, as well as financial and organizational implications. In FY08, Management, all Investment Departments and some support departments (a total of 21 sessions) used this process, and IFC is planning to roll it out further across the Corporation for the FY10 planning cycle. The process allows for continuous review and improvement, and the output of one year is then used as the basis for subsequent discussions.

4.6 **Implementation.** Following Management's strategy discussions, which took place over a three-day period, guidelines were issued to investment departments as input for their three-day planning sessions. Their deliberations resulted in submissions to Management in December which were discussed during a week of strategy meetings in January. World Bank Vice Presidents were invited to many of the sessions, and several attended or sent senior representatives, leading to fruitful input and discussion. Each department was asked to present three operational scenarios (Low, Base and High), and in each scenario, departments were asked to describe lower priority activities which could be scaled back or dropped. For example, many departments cited the inability to expand significantly their IDA reach in a Low Case scenario because of the need to build capacity in these markets.

4.7 In compiling the 'preferred case' from the submissions and subsequent discussions, Management took account of where IFC's additionality and development impact would be highest, as well as the key corporate priorities of increasing the shift toward business in IDA countries and the frontier, the regional priorities, as well as the enhanced focus on climate change. They therefore combined departments' high case IDA projections with base or low cases for other countries, making tradeoffs to ensure that the corporate priorities were being addressed and lower priority activities received reduced focus and resources. They also included implementation of the Special Initiatives mentioned in the Road Map and discussed later in this section.

4.8 Following Board endorsement of the 'preferred case' (which implied an 11.5% budget increase in FY09) in March at the Committee of the Whole discussion of the IFC Road Map, Management provided departments with an Indicative Budget corresponding to the department's strategy. This included specific allocations for initiatives endorsed by the Board (e.g., enhanced activities in Central America, Central Asia, Africa Health Initiative, Pacific Islands). IFC then held internal budget discussions in April based on the 'preferred case.' The resulting decisions on priorities and resource allocations are now presented in this Paper.

4.9 From the outset, the new strategy and business planning process included the formulation of budgets to support the strategic scenarios and unlike previous years, indicative budgets were provided by investment departments in support of their strategies in Phase 1. This enabled the Corporation to assess the impact of business plans on the underlying budgets and to assess budgetary compliance and discipline with the overall strategy. This in turn provided indicative pricing for the three growth scenarios as included in the Road Map and enabled the Board to make decisions on the 'preferred case' scenario based on the strategy itself and the underlying costs.

4.10 A further enhancement afforded by the new process was the establishment of recruitment plans linked to the various regional and corporate priorities, and the alignment of budgetary resources accordingly. This entailed a ground-up review of investment operations and investment support staff located in the field and in Washington, both as of March 2008 and for FY09. Particular focus was given to the shift of investment staff from Washington to the field, and in particular to IDA countries where IFC will significantly increase its presence in FY09.

4.11 Finally, the refined budget and staff planning processes enabled IFC to provide a comprehensive view of resources allocated to the regions including the costs associated with Regional and Industry Departments operating in the field within a matrix organization. Table 4.2 provides this matrix view for IFC's decentralized investment operations in the regions.

BUDGETS FOR INVESTMENT OPERATIONS

4.12 In translating the strategy into budget figures, Management considered the resources that would be placed in each region. This includes the respective Regional Department's budget, but it also includes Industry Department staff based in the field. Table 4.2 shows these resources for each region for FY08 and FY09.

Table 4.2: Resources in the Field†

US$ millions

	CAF			CEA			CEU			CLA		
	FY08	FY09	%	FY08	FY09	%	FY08	FY09	%	FY08	FY09	%
Regional Dept.	25.0	27.1		16.2	17.6		8.5	7.9		14.0	16.1	
Industry Dept.	6.3	9.4		8.5	8.2		2.6	3.2		7.0	7.3	
Total Field Based	**31.3**	**36.5**	**17%**	**24.7**	**25.8**	**5%**	**11.1**	**11.1**	**0%**	**21.0**	**23.4**	**11%**

	CME			CSA			CSE			Total		
	FY08	FY09	%	FY08	FY09	%	FY08	FY09	%	FY08	FY09	%
Regional Dept.	9.8	10.7		9.0	9.7		8.6	10.8		91.0	99.9	10%
Industry Dept.	2.7	4.0		2.1	4.0		4.3	4.2		33.6	40.2	20%
Total Field Based	**12.5**	**14.7**	**17%**	**11.1**	**13.7**	**24%**	**13.0**	**15.0**	**15%**	**124.6**	**140.2**	**12%**

†Legend: CAF – Sub-Saharan Africa; CEA – East Asia & Pacific; CEU – Central & Eastern Europe; CLA – Latin America & Caribbean; CME – Middle East & North Africa; CSA – South Asia (does not include rent increase for Mumbai office of $1.2 million in FY09); and CSE – Southern Europe & Central Asia.

4.13 In line with the Corporation's decentralization strategy, additional Industry Department staff will either be hired in the field or sent from Washington to the Regions. As a result, this component of resources in the field is increasing 20% overall. The increase of decentralized industry specialists is significantly higher in the three frontier regions –Sub-Saharan Africa (CAF), Middle East & Northern Africa (CME), and South Asia (CSA).

4.14 CEU's resources in the field will remain flat, reflecting a a stable business program. The decline in the CEU's Department Budget is an attempt to reallocate resources to the high-valued added activities of the Industry Departments in this region. The reallocation is driven by the need to support existing clients who might be adversely impacted by developments in the global financial system, increased investment in IDA countries and frontier regions of non-IDA countries, and a focus on climate change-related investments within CEU. In line with strategic priorities and the market conditions, there will be a rebalancing of in the Global Financial Markets Department (CGF) as attention shifts from new investments to a more balanced new business/portfolio mix.

4.15 **Decline in the US Dollar.** As IFC decentralizes its operations in a phased and incremental manner, administrative costs denominated in foreign currencies are rising due to the decline of purchasing power of US Dollar against currencies in which IFC incurs expenses. To ascertain the full fiscal year effect of the declining US dollar, IFC carried out an analysis of FY07 spending in non-US$ currencies in November 2007 and refreshed the analysis in March 2008. In FY07, non-US$ expenses accounted for 12.5% of the Total Administrative Budget, or $65 million out of $526 million. Revaluing the expenses in November 2007 resulted in an 8% increase of non-US$ expenses due to the dollar's decline; the March 2008 revaluation lowers this slightly to 7% due to a favorable US Dollar : South African Rand exchange rate.

4.16 In FY08, the non-US$ expenses component of the Total Administrative Budget is expected to increase to 13.7%, and increase further to 14.9% in FY09, due to IFC's emphasis on further decentralization and increasing local presence. To get back to the spending power IFC had in FY07 in US dollar terms, IFC would need additional administrative budget in FY09 of $7 million based on March 2008 rates (approximately 1% additional administrative budget). IFC records expenses in about 100 currencies. The top ten currencies, other than the US dollar, account for 65% of the total non-US$ expenses. These currencies are South African Rand, Brazilian Real, Indian Rupee, Russian Ruble, Turkish New Lira, Chinese Yuan, Hong Kong Dollar, British Pound, Euro, and Mexican Peso. The effect was particularly strong for the South Asia region.

4.17 The decline in spending power due to appreciation in the local currency relative to the US$ is further exacerbated by the current World Bank Group price factor methodology that transforms US dollar-denominated Regional budgets from real to nominal dollars without incorporating increases in emerging markets wages or prices. Thus, wage and price increases in country offices that outstrip the price factor must be absorbed by the Regions through internal redeployments.

STRATEGIC SECTORS

4.18 IFC's strategic priorities (see para 1.3) include a focus on specific sectors which are critical to building a robust private sector in developing countries. The following paragraphs discuss the resources that IFC will devote to these sectors, namely: i) frontier markets with an emphasis on IDA countries; ii) climate change and environment & social sustainability activities; iii) agribusiness; iv) infrastructure; v) health & education; and vi) financial markets development.

4.19 **IDA countries and Frontier.** IFC's business is increasingly focused on IDA countries as outlined in IFC's Road Map and reiterated in Section III of this paper. To highlight the importance of doing business in IDA countries, Management has, for the first time, asked Departments to estimate the resources that will be devoted to IDA countries in FY09. It is important to note that these figures are strictly indicative, as budgets have been developed at the Regional and Departmental levels rather than on a country-by-country basis. Nonetheless, IFC expects to devote approximately $135 million, or 46% of the budget for Investment Department and Business Advisory Services, to work in IDA countries. IFC has also created a new Vice Presidency for Africa to better coordinate and manage the Corporation's efforts in this region which has a heavy concentration of IDA countries. In addition, the former position of Director, Sub-Saharan Africa is being split into two positions – Director, West and Central Africa and Director, East and Southern Africa – to further augment IFC's attention to the region.

4.20 **Climate Change.** Investment Departments are ramping up work on climate change, primarily through a reallocation of existing resources, in an effort to meet the Corporation's goal of doubling or tripling its renewable energy/energy efficiency (RE/EE) investments (see para. 3.9). IFC will also be addressing climate change through three separately funded corporate initiatives:

i) **Climate Change Unit.** $0.6 million is being devoted to the Climate Change Unit in the Environment and Social Development Department (CES). Building on efforts begun in FY08, the Unit's primary function will be to lead IFC's efforts on climate change. The Unit will develop methodologies and tools to assess risks and opportunities to IFC related to climate change, e.g. clean energy tracking, carbon accounting, and shadow-pricing of green house gas emissions for information purposes. They will conduct pilot studies on the climate change risks to IFC investments and draft tools for review of climate risks of new investments. As part of their assignment, they will provide Cleaner Production support to investment and advisory staff across departments. The Unit will be the focal point for climate change collaboration with the rest of the World Bank Group, e.g. as the Group's Strategic Framework on Climate Change is being finalized.

ii) **Carbon Finance.** $1.6 million is allocated for Carbon Finance in FY09. The vision of IFC's new Carbon Finance program is to position IFC as a key facilitator of carbon market access for developing country projects by 2012. The program is expected to deliver booked assets/ volumes related to carbon products of more than $1 billion by 2012, and to support investment in carbon funds with potential commitments of $200 to $300 million over the next 3 years. The program includes the development of new financial products with global partners as well as the development of products for voluntary markets, potentially in collaboration with Equator Banks. Also part of this effort will be the design and delivery of a new Carbon Advisory product with support for other financial institutions and advising municipalities.

iii) **Footprint Program.** $0.7 million will be used for IFC's Footprint Program in the Environment and Social Development Department (CES). Under this program, IFC will implement best practices and innovative initiatives to manage the Corporation's environmental and carbon footprint. This program will also raise awareness throughout IFC about the footprint objectives. Lastly, the budget helps implement proper measuring, monitoring, and reporting on IFC's global footprint and carbon neutrality.

4.21 **Agribusiness.** The FY09 budget for the Agribusiness Department (CAG) is $13.1 million, a 23% increase from FY08. The budget will help scale up the department's operations in view of its central role in the development agenda and the challenge to face the current food crisis. The Department will significantly increase its staff resources located in Sub-Saharan Africa and Asia, including Central Asia. Priority will be given to IDA countries, where the Department expects to do half of its projects. CAG's strategy in Sub-Saharan Africa will be to: (i) Scale up its direct investments to improve productivity and provide working capital; (ii) Support the distribution of agricultural products and inputs; (iii) Scale up its wholesaling activity through traders and financial institutions to improve access to credit by farmers and smaller rural enterprises; and, (iv) Develop investment models that improve the productive and sustainable use of land (e.g. contract farming). Globally, the Department will continue to provide technical assistance to add value to its investments and respond to its clients mostly in the social (farm and SME linkages) and environment (energy and water efficiency, sustainability certification) areas. As a response to the current food price crisis, the Department is formulating a strategy that addresses short-term and long-term concerns. In the short-term, IFC will make available working capital facilities for its clients in good standing and select new clients. For the medium-term, the Department is pursuing and supporting alternative schemes (direct investment, investment funds, etc) designed to improve the productivity and sustainability of agricultural land, as well as reduce logistic inefficiencies in the agricultural supply chain..

4.22 **Infrastructure.** The FY09 budget for the Infrastructure Department (CIN) is $23.9 million, a 10% increase from FY08. The Department plans to double its staff resources in Sub-Saharan Africa and put staff in South Asia for the first time. The increased budget will help to address the sizeable global infrastructure access gap by "crowding in" private sector investments, particularly in IDA countries and regions. Priority will be given to the poorest countries in Sub-Saharan Africa, the Middle East & North Africa, and Asia. Partnerships within IFC and the World Bank Group, as well as with other financial institutions and donors will be leveraged to ensure that over a third of all new IFC infrastructure projects are in IDA countries. Mainstreaming the climate change strategy across all infrastructure sectors will be a priority. CIN will continue to develop Public-Private Partnerships in all infrastructure sectors – especially in IDA countries – where traditional concession or privatization approaches cannot be relied upon. In order to provide advisory services and financing, a programmatic approach will be employed to support national and regional infrastructure development, using facilities such as the Latin America Infrastructure Fund and the India Infrastructure Fund. CIN's strategy in Sub-Saharan Africa will be two-fold: i) Focus on riskier and "harder" IDA countries with the greatest needs through Infra-Ventures; and (ii) continued development of projects within IDA countries that have significant financing and access gap, but more favorable business conditions. In South Asia, CIN will continue its work in India according to the "India Infrastructure Strategy" presented to the Board in September, 2007. In addition, CIN plans to develop business in Bangladesh and Nepal, while increasing investments in Pakistan and smaller Central Asian countries.

4.23 **Health & Education.** The FY09 budget for the Health & Education Department (CHE) is $8.5 million, a 31% increase from FY08. This includes $1.0 million for the New Africa Healthcare Strategy which will is discussed below in para 4.27. CHE has had very few of its staff based in Regions but plans to move more staff to the field in

FY09. The FY09 plan will result in an increase of staff resources in the field from $0.3 million in FY08 to $1.5 million in FY09. More than half of that amount ($0.8 million) would be for the Sub-Saharan Africa Region, in line with the priority focus on that region. CHE will continue to roll out wholesaling facilities in Sub-Saharan Africa and plans new school projects as well. Staff resources in the Middle East & North African Region will increase from $0.1 million to $0.3 million as CHE plans to do one third of its projects (7 out of 21) there in FY09. A sizable program is also planned for the Middle East & North Africa with direct investments in health and education providers, student lending facilities, and wholesaling operations targeted at smaller institutions (Pakistan, Lebanon, Morocco, Jordan and Syria). Partnerships are also planned with GCC companies that are interested in investing elsewhere in the region. Finally, CHE will expand into new markets in Central America and the Caribbean.

4.24 **Financial Markets.** The Global Financial Markets Department (CGF) is the largest of IFC's Industry Departments. The FY09 budget for CGF will increase by 5%. CGF is the most decentralized Industry Department with nearly 100 grade F+ staff based in country offices. In FY09 it will selectively move banking, micro and housing specialists closer clients and will strengthen the portfolio function to counter the emerging lack of liquidity in selected countries in the financial sector in CEU and CSE. CGF will increasingly use staff rotations from region to region versus HQ to region to facilitate career growth and balance investment needs. The focus of CGF's investment program will be the development of local financial markets in IDA countries and frontier regions of non-IDA countries. CGF will also focus on financing climate change in large carbon emitter countries where the potential impact of investments is most significant. CGF's investment program will focus on SME and microfinance, trade and housing finance, equity for institution building purposes, and other innovative products, such as joint ventures in agribusiness, health and education, and infrastructure. Insurance and asset management projects will also be pursued in markets that are sufficiently developed.

4.25 **IDA countries and Frontier.** IFC's business is increasingly focused on IDA countries as outlined in IFC's Road Map and reiterated in Section III of this paper. To highlight the importance of doing business in IDA countries, Management has, for the first time, asked Departments to estimate the resources that will be devoted to IDA countries in FY09. It is important to note that these figures are strictly indicative, as budgets have been developed at the Regional and Departmental levels rather than on a country-by-country basis. Nonetheless, IFC expects to devote approximately $135 million, or 46% of the budget for Investment Department and Business Advisory Services, to work in IDA countries. IFC has also created a new Vice Presidency for Africa to better coordinate and manage the Corporation's efforts in this region which has a heavy concentration of IDA countries. In addition, the former position of Director, Sub-Saharan Africa is being split into two positions – Director, West and Central Africa and Director, East and Southern Africa – to further augment IFC's attention to the region.

STRATEGIC INITIATIVES

4.26 IFC will undertake six strategic initiatives within Investment Operations in FY09. The total cost for these ($5.3 million) is included in the budgets of the Regions shown in Table 4.2. It is important, however, to highlight each as they represent an important element of IFC's strategy.

Table 4.3: Strategic Initiatives
US$ millions

	Amount
New Africa Healthcare Strategy	1.0
Amazon Strategy	0.7
Central America	0.4
Caribbean Islands	0.6
Central Asia	1.8
Pacific Islands	0.9
Total†	**5.3**

†Total does not add due to rounding.

4.26 **New Africa Healthcare Strategy.** IFC and the Gates Foundation jointly funded an in-depth analysis of the private health sector in sub-Saharan Africa which resulted in recommendations of potential strategies and funding mechanisms for IFC to pursue in the sector. Based on the study's conclusions, IFC will implement a new Healthcare strategy in Sub-Saharan Africa. The strategy aims to i) improve access to capital through an equity investment vehicle; ii) improve the regulatory and investment environment for private healthcare by creating a technical assistance fund; iii)invest in the education of health workers; and iv) encourage the development of risk pooling mechanisms including health maintenance organizations, pre-paid plans, and other innovative structures.

4.27 **Amazon Strategy.** IFC will initiate a program to support sustainability-driven private sector investments in the Brazilian Amazon. A number of potential business opportunities have already been identified, and they may result in six to nine projects for an expected investment amount of US$120-180 million. IFC's work will focus on: i) sustainable management and use of forested areas, including sustainably managed production of forests, as well as management of private reserves and conservation areas; ii) sustainable and intensive use of already deforested areas (particularly those that are currently abandoned and underutilized); and iii) poverty alleviation and forest conservation, with a major focus on sustainable financing and access to finance, supply-chain income generation business linkages, stakeholders engagement and improving the business environment for sustainable development.

4.28 **Central America.** Central American countries have traditionally been underserved by IFC. This initiative seeks to reverse the situation with a focus on: i) private sector participation in infrastructure, including ports, renewable energy and roads; ii) local banks and the development of the region's capital markets; iii) tourism, real estate development (including housing and commercial properties), and the healthcare, agribusiness and manufacturing sectors; and iv) projects that would strengthen regional integration.

4.29 **Caribbean Islands.** The initiative for the Caribbean Islands seeks to improve access to finance through a combination of increased advisory and investments, and the creation of a regional credit bureau. Advisory work will focus on the development of Public-Private Partnerships for infrastructure.

4.30 **Central Asia.** This initiative aims to strengthen project development and management capacity in the region by expanding the resources on the ground. The plan is to increase the number of investments with special focus on IDA and post-conflict countries and small investments. IFC will continue to integrate its investment and advisory programs in the region with the financial sector being the initial priority. The field-based portfolio management function for the region will also be strengthened by adding new staff. There are, however, serious risks to be addressed in the region. The business environment is particularly challenging due to inadequate regulatory frameworks. Similarly, there are few transparency measures governing the extract industries in many countries in the region. If reforms continue at a slow pace, mobilizing investments and attracting external investors will be more difficult in the short run and will require more effort on business enabling and government relations.

4.31 **Pacific Islands.** The Pacific Islands have seven IDA countries. The initiative's three priorities are to i) significantly increase investment in the IDA countries; ii) strengthen the focus on climate change; and iii) increase the emphasis on financial markets and infrastructure. The Pacific Islands also include four conflict–affected members plus one failing state. There is a consensus that the area is at a tipping point and that the private sector has a key role to play in stabilization and growth. The initiative follows IFC's overall decentralization strategy by putting additional staff resources in several island nations to advance the Corporation's investment and advisory work.

BOX 4.1: ITEMS NOT INCLUDED IN THE FY09 BUDGET PROPOSAL

As indicated in the IFC Road Map, under the Preferred Case scenario growth in non-IDA markets of East Asia, Latin America and Eastern and Southern Europe regions would be selective and likely to be focused on reaching the underserved, climate change and second tier companies. However, even with this greater selectivity, there are areas of business where IFC has decided to reduce its focus given the resource constraints of the Preferred Case and the decision to reallocate resources elsewhere. These areas include:

- Central and Eastern Europe: this region will receive a flat/slightly declining budget, moving its investment focus to frontier regions and high value added products. This implies a relative increase in real sector vs financial sector activities as compared to current investments. CEU is expected to work increasingly close with CSE to optimize higher level staff use in both regions.

- East Asia: less activity in non-climate change related global manufacturing projects.

- Latin America: a more focused approach to global manufacturing, Information and Communication Technology and equity funds.

- Southern Europe and Central Asia:
  - Even greater selectivity in activities in Bulgaria and Romania.
  - Greater use of integrated teams in each sub-region (and across Regions, where possible).

- Infrastructure: delayed ability to ramp up significantly on the water sector.

- Global Manufacturing: reallocation of resources to Agribusiness.

MAJOR SUPPORT FUNCTIONS

4.32 There are critical support functions which work closely with IFC's Investment Departments to deliver the business program and ensure that the Corporation meets its mandate to deliver development impact and additionality. In order to keep up with IFC's growth, budgets for these functions have been increased, most significantly for Risk Management and Information Technology.

Table 4.4: Major Support Functions
US$ millions

	FY08 Budget	FY09 Proposed Budget
Legal	23.3	23.0
Environment & Social Development Department	18.3	18.1
Finance & Treasury	14.9	16.0
Risk Management	50.1	55.2
Information Technology	11.3	16.8
Human Resources & Communications	12.5	13.8
Total	**130.4**	**142.9**

4.33 **Legal.** The Legal Department is a critical function that works hand-in-glove with Investment Departments to deliver IFC's investment program. In line with the decentralization strategy, the Legal Department has been moving lawyers to every region in which IFC operates. As the Corporation continues to grow and do more complex investments, the workload and costs of the Legal Department have increased significantly. In order to contain the growth of its administrative budget while still meeting the growth in demand for legal services, the Legal Department will rely more on external counsel to leverage the time of internal IFC lawyers. In addition, clients will be charged for the costs of counsel in circumstances where to do so is in line with industry practice and, in other cases where outside assistance is still needed (e.g. some equity investments), fee income will be used to offset the cost of counsel. This allows Management to marginally reduce the Legal Department's administrative budget by 1.3% while maintaining the volume and quality of its work.

4.34 **Environment & Social Development.** Services provided by the Environment & Social Development Department (CES) have been identified by IFC's clients as one of the Corporation's comparative advantages. In FY09, CES will continue to build IFC's global leadership in Environmental & Social (E&S) Sustainability. Particular focus will be given to the ongoing implementation and strengthening of IFC's E&S risk management system which supports investment operations. The Department will also further its outreach to financial institutions, bi-laterals, multi-laterals, export-credit agencies and others to assist them with the use of IFC's E&S Performance Standards/Equator Principles. These are only a sample of CES's functions which are expanding to meet growing demand for IFC's E&S services while maintaining strong support for IFC's traditional investment program. The administrative budget for CES will decrease slightly in FY09 by 1% (not including the climate change and social sustainability initiatives discussed in paras. 4.17 – 4.20). The administrative budget is, however, only one of several sources of funds used by CES. The Department also draws funds from donors and increasingly seeks to charge clients directly for services.

4.35 **Finance & Treasury.** Treasury performs core functions to protect IFC's balance sheet while actively supporting investment operations. Its work includes mobilizing market funding through syndications and structured & securitized products. Treasury has scaled up its local currency financing initiatives using derivatives, structured finance (including MATCH) and borrowing-and-onlending. It also provides new financial techniques and market intelligence on pricing to assist Investment Departments as they formulate deals. IFC's growth also translates into a larger funding program which requires greater access to a broader range of markets, currencies, and investors. Similar to the Investment Departments it supports, Treasury faces difficulty in hiring and retaining highly skilled technical staff in a very competitive marketplace. Treasury's budget will increase by $1.1 million, or 7% in FY09 to hire new staff to augment local currency financing efforts, and allow for the mainstreaming of staff who were previously funded by syndications fees.

4.36 **Risk Management.** As IFC scales up its activities and decentralizes further, the management of risk remains critical, including the maintenance of a sound financial structure and appropriate risk management practices, particularly in light of the recent market volatility and uncertainties. IFC intends to focus considerably more resources on this area in the upcoming fiscal year.

4.37 IFC established a stand-alone Risk Management Vice Presidency last year to strengthen the essential risk management practices within the context of growth and decentralization. A number of initiatives undertaken to date have provided the foundation for more rigorous portfolio and risk management at IFC. These include:

(i) Establishing a new Market and Liquidity Risk unit and implementing a Corporate-wide Value at Risk measurement and management system to achieve a more uniform and consistent approach to market and liquidity risk management;

(ii) Securing Board approval of the adoption of the Capital Pricing and Risk (CAPRI) economic capital approach to IFC's capital adequacy framework and also modifications to IFC's liquidity policies. Together, these two milestones allow for finer differentiation of risks, greater flexibility to manage those risks with adequate liquidity and capital, and also support a wide range of internal risk management applications, including pricing discipline, performance measurement, exposure limit setting, and portfolio management;

(iii) Coincident with and supplementing the holistic assessments undertaken for the restatement of IFC's prior years' financial statements, comprehensive changes are being implemented to strengthen internal controls, establish clear responsibilities for technical accounting reviews of investment transactions, improve financial close processes, and tighten valuation accountabilities and roll-out formal documentation requirements; and,

(iv) Implementing a formal, objective criteria-based policy for initiating involvement of IFC's Special Operations Department[4] in problem investments on an enterprise-wide basis in FY07, and increasing the frequency of comprehensive portfolio reviews from semi-annually to quarterly with particular focus on projects and clients under actual or potential stress.

4.38 **Decentralized Risk Management.** In addition to these initiatives, IFC will facilitate improved client service and efficiency while retaining appropriate checks and balances on decentralized decision-making. Credit review and, eventually, further components of risk management oversight and support will be shifted to the field to parallel the decentralization of business decision-making there. In particular,

(i) Two Credit Officers have been located in Hong Kong since the end of 2006 to cover both East Asia and South Asia; a third will be added this year. In FY08-09, two to three Credit Officers will be relocated to Istanbul to support investments in Southern Europe and Central Asia (SECA), Middle East and North Africa (MENA), and Central and Eastern Europe (CEU), and two Credit Officers will move to Johannesburg.

(ii) Six Special Operations Officers will be moved to the field to cover the southern cone of South America, MENA, SECA and South and East Asia.

(iii) Delegated decision making and accountabilities will increasingly be driven by risk-adjusted project assessment and objective credit review criteria to increase local client responsiveness balanced with appropriate risk oversight.

(iv) IFC's policies and procedures governing investment and advisory operations are being inventoried and organized for easy-access by field-based staff, along with clear accountabilities for compliance oversight within the Risk Vice Presidency.

4.39 **Integrity Due Diligence**. "Sponsor due diligence" has always been an integral part of IFC's appraisal process. During FY08, a standardized integrity due diligence process was developed as another element of the risk management initiatives to support decentralization. For FY09, emphasis will be placed on formulating a risk-based methodology which will enhance current efforts to promote consistent due diligence by all staff and departments across IFC, and ensure appropriate documentation of decisions with maximum future re-use and accessibility of the collected information. The enhanced due diligence process will also provide a risk assessment framework for staff to determine the appropriate level of due diligence to be conducted along with a range of due diligence measures to be taken beyond a mandatory minimum. The roll-out to both

[4] The department is comprised of a small number of workout professionals who have extensive experience handling jeopardy projects.

investment and advisory operations will be supported by an e-learning program to facilitate a detailed understanding of the process and a network of regional champions. Other initiatives that further strengthened integrity due diligence capacity during FY08 included the regular screening of clients and associated parties by INT and internal data quality analysis of IFC contacts and partners. In FY09, this computerized screening of clients and associated parties will continue against a database containing persons sanctioned by the UN and national governments, lists of politically exposed persons, and media reports.

4.40 **Internal Controls**. During FY08 IFC has progressed with its risk-based internal control initiative, with renewed impetus and focus following the restatement of IFC financial statements. An in-depth study of the financial closing process was begun in Q1 FY08 and has identified several opportunities to improve internal control, as well as speed and efficiency, to support timely, accurate and complete financial reporting. Recommendations arising from this initiative are already being implemented and have been shared with Internal Audit (IAD).[5] Among the areas receiving attention, IFC Management attaches most importance to establishing clear responsibilities and processes for technical accounting reviews of investment transactions, and measures will be taken in this regard both in the short term and through FY09. Building on this work, IFC plans to implement enhanced compliance testing of internal controls over financial reporting during FY09. On a broader front, management also plans to initiate a self assessment program during FY09, as part of the expanded scope for its operational risk management efforts. Taken together, these various components of the internal control initiative will build towards providing management with a more integrated view of the state of internal control in IFC, encompassing not only the key area of financial reporting, but also other significant aspects of its operations, including advisory services.

4.41 **Portfolio Management.** While IFC regional and industry departments are responsible for investment portfolio management, portfolio exposure is also monitored at the corporate level by sponsor, sector and country of exposure. Risk and financial performance metrics are also aggregated by region and sector. As tools of portfolio management, quarterly Credit Risk Rating (CRR) reviews are conducted on a client by client basis, from which specific and general loss reserve amounts are derived. In addition to factors reviewed in the quarterly CRRs, a more in-depth annual portfolio supervision report (PSR) is prepared for each client, which often involves a site visit and includes such key areas as development impact. Several steps toward a more structured approach to portfolio management have recently been undertaken:

- (i) Increased frequency of portfolio reviews,
- (ii) Stress tests for larger IFC exposure countries,
- (iii) Greater scrutiny and due diligence of equity and derivative valuations,
- (iv) Accelerated transfer of problem projects to the Special Operations Department as noted above,

[5] A discussion of lessons learned from the restatement will take place in the Audit Committee in early May 2008.

(v) More frequent country pricing and macro spread reviews and a targeted review of indicative pricing for undisbursed transactions in this period of market volatility, and
(vi) Launch of a Portfolio Business Process Review to make portfolio supervision more efficient and improve client responsiveness while ensuring that risks are addressed pro-actively.

4.42 **Enhanced State of Readiness**. Several actions have been taken in recent months to promote a collective and dynamic perspective on the possible sources of and country/regions of potential downturn or crisis to enable IFC to act swiftly in support of our clients and in our traditional countercyclical role. In addition to those noted above, further functions and activities include:

(i) IFC's Finance and Risk Committee, a subset of the Management Group, will be the point of integration to enable a more in-depth identification of high-risk regions, countries, sectors and sub-sectors, to capture any vulnerabilities as well as identify opportunities proactively;
(ii) An internal group to review the early warning indicators by country as input for Management decisions;
(iii) A disciplined and well-documented country exposure review process is now in place which will enhance IFC's effectiveness in anticipating or responding to countercyclical threats and opportunities over the coming months;
(iv) A review of actions and resources needed for a contingency crisis response plan has been completed by IFC's Special Operations Department based on IFC's experience in past crises and scenario analyses. An estimate of $4-5 million for work-outs and client services, if needed, would be funded through internal reallocation;
(v) As part of IFC's action plan toward an enhanced state of readiness, IFC will maintain the annual Investment Facility for Jeopardy Cases. This facility was approved by the Board in August 2001 to allow IFC under delegated authority to commit new money to support clients and protect IFC's interests in the event of emergencies and unforeseen events. When used, this has allowed IFC to respond quickly to crisis-affected projects as well as projects in jeopardy for other reasons. Please refer to paras. 11.2 – 11.3 for further details about this Facility.

4.43 **Risk Management Moving Forward.** Taken together, the above initiatives, activities and enhanced tools for risk management allow for greater decentralization and enhanced accountability for a broad range of best-practice risk management activities and policies. More specifically, these policies, tools and resources will be leveraged in coming years to support:

(i) Development and implementation of a more granular standardized risk rating system, eventually incorporating IFC's development mandate and environment/social risk dimensions into the rating methodology;

(ii) Consistent application of a risk rating for every project upfront to improve pricing for risk, as a well as generating a more robust overall risk profile and greater transparency in our decision-making and reporting on financial performance and development impact expectations; and,

(iii) Improvements in the content, quality and strategic nature of the risk reporting to provide strategic risk analyses and pro-active management of any emerging concentrations or potential policy exceptions.

4.44 Implementation of the improvements and initiatives discussed above will require substantial resources to ensure that the Corporation's risk management function meets the needs of a growing organization. As such, the Risk Management Vice Presidency will received a budget increase of 10%.

4.45 **Information Technology.** Information technology is a critical function which supports every aspect of IFC's work. As the Corporation decentralizes decision-making to the field, stable IT systems are necessary to maintain seamless work flow and communications between HQ and the Country Offices. The combination of Corporate growth, decentralization, and greater complexity of investment deals greatly increases the demand for IT services throughout IFC. IFC will also be incurring incremental costs to transition from one outsourcing vendor to another due to irregularities with the existing vendor. In addition, IFC experienced a number of serious, highly sophisticated attacks on its information security during FY08 which has forced Management to revamp the IT security function. The administrative budget for the Corporate Business Informatics Department (CBI) is increasing significantly ($5.5 million, or 49%) in FY09 to address these issues. This increase is designed to accomplish two objectives: better align budgeting with financial reporting; and address contractor conflict of interest. Travel costs associated with essential post-implementation IT to country offices are also budgeted to increase further in FY09.

4.46 **Human Resources & Communications.** IFC's growth and decentralization strategies have significantly expanded the traditional workload of the Human Resources Department (HR). The process of sending HR staff to the field will continue in FY09 in order to further develop local capacity, support field-based management, and conduct local recruitment. A new Global Career Framework will also be implemented to enhance career and mobility opportunities for staff in a more decentralized IFC. The Corporation's growth strategy means that HR will have to recruit a record number of staff in FY09. Once new staff have been successfully recruited, HR then conducts an intensive on-boarding program to get them up to speed and disseminate IFC's culture and practices as quickly as possible. HR is also working closely with their counterparts at IBRD to develop and implement the new WBG Compensation system. To accommodate the expanded work of HR, the administrative budget will increase by $0.7 million, or 10%.

4.47 The Corporate Relations Department is also managed by the HR, Communications & Administration Vice Presidency. Its budget will increase by $0.5 million, or 11% in FY09. One of the key goals of Corporate Relations will be to augment strategic communications, and to promote and articulate IFC's brand through strategic messaging, media outreach, marketing, publications, and stakeholder relations. The Department will also work to strengthen internal communications so that as IFC grows and decentralizes, staff stay informed of the Corporation's operations, priorities and values.

BUDGETS FOR CORPORATE OVERHEADS

4.48 Corporate Overheads represent a broad category of expenses which are not directly attributable to individual Departments but which are necessary for the normal functioning of any corporation. Responsibility for budgeting, monitoring and controlling these corporate-wide expenses is assigned to specific Departments based on their expertise. Services provided by IBRD for IFC are included in this category. The specific overheads with corresponding budgets are shown in Table 4.5.

Table 4.5: Corporate Overheads
US$ millions

	FY08 Budget	FY09 Proposed Budget
IT Maintenance & Support	13.0	21.7
Overheads Managed by HR	17.1	20.1
IBRD Support Services	10.5	11.4
IBRD Internal Audit Services	1.4	2.2
Publications	1.3	1.4
Pangea Operations	-	0.7
Net Benefits Recovery	(28.2)	(26.3)
WBG Community Outreach	0.3	0.3
Facilities Management	12.9	13.7
Insurance	2.3	2.3
IDA / IFC Secretariat	-	0.5
Total	**30.6**	**48.1**

4.49 Increases in Corporate Overheads are driven largely by the Corporation's growth strategy. The largest increases to Corporate Overheads come from IT Maintenance & Support, and Overheads managed by HR.

4.50 **IT Maintenance & Support.** This category accounts for $8.7 million of the $17.5 million increase for Corporate Overheads. IT Maintenance & Support includes i) the costs for services provided by IBRD's Information Solutions Group (ISG); ii) the software and hardware annual license and maintenance fees paid to vendors; and iii) fees paid to outsourced service providers for support and maintenance of IFC IT applications and infrastructure environments. The increase in costs from FY08 to FY09 is mainly due to the growth of IFC's IT asset portfolio which supports all aspects of IFC's business from operations to treasury to advisory services. As IFC continues to invest in IT assets which are essential for the smooth functioning and decentralization of the Corporation in the delivery of its strategy, support and maintenance costs are expected to increase in future years.

4.51 **Overheads managed by HR.** These costs are increasing across the board, largely driven by the Corporation's growth strategy and the need to fund programs which are based on staff numbers. Corporate training is increasing by 5% to accommodate the growth in staff. Training is especially critical for staff in the field to ensure that people management skills and understanding of IFC's policies/procedures are properly developed for office heads throughout the world. IFC will increase spending on several incentive programs which are necessary to attract and retain high quality staff in an increasingly competitive global market for people with finance skills. In certain job streams, the market value is at least 35% higher than Bank Group salary ranges. To compete, IFC must pay market premiums to attract the best people.

4.52 **IBRD Support Services.** IFC closely cooperates with IBRD to enhance cost effectiveness. Table 4.6 lists funding for these services from IFC's regular budget (see Table 4.7 for other items). As FY09 represents another year of planned growth for IFC, its use of IBRD Support Services will necessarily be increasing, thus driving up IFC's cost for services from ISG, IAD, and GSD to name a few. In addition to increased usage, many cost sharing agreements are based on the proportion of IFC:IBRD staff. Since this ratio is now higher due to IFC staff growth, the costs have increased accordingly.

Table 4.6: IBRD Support Services
US$ millions

	FY08 Budget	**FY09 Proposed Budget**
Information Solutions Group	3.2	3.3
Library Services	1.4	1.5
HR Services	2.8	3.4
GSD Services	0.3	0.5
Treasury Services	0.2	0.2
Controllers Services	1.9	2.1
Legal Services	0.4	0.4
Contingency for IAD	0.3	-
Total	**10.5**	**11.4**

4.53 **IDA-IFC Secretariat.** This is a new addition to Corporate Overheads with $0.5 million allotted for IFC's share of the new IDA-IFC Secretariat. The Secretariat was recently established to forge more effective collaboration across the World Bank Group and to better coordinate its work in IDA countries. The Secretariat reports directly to both the World Bank Group Chief Financial Officer and IFC's EVP. It seeks to foster more joint projects, where IDA, IFC and MIGA working together would enhance development impact. Specifically, the Secretariat will establish mechanisms for implementation and follow-up of Group activities in the broader private sector development agenda (with emphasis on finance, trade and infrastructure). Its key priorities include: (a) managing the overall process of bringing greater private sector focus into operations of IDA through partnership with IFC; (b) working collaboratively across the World Bank Group to achieve the collective goal of better deploying the Group's instruments in IDA countries; and (c) developing and monitoring indicators of success of private sector development in IDA countries.

TOTAL BUDGET

4.54 The Total Budget comprises the Regular Budget plus items that fluctuate independently of discretionary budget allocations. These items are i) Depreciation Expenses which are the product of previous capital budget allocations; ii) costs for the Corporate Secretariat & Board; iii) Contributions to Retirement Accounts; and iv) Other items such as the Compliance Officer/Ombudsman and the Independent Evaluation Group.

Table 4.7: Total Budget
US$ millions

	FY08 Budget	FY09 Proposed Budget
REGULAR BUDGET	**455.0**	**507.3**
Other Budget Items		
Total Depreciation	38.1	40.5
Corporate Secretariat & Board	16.8	22.0
Risk-based Internal Control Initiative	1.9	1.9
Ombudsman / Compliance Advisor	2.2	2.8
Field Security	4.1	5.6
Business Continuity	3.2	3.2
Independent Evaluation	4.7	5.1
Contributions to SRP, PEBP & RSBP	71.8	67.9
Subtotal Other Budget Items	**142.9**	**149.0**
TOTAL BUDGET	**597.9**	**656.4**

4.55 **Depreciation Expense.** Overall depreciation costs in FY09 will increase as compared to FY08. This increase relates to the Corporation's increased capital spending in recent years. More than half of the depreciation expenses results from investment in IT Projects which are necessary to provide the tools needed to conduct regular, ongoing business on a global scale.

Table 4.8: Depreciation Expenses FY08-13
US$ million

	FY08 Estimated	FY09 Budget (Proposed)	FY10 Budget (Indicative)	FY11 Budget (Indicative)	FY12 Budget (Indicative)	FY13 Budget (Indicative)
IT Projects	24.9	28.2	28.1	26.0	26.9	27.5
PC Equipment	2.2	1.0	4.3	5.1	6.1	4.9
HQ and CO Facilities	5.4	7.2	8.2	9.0	9.2	10.6
HQ Building	4.1	4.1	4.1	4.1	4.1	4.1
Total	**36.6**	**40.5**	**44.7**	**44.1**	**46.3**	**47.1**

4.56 **Corporate Secretariat & Board.** The proposed budget for the Corporate Secretariat and Board is for IFC's share in the cost of operation of the Board of Governors, Executive Directors, Development Committee and Corporate Secretariat. The total cost of operations is shared among IBRD, IFC and MIGA through service and support fee agreements which closely reflect the actual use of the Board time by the respective institutions. The significant increase of $5.2 million or 31% increase over FY08 reflects the increased use of Board time by IFC due to significant growth in business.

4.57 **Contributions to Retirement Accounts.** Contributions to the Staff Retirement Plan, the Retired Staff Benefits Plan, and the Post Employment Benefits Plan are expected to decrease by $3.9 million to an estimated $67.9 million in FY09, as approved by the Pension Finance Committee in April 2008. This reflects the actuarial estimates of funding requirements based on the market valuation of the underlying assets relative to pension plan liabilities. It also reflects the budget set aside for tax supplements expected to be paid in connection with the net pension plan.

4.58 **Other Budget Items.** This category includes the Risk-based Internal Controls, the Compliance Advisor/Ombudsman, Field Security, Business Continuity, and IFC's Independent Evaluation Group (IEG).

SECTION V: DECENTRALIZATION

5.1 Increased international capital flows provided IFC with a judicious opportunity to re-articulate its value proposition. Significant transformation of IFC's client demographics (64% local clients) over the years had not been met by corresponding changes to how IFC worked (largely from Washington). Furthermore, there was growing demand from IFC's stakeholders to increase focus on development impact. Several years of strong performance provided IFC a unique opportunity to build on its strengths undertake considerable changes without major disruptions in its business. The decentralization of staff that had been ongoing in a phased and incremental manner since FY03 has been accelerated in recent years to include decentralization of decision making.

5.2 As of FY08, IFC has more staff in field offices than at headquarters. Coupled with advisory services facilities already in the field, this enhanced field presence is enabling IFC to adopt a more client-centric, strategic approach than has been possible in the past. IFC's approach to better service clients consists of: (i) continued delegation of decision making to Regional Directors in the field; (ii) re-locating experienced staff to the regions; and (iii) expanding local recruitment. Empowerment of staff closer to clients is intended to facilitate more programmatic and strategic relationships with clients, and faster delivery of products and services that are tailored to meet client needs. An interim assessment from the Asia Pilot shows some promising results, but implementation challenges of course remain.

5.3 **Asia Pilot.** On July 1, 2007, IFC launched a pilot exercise for delegated authority in two regions: East Asia and the Pacific, and South Asia ("the Asia Pilot"). Projects under the Asia Delegated Authority Procedure ("ADAP") were to meet certain requirements, i.e.: (i) be within certain investment volume thresholds (less than $10 million in equity and less than $50 million in total IFC investment); and (ii) have no major policy (e.g. reputational, environmental and social, sponsor) issues. Because of the need for critical mass (of field staff presence and of number of projects) for ADAP to be operationally feasible, the three largest industry departments – Global Financial Markets, General Manufacturing and Infrastructure – were included in ADAP. And as part of the work on strengthening the risk management function, credit and environmental officers were also located in the field. The presence of credit officers in the field has provided significant support in early stage discussions around business fundamentals and project structuring issues. According to a mid-term assessment by the Asia regional management teams undertaken in January 2008, some initial successes can be seen:

(i) *Client Relationship Management* has been strengthened with the "One Team" approach: staff from industry and regional departments working together across the matrix to present a unified face to the client. Sector strategies have been formulated and top clients have been identified. Client Relationship Leaders have been assigned to strategic clients, and Client Engagement Plans have been formulated. Client Industry Managers have been appointed in both Asia regions for the three largest departments; they bring industry expertise to the field.

(ii) *Business Process Review ("BPR"):* Client Survey results in recent years reflected a clear need for IFC to improve responsiveness. BPR is an internal process exercise intended to streamline procedures to achieve significant improvements in client responsiveness. Early stage Concept Review Meetings under ADAP have helped identify issues early on, and brought an integrated perspective between investment and advisory services.

(iii) *Knowledge Management ("KM")*: With greater decentralization and client focus, IFC recognizes that staff will need to more systematically tap into its global knowledge base. Practice Groups are being created to provide a channel to ensure that staff: (a) have access and contribute to IFC's specialized knowledge; and (b) develop their career as part of a specialized global community. Regional staff will be mapped to industry Practice Groups as part of the KM effort.

(iv) *Advisory Services:* Greater collaboration between investment and advisory services is now possible, thanks to: (a) increased field presence of investment staff; (b) participation of advisory services staff in Early Concept Review meetings; and (c) joint formulation of client strategies.

5.4 **Decentralization of Project Processing.** In recent years, IFC's industry departments have been moving investment operations and task management to the field. The Corporation as a whole is trending in the right direction, i.e. more projects are being processed by investment staff based in the field, closer to the client. The percentage of projects led by client-based investment staff has increased to 37% of the total in FY08 from 23% in FY06. However, smaller industry departments have been challenged in this regard as they have hitherto lacked the critical mass of staff in the field. To further leverage field staff worldwide, smaller industry departments are clustering with the three larger ones. Clustering is expected to translate into an increased number of regionally-based staff that will be able to work across industry sectors in a rigorous way. In turn, clustering of staff that can work across industry sectors is expected to enable IFC to put a more local, and experienced face across its work in all sectors.

5.5 **IFC Presence in IDA.** Decentralization is the most effective and efficient way for IFC to pursue its strategy of reaching further into frontier markets. Enhanced field presence in IDA has enabled IFC to better serve smaller clients who are out of reach from Washington. IFC now has offices in more than 50% (41 out of 80) IDA countries in all seven regions. 656 IFC staff are in IDA countries, up from 449 staff (a 46% increase) in FY05. On the investment side, 88 staff (at F level and above) work in IDA countries, nearly half of whom have been at IFC for more than four years. On the advisory services side, 189 staff (at F level and above) work in IDA countries. Decentralization has allowed IFC to scale up its investment and advisory activities aimed at creating opportunities in FY07, with commitments in IDA countries amounting to $3 billion ($1.5 billion in FY06) – and 44% of all investment commitments – and advisory expenditures accounting for 62% of total. Together with IFC's contribution to IDA and the newly established IDA-IFC Secretariat, continued decentralization of IFC operations in IDA is expected to further increased focus on private sector development in these countries.

5.6 **Implementation Challenges.** There are many early signs of success, but also challenges which IFC must address if decentralization is to be implemented in a sustainable manner:

(i) *Mobility:* IFC must improve incentives for experienced IFC staff to move to the field. IFC is addressing this in a number of ways, and for example has contracted a pilot Destination Service Provider (DSP) for the two Asia regions to provide enhanced relocation support to IFC staff and families, effective March 1, 2008.

(ii) *"Culture Carriers"/Training:* Decentralization combined with rapid growth means that IFC must develop a new model for training and disseminating IFC culture. As part of these efforts, IFC is launching a consultative process both in Washington and in the field to discuss the key elements of its corporate culture, 'The IFC Way.' IFC has also increased significantly the number of locations and frequency of induction and other training. Nonetheless, much more remains to be done, and in FY09 IFC expects to devote significant resources to ratchet up its training offerings.

(iii) *Career Paths:* With investment operations moving increasingly to the field, career development paths for many staff need to be further defined. IFC is in the process of developing a new Global Career Framework, which will be of paramount importance to ensure recruitment, development and retention of high quality staff.

(iv) *Process Overload:* According to the latest Staff Survey, a great majority of client-facing IFC staff do not believe current practices help them deliver high quality service to clients. There is a pressing need to accelerate the work on streamlining of business processes and this is currently under review.

5.7 **Regional Roll-out.** In FY09, Delegated Authority will be expanded to additional regions: initially Sub-Saharan Africa and Latin America and Caribbean, likely to be followed by other regions. As in all other projects processed under delegated authority demonstration of clear additionality, development impact and IFC role will be required. And as in the case of the Asia pilot, all Delegated Authority projects will continue to be subject to Board approval as under existing procedures.

5.8 **Implementation Support.** Since February 2007, IFC's Global/Local Program Management Office ("PMO") has overseen the implementation of decentralization, and has managed internal communications and engagement around the decentralization process. The PMO helps ensure the coordination and consistency of diverse and interconnected corporate initiatives as they affect the decentralization exercise. Going forward, the PMO will also focus on capturing and disseminating lessons learned to date, through IFC's own Asia Pilot as well as through the World Bank's decentralization exercise.

5.11 **Decentralization Costs.** In FY08, as shown in Table 4.2, $124.6 million, or 27% of the FY08 Regular Administrative Budget, was directly allocated to investment operations in the field. This amount is comprised of the total operating budgets of

Regional Departments ($91.0 million) plus the costs ($33.6 million of staff salaries and benefits, including field benefits) of Industry Department staff based in the field.

5.12 In FY09, $140.2 million, or 28% of the proposed FY09 Regular Administrative Budget, will be directly allocated to investment operations in the field. This represents a 12% increase from FY08, slightly higher than the 11.5% increase of the Regular Administrative Budget. This amount is comprised of the Regional Departments' budgets of $99.9 million, a 10% increase from FY08, and the costs of field-based Industry Department staff of $40.2 million, a 20% increase from FY08. Much of this increase is driven by the significant cost to put expatriate staff in the field. As such, experienced expatriate staff will focus on training newer local staff in the short-term so that IFC will develop a solid foundation of more cost-effective local staff in the medium-term.

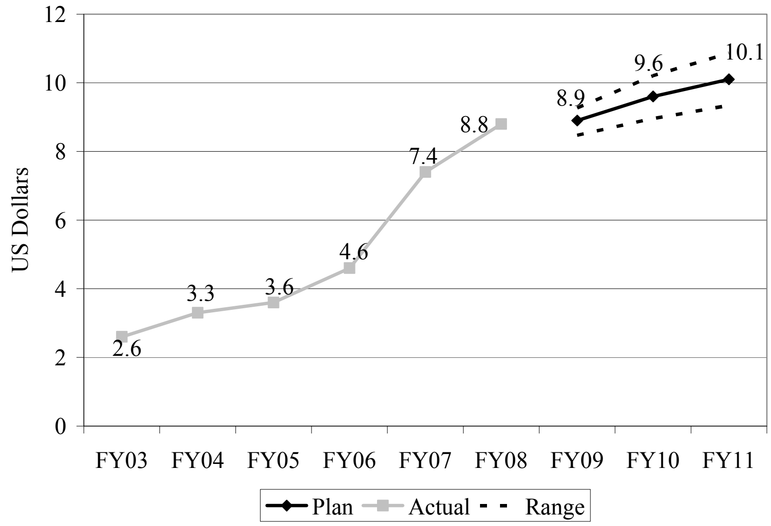
5.13 This substantial 20% growth in budget resources for field-based Industry Department staff is consistent not only with IFC's decentralization strategy but also its corporate priorities as the growth rates in resources for field-based Industry Department staff are highest in the three priority regions of Sub-Saharan Africa, Middle East & North Africa, and South Asia with increases from FY08 to FY09 of 49%, 47% and 90% respectively.

SECTION VI: PRODUCTIVITY AND EFFICIENCY

INVESTMENT OPERATIONS

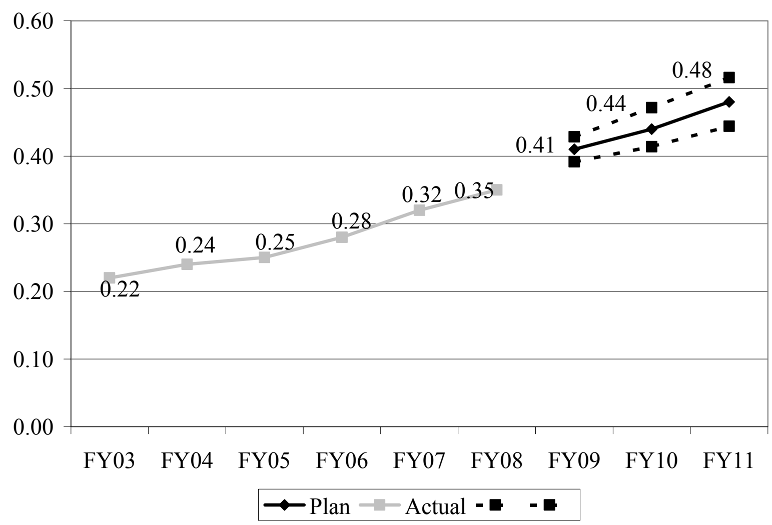
6.1 Since the IFC Reorganization at the beginning of FY03, the Corporation has measured its productivity by comparing its output in terms of both Commitment Volume and Number of Commitments to its Regular Administrative Budget. Graph 6.1 shows a significantly positive trend in this ratio for the investment program in IDA Countries (incl. IDA-Blend). The growth of the ratio is driven by strong growth in IDA Volume from FY03-08 from $783 million to $3,809 million estimated for FY08 and from a planned $4,499 million in FY09 to $6,145 million in FY11.

Graph 6.1: $ of IDA Commitments per $ of Budget



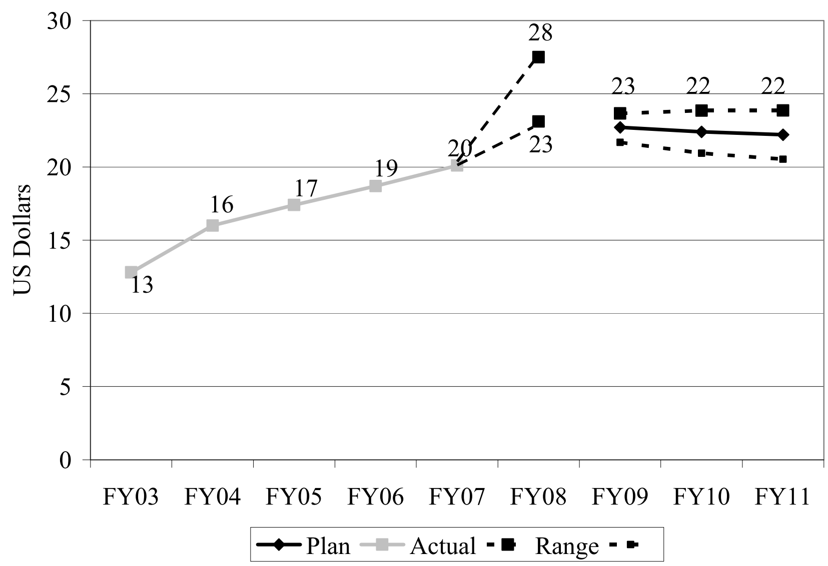
6.2 Similarly, the number of projects committed in IDA countries increased from 67 in FY03 to an estimated 151 in FY08 and is expected to rise from 208 in FY09 to 292 in FY11. Graph 6.2 shows the corresponding upward trend in the ratios based on number of commitments in IDA countries.

Graph 6.2: Number of IDA Commitments per $million of Budget



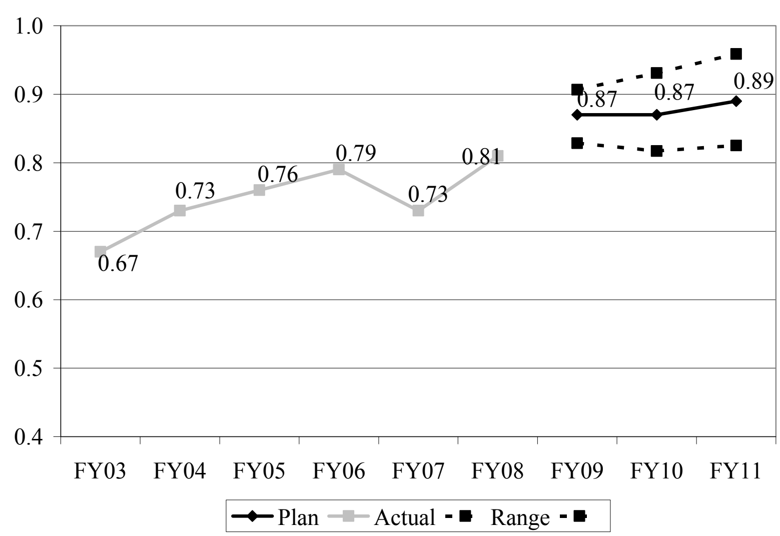
6.3 The upward trend is less pronounced, but still highly positive for all IFC commitments regardless of location as shown in Graph 6.3. It is evident that the ratio in the outer years FY09-11 declines somewhat. This is direct result of the fact that IFC's commitment volume is for now projected to grow at a more moderate rate in the next few years while the Corporation increases its focus on doing more IDA and frontier projects which are smaller in size but are resource intensive. As already noted, however, these projections are conservative in view of the increased demand from clients IFC is experiencing due to difficulties in many markets.

Graph 6.3: $ of Commitment per $ of Budget



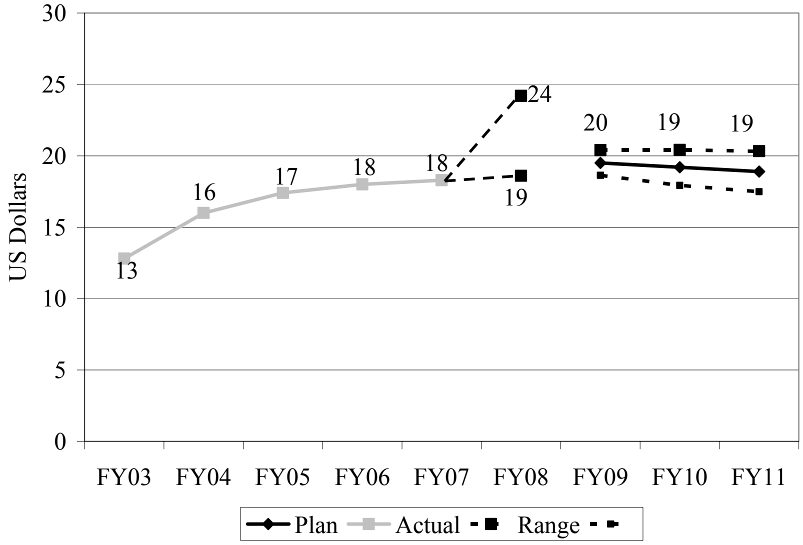
6.4 Renewed efforts to focus on growth in number of commitments is visible not only for FY08 below but is expected to continue during the next three years: The number of commitments for each $ million of Regular Admin Budget is expected to increase above the levels seen FY03-07 (Graph 6.4).

Graph 6.4: Number of Commitments per $million of Budget

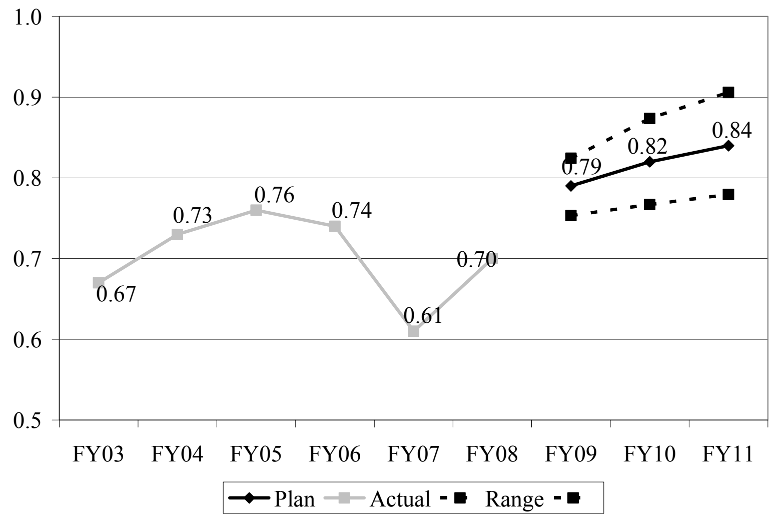


6.5 These trends also holds true when Trade Finance projects are excluded:

Graph 6.5: $ of Commitment (excl. Trade Finance) per $ of Budget



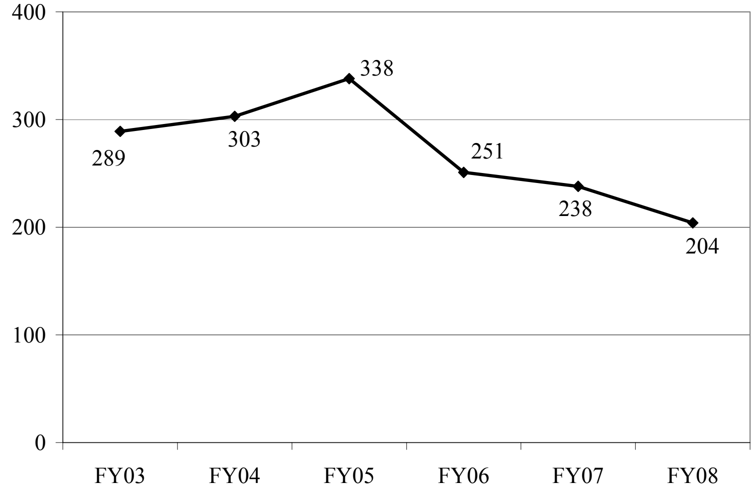
Graph 6.6: Number of Commitments (excl. Trade Finance) per $million of Budget



6.6 Looking forward, the volume based ratios are not expected to continue increasing. This is in line with the reduction in the pace of commitment volume growth which was indicated in IFC's Road Map and reflects Management's intention to dedicate more resources to smaller projects, projects in IDA countries and those in frontier regions of non-IDA countries.

6.7 In addition to the productivity ratios with respect to budget shown above, IFC also measures its efficiency by its ability to improve client service through increased processing speed for investment projects, measured in days elapsed from completion of the PDS-Early Review Project Stage to Commitment as shown in Graph 6.7.

Graph 6.7: Elapsed Days from PDS-ER to Commitment



6.8 **Client-facing measures**. The average time taken for IFC to make the first disbursement after reaching an initial understanding with the client has decreased by 19 weeks (over four months) from 47 weeks in 2005 to 28 weeks in 2007. The difference between clients' expectations and IFC's actual performance has also decreased, from 27 weeks to 14 weeks. It is important to note that while IFC has improved in its speed of delivering the first disbursement, the client is also generally demanding faster delivery (client expectations of 14 weeks in 2008 compared to 20 weeks in 2005), and that the time taken is still, on average, twice as long as the client expects. The Client Survey data is supported by data from IFC's internal systems, which show that the time taken from early review of a project to commitment improved from 338 days in FY05 to 238 days in FY07.

Table 6.1: Time to First Disbursement

	2005	2006	2007	2008
Approximate time taken (no. of weeks)	47	43	30	28
Client's expectation (no. of weeks)	20	18	12	14
Difference (no. of weeks)	27	25	18	14

Source: IFC Client Survey 2005-2007.

MORE EFFICIENT USE OF HEADQUARTERS (HQ) BUILDING

6.9 Since FY03 IFC has reconfigured its space to increase seating efficiency, and will have added 730 seats altogether over the FY03-FY08 period to accommodate the increase in the number of HQ staff, as well as consultants and contractors. The building seating capacity was increased from the original design of 1,775 seats to the current level of 2,650 seats by reducing the net square footage per office from 150 to 100 sft, and per workstation from 100 to 75 sft. By compressing its existing space, IFC has saved approximately $35 million over the past six years, compared to the alternative of renting commercial space in the same area (in FY08 alone, IFC has saved about $11 million in rent). As a result of the reconfiguration, IFC average office space per staff is about 13% less (180 assignable square feet - asf[6]) than the Bank Group standard (206 asf).

PRODUCTIVITY GAINS FROM INFORMATION TECHNOLOGY

6.10 In FY09, IFC is seeking to improve productivity through information technology in two major areas: internal IT efficiency and leveraging the power of IT to improve the productivity of client-facing staff. These gains will be in addition to the near best-in-class performance of IFC's Corporate Business Informatics (CBI) Department, as compared to other International Financial Institutes and commercial banks.

6.11 Over the past twelve months, the Management Group has taken a number of actions designed to strengthen and improve the alignment of CBI with business priorities. In July 2007, new "Guiding Principles for IT" were developed and endorsed to clearly align IT decision making with Corporate priorities and sound IT development principles. Concurrently, a new organization structure, operating model and sourcing strategy were approved. With this budget cycle, substantial adjustments have been made to the funding of IT initiatives.

6.12 In combination, these efforts should result in a quicker response time, lowered total cost of application development, deployment and ongoing maintenance, and an increased ability to scale – up and down – in response to changing business requirements. Positioning CBI as a "gatekeeper" for the Corporation's best interests and relegating its development role to one of "preferred provider" are in stark contrast to its historic role of "in house, monopoly provider." This is designed to result in dramatically increased ability to focus on corporate priorities, respond to specific issues and requirements, and maintain tight cost control.

6.13 This new structure is designed to substantially increase the focus of CBI staff on leveraging the productivity of IFC at large, rather than on specific technical tasks. The greatest "return on investment" gained from IT initiatives are the hours of field-based staff that can be reallocated to high-value client interactions. With the Corporation's expansion into and increased focus on IDA countries and frontier regions, the priorities of CBI have shifted from a purely IT viewpoint to a focus on the overall business process and the proper role for automation in environments that are highly challenging from an IT perspective.

6.14 The newly-created Client Relationship Units (CRU) within CBI are a manifestation of this different approach. Staffed with seasoned professionals who understand our business, this unit will better leverage their business expertise to improve the productivity and efficient use of IT tools by client-facing Investment Officers and Advisory Services personnel.

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[6] Assignable square footage (asf) refers to typical office space areas including the circulation space and special areas that are generally dedicated to departments (e.g. meeting rooms, copy rooms, pantries) but do not include areas that serve the entire building (e.g. auditorium, fitness center, cafeteria).

SECTION VII: ADVISORY SERVICES

7.1 **Continued growth.** IFC's Advisory Services (AS) are an important and growing part of IFC's business. They contribute significantly to IFC's additionality by improving the business enabling environment for the private sector as well as the capabilities of private firms and service providers. The AS business has grown at nearly 30% per annum since 2001, and this year is no different. AS expenditures funded by both IFC and donor/partners in FY08 is expected to be approximately $230 million up from $190 million in FY07. Donor commitments to IFC's Advisory work remain strong with over $180 million in new commitments in the first nine months of FY08.

7.2 **AS portfolio targets frontier and conflict-affected states.** Over 46% of AS expenditures are going into IDA country-specific programs. The current portfolio includes 866 projects with approved value of $928 million across 104 countries, including 56 IDA and 33 conflict-affected states.

Table 7.1: Advisory Services by Region

Region	Percentage share (based on project expenditure)
Sub-Saharan Africa	28%
Central and Eastern Europe	10%
East Asia and Pacific	14%
Latin America and Caribbean	8%
Middle East and North Africa	8%
South Asia	6%
Southern Europe & Central Asia	11%
World (multi-region)	14%

7.3 **AS staffing.** Staff numbers continue to grow in support of the AS business. In FY08, the number of donor funded staff is projected to increase by about 10% to 1,025 on June 30, 2008, for a net gain of about 100. Nearly 80% of these staff are based in the field, operating from 61 offices around the globe.

7.4 **Roll-out of Climate Change Programs.** In FY08, AS made progress in the rollout of commercially viable business models related to sustainability and climate change mitigation to Brazil, China, India, the Philippines, and Russia.

7.5 **Promoting further World Bank Group Cooperation.** Guidelines have been issued to IFC AS staff to enhance the cooperation and alignment with other parts of the World Bank Group. Additionally, the World Bank Group Vice President for Financial and Private Sector Development and IFC Vice President and Chief Economist, has commenced a round of regular strategy development work planning meetings of key regional World Bank Group Staff.

7.6 **Pricing of AS Work.** In FY08, IFC introduced Corporate-wide guidelines for pricings its AS work to: (i) ensure that any subsidies are justified on public benefit grounds; (ii) strengthen client commitment; (iii) strengthen business discipline; (iv) leverage funding resources; and (v) more transparency highlighting the absence of subsidies in IFC's advisory services.

7.7 **Greater Alignment of Trust Fund Management.** Following discussion with the Board, IFC will further align its trust fund management arrangements with those of the World Bank. Key aspects of arrangements going forward are: (i) no new tied trust funds; (ii) a minimum size of $250,000 for new trust funds; (iii) in collaboration with the World Bank, evaluation of the introduction of a proposed new "Externally Financed Output" instrument for smaller, donor-funded IFC activities; and (iv) in collaboration with the World Bank and donor partners, further improvements in donor reporting arrangements.

BUSINESS LINES

7.8 Advisory Services is organized in to five business lines:

i) Access to Finance (A2F) – to expand the availability of financial services to micro and small businesses and low-income households;
ii) Business Enabling Environment (BEE) – to improve the business environment that will allow projects to be viable;
iii) Environmental and Social Sustainability (ESS) – to improve sustainability of IFC clients and through them demonstrate innovative environmental and social business models to the market.
iv) Infrastructure (INF) – to improve access to basic services in road infrastructure, telecommunications, water, energy utilities, health and education; and
v) Value addition to Firms (VA2F) – to improve the business capability of private sector companies (particularly in countries where IFC currently has limited opportunities to provide investment finance);

7.9 **Focus on Core Competencies.** Over the past year the business lines have worked to improve the focus of IFC's advisory work specifically to concentrate on the development and delivery of AS projects in areas of core competence for IFC. We define these areas through products considered 'developed' or 'in-development.' Developed products have considerable scale, have been replicated across regions and bring a strong evaluation history with positive results. Products in-development are also highly demanded but require more time to come to scale and full replicability. The intention of our product specialization is to ensure that we develop and leverage core competencies supported by expert staff and informed by robust, repeated measurement. Our target is 80% of AS spending goes to developed and in-development products. Of course we must preserve space for innovation and for highly specialized interventions that are particular to a given market but may never be fully scalable.

Table 7.2: Advisory Services by Business Line and Products

Business Line of Product	Product Type	Product Name	FY08 Q3 YTD Project Expenditure
A2F	Developed	Credit Bureaus	2%
		Leasing & Non-bank Financial Institutions	2%
		Microfinance	5%
25%		SME Banking	6%
	In Development	Collateral Registries / Secured Transactions	0%
		Energy Efficiency Finance	1%
		Housing Finance	4%
		Sustainability Finance	0%
BEE 21%	Developed	Business Entry	5%
		Licensing, Permits & Inspections	4%
	In Development	Alternative Dispute Resolution	1%
		Business Taxation	1%
		Investment Policy & Promotion	2%
		Sub-National Doing Business	1%
ESS 11%	In Development	Sustainable Energy	3%
		Biodiversity	3%
		Social Responsibility	3%
		Sustainable Investing	1%
INF 14%	Developed	Advisory Mandate	9%
	In Development	Support for Extending Access	0%
VA2F 30%	In Development	IFC Against AIDS	1%
		SME Toolkit	0%
		Corporate Governance	5%
		Linkages	6%
		Business Edge	1%
Total Developed and In Development Products			68%
Total Other Products			32%
Total			**100%**

7.10 **Results Measurement commitment.** IFC is committed to the robust measurement of results and development impact from our advisory business. In fact, donor and NGOs recognize IFC as the leader and standard-setter for measurement of advisory work. IFC organizes meetings twice a year to facilitate the exchange of ideas and experiences among academics, foundations, donors and other partners.

7.11 **Results Measurement tools.** The Advisory Services Results Measurement unit develops tools specific to each business line and product area including standard performance indicators on outputs, outcomes and impacts used for project supervision and project completion reports. As of October 2007, 552 project completion reports had been submitted, including 300 reviewed by IEG. Overall success rates for Development Effectiveness are 70%. Because impacts of most advisory projects take longer to materialize and measure, we are now beginning to track development results past the operational completion of a project. Key indicators may be tracked for up to 5 years.

7.12 **External Program Reviews.** In addition to the self-reported performance ratings assigned through supervision and project completion reports, IFC uses external measures to assess the advisory business. These reviews are learning focused and look for lessons of experience and ways to improve the measurement of results. The reviews are used to refine on-going projects and to shape designs of new projects. Thirty reviews have been completed or are underway currently.

7.13 **Experimental/Randomized Trials.** The most robust method of evaluation used in advisory services is experimental design. Unlike investment projects where clear market tests such as ERRs are present, advisory services lack such clear market benchmarks. In order to objectively measure and attribute the impact of IFC's work, experiments are constructed using control and target groups. We conduct these experiments in partnership with leaders in this field including MIT's Poverty Action Lab. Currently 31 experimental trials are completed or underway.

Table 7.3: External Reviews and Experimental Designs by Business Line

Business Line	External Reviews	Experimental Designs
A2F	8	2
BEE	5	8
ESS	6	4
INFR	2	3
VA2F	9	14
Total	**30**	**31**

Designation of Retained Earnings for FMTAAS

7.17 On September 24, 2007, the Board approved IFC's proposal to designate $170 million of retained earnings for FMTAAS, bringing the total FMTAAS designation envelope since inception to $750 million. An analysis of current spending leads to an estimate for total spending against this envelope of $300 million by June 30, 2008. The spending limit for FY09 has been set at $130 million. Based on FY08 financial results, Management will propose a further net income allocation at the beginning of FY09.

SECTION VIII: HUMAN RESOURCES AND STAFFING

8.1 IFC's human resource (HR) strategy has matured from rapid expansion to managing growth. The strategy continues to support the decentralized business model with the objective of enhancing IFC's impact on the ground. To this end, IFC will further accelerate decentralization of its operations, based on regional business needs and development impact opportunities, particularly in frontier regions. The FY09-FY11 proposed growth strategy for IFC—to place the right professionals closer to the clients to provide more programmatic impact—requires budget resources to support a more geographically dispersed workforce. One of our priorities is to ensure that a decentralized staff is equipped to represent IFC in a consistent way to our clients globally.

8.2 **Staff Growth Led by the Field.** IFC's workforce has increased by 67% from 1,957 staff in FY01 to 3,270 staff in FY08 (as of March 31, 2008). IFC's business strategy is highlighted by the fact that today 53% of IFC's total staff is based in the field compared with 50% at the end of FY07, and 32% in FY01. In addition, since FY01 regionally based investment staff grew by 169%, while Washington-based investment staff decreased by 2%.

8.3 To help manage IFC's growth and mitigate potential risks associated with decentralization, the HR function will also further decentralize operations. In FY09, IFC will have three HR Heads in the field with increased decision authority within HR guidelines. A decentralized human resource function provides our growing field-based staff with better access to client services.

8.4 IFC is preparing to introduce a new global career framework, that will provide field-based staff with stronger development opportunities. Already about two-thirds of corporate-led training programs were held in the field in FY07 and FY08. Entry into the managerial cadre also requires significant experience in a developing country.

8.5 **Recruitment.** For FY08, IFC projects to increase the number of staff funded from the administrative budget by about 4.3% or about 100 staff to about 2,300 on June 30, 2008. The number of donor funded staff is projected to increase by about 10% to 1,025 on June 30, 2008, for a net gain of about 100. Projected turnover in FY08 in the staff funded from the administrative budget is nearly 8%, up from 7% in FY07. For donor funded staff, projected turnover is nearly 15%. The total expected recruitment for FY08 will be about 500 staff, more than twice as high as the net increase, due to staff turnover. This will bring total staff at IFC (administrative budget plus donor funded) to around 3,325 on June 30, 2008.

8.6 For FY09, the number of staff funded from the administrative budget is projected to increase by about 6.5%, to about 2,450 on June 30, 2009, for a net gain of about 150 staff. Following implementation of the decentralization pilot in the South and East Asia regions, in FY09 Africa, Latin America and Caribbean, Southern Europe & Central Asia, and Central & Eastern Europe are shifting more of their resources and authorities from Washington to the field. Recruitment and relocation efforts in these regions will increase accordingly. In total, to cover staff turnover as well as net growth, 260 to 280 staff are expected to be hired from the administrative budget (mostly in the field), with about 180 of these at Grade F and above. Staff recruitment from donor funds for FY09 will be around 160 to 180. The number of donor funded staff, however, is projected to increase by about 2% during FY09 to about 1,045 on June 30, 2009 (90% of whom will be in the field, and the great majority will be on coterminous contracts), for a net gain of about 20 staff. Table 8.1 provides a breakdown of staff numbers between HQ and the field for staff funded from the administrative budget. Table 8.2 provides the same breakdown for donor funded staff.

Table 8.1: Number of Staff funded from Administrative Budget

	As of June 30, 2007	Estimate as of June 30, 2008	Projected as of June 30, 2009
HQ	1,467	1,472	1,495
Field Based	738	828	955
Total	**2,205**	**2,300**	**2,450**

Table 8.2: Number of Staff funded from Donor Funds

	As of June 30, 2007	Estimate as of June 30, 2008	Projected as of June 30, 2009
HQ	83	110	115
Field Based	846	915	930
Total	**929**	**1,025**	**1,045**

8.7 To achieve IFC's growth strategy, the proposed budget increase for FY09 is focused primarily on strengthening operational capacity to more effectively and efficiently meet client needs while enhancing development impact. Following the successful decentralization pilot in the South and East Asia regions, in FY09 Africa, Latin America and Caribbean (LAC), and Southern Europe and Central Asia (SECA) are shifting more of their resources and authorities from Washington to the field. Recruitment and relocation efforts in these regions will increase accordingly. In particular, this will entail ramping-up the recruitment of mid-career and entry level professionals in regional offices, with a focus on Africa and the LAC regions. Lastly, operational support and service departments, such as Legal and Environment & Social Development departments are projected to grow, in parallel to business growth in core operations, and are expected to focus their staff growth in the field.

8.8 During FY07-FY08, recruitment in many regions has been a major challenge, particularly when recruiting mid-career local staff with finance and investment backgrounds. In FY08, only 43 out of 106 mid-career positions originally planned in the field have been filled with external candidates. Even though labor market conditions are beginning to be more favorable for employers, IFC continues to face a major recruitment challenge as it competes for talent in competitive employment markets worldwide. Based on market data and on rejections of offers from IFC, IFC believes that finance/investment professionals with experience in emerging markets will continue to command competitive salary packages. IFC's recruitment experience in FY08-FY09 shows a more acute challenge to attract experienced finance professionals with local compensation packages in markets such as China, Russia, South Africa, Brazil, and India. In order to meet its objectives, IFC will need to find alternatives to hire local experienced staff more effectively.

8.9 **Compensation Implications.** In light of the external labor market demand for the skill-sets and global experiences of IFC investment staff, coupled with private sector compensation packages, IFC continues to experience constraints in hiring and retaining staff. The turnover of investment staff continues to increase, particularly with staff who have 5 to 8 years of experience with IFC; for example, 34% of the investment staff who joined IFC in FY01 have left the organization. IFC is working closely with IBRD to investigate opportunities to implement a more market-sensitive and performance-based framework. This could help mitigate some of IFC's staffing challenges.

8.10 **Performance Awards and Long Term Performance Awards (LTPA).** To help address the compensation challenges, IFC continues to implement and enhance its Performance Awards programs. This year, IFC is including a FY09 budget of $4.43 million for the existing Annual Performance Awards Program, or 1.1% of payroll since 2004.

8.11 In addition, the Long Term Performance Awards (LTPA) program, as authorized by the Board, allows IFC management to use the full amount of the Market Premium to fund the program (in FY09, the amount of the Market Premium for Investment Officers is equivalent to about $7.7 million) and to carryforward any unused funds for 3 years. After several years of testing the implementation methodology, IFC expanded the program to better align awards with the recognition for performance and alignment with IFC's priorities on development impact and serving the neediest. IFC is presenting an FY09 budget request of $2.67 million for long-term awards, 11% more than in FY08, in order to reach more high performers, keep pace with staffing growth and introduce several new award programs that focus on results in IDA countries.

8.12 IFC's experience with its Performance Award Program has been very successful, has helped to introduce new ways to highlight and recognize development results and has increasingly focused on team efforts. As special recognition for development achievements, and to recognize outstanding teamwork, IFC plans to expand its award coverage beyond the 25% of staff authorized by the Board. In the World Bank Compensation Paper, scheduled to be presented to the Board in May 2008, IFC will be requesting Board approval to exclude team awards from the coverage limit of 25%[7]. The expansion of IFC's award programs, including award criteria linked to development results, and an increase in the number of team awards, has been encouraged by the Personnel Committee (PC).

[7] Overall award coverage is expected to remain below 40% of staff due to budget constraints and selection criteria.

8.13 **Enhancing Diversity.** Maintaining diversity continues to be a key corporate priority in recruiting new staff. IFC has taken many steps to improve diversity and inclusion in the corporation. Going forward, IFC's decentralization strategy will foster and encourage an enhancement of diversity by building a truly global organization, with opportunities for recruitment and development from a wider net of regional and national representation. FY08 Corporate diversity indicators are as follows:

i) Percentage of professional and senior women increased:
- Grades F and G Women increased to 43.1% up from 41.1% in FY07.
- Women in Grade H and above increased to 25.3% up from 24.3% in FY07.

ii) Percentage of professional level Part 2 countries and Sub-Saharan African & Caribbean nationalities was broadly stable:
- Sub-Saharan African & Caribbean nationalities represent 9.0% of staff Grade F and above on international contracts (FY 07 9.2%)
- Part II staff in Grades F and above represent 42.1% (FY07 42.8%).

SECTION IX: CAPITAL BUDGET

9.1 The Corporation's capital budget funds Headquarters (HQ) and Country Office (CO) facility needs, as well as centrally managed IT projects. For FY09, the total recommended capital budget is $89.9 million.

Table 9.1: FY09 Capital Budget Proposal
US$ millions

	FY08 Budget	FY09 Proposed Budget
CO Facilities	31.1	16.7
Central IT Projects	36.1	64.5
HQ Facilities	4.7	7.2
Contingency	2.5	1.5
Total	**74.4**	**89.9**

COUNTRY OFFICE (CO) FACILITIES

9.2 The FY09 CO Facilities capital budget supports IFC's continued push to decentralize and grow in the field. IFC has 107 offices throughout the world, with relocations for Lagos, Manila, and Mumbai scheduled for FY09. The requested amount of $16.7 million will be used to fit out approximately 35 Country Offices, most of which are in Sub-Saharan Africa.

9.3 Planning continues for buildings in Accra and Nairobi for which capital budgets of $9.7 million and $15.9 million, respectively, were approved in FY07 and FY08. The projected staffing for Accra has increased since the original cost estimates were developed bringing current project cost estimates to $11.9 million.

9.4 IFC is embarking on a more structured long-term planning process to implement its decentralization plans with greater focus on IDA countries. Rigorous criteria are being developed to ensure the cost-effectiveness of Country Office construction programs while balancing safety and security concerns.

CENTRAL IT PROJECTS

9.5 Information is one of the core assets of every financial institution. As IFC responds to changes in markets and growth, the judicious and creative application of information technology is essential to its success. This reaches well beyond traditional automation and includes a thorough review of IFC's overall business approach and processes, seeking advantage by leveraging global capabilities to support a global business.

9.6 As IFC continues to move its operations closer to its clients, IT capabilities will be essential to ensuring that the Corporation's global expertise is available to local clients. Simultaneously, decentralized operations demand more rigorous risk management, which can only be achieved through more sophisticated and robust business intelligence capabilities.

9.7 All of this will require a different approach to developing and deploying IT assets. Over this planning horizon, the Corporation's IT function will focus on building Corporate-wide platforms, based on commercially available software implemented through outsourcing partners, rather than its traditional approach of building customized applications focused on individual departments. Some smaller, department-specific systems will still be required, but will be pursued on an exception basis rather than as a rule.

9.8 This revised operating model is designed to mitigate operational and technological risk across several categories. Market-leading commercial software benefits from substantial ongoing vendor investment to enhance functionality, improve security and leverage new technology, which greatly extend the useful life of IT investments. Widely deployed software has a larger pool of skilled resources available in the market, lowering the Corporation's reliance on a single person or partner. Most importantly, these benefits create a virtuous cycle that will improve the responsiveness of IT to dynamic business requirements.

9.9 FY09 also includes the replacement of a large number of PC's as part of WBG-wide deployment of an updated PC software suite (Enterprise Desktop 5) for both desktops and laptops. Rather than continue with the longstanding approach of a quadrennial wholesale replacement of all PCs, IFC will shift to an annual partial refresh. Over time, this approach will level out the capital budget requirement year on year; it will also lower the average age of the PC population, improving IFC's ability to deploy leading edge tools and technologies. In addition, IFC will adopt a general policy that limits the number of PC's to only one per person.

9.10 The total capital budget requested for Central IT systems of $64.5 million comprises:

- $13.5 million to maintain steady state operations;
- $17.2 million for projects which are mandatory (e.g., replacement of the equity accounting system);
- $20.0 million for major discretionary programs; and
- $13.8 million for the Enterprise Desktop 5 PC replacement program

9.11 **Accomplishments.** There was substantial progress on the work program in FY08 including several major projects conducted in collaboration with IBRD/ISG:

- *Electronic Content Management.* IBRD-IFC joint initiative. Completed the pilot and conducted IFC architecture study with roadmap for platform implementation at a cost of $2.0 million; platform deployment is scheduled for FY09 for an additional $2.0 million.

- *Global Telecommunications Improvements.* IBRD-IFC joint initiative. Continued deployment of Multi Protocol Label Switching (MPLS) that enhances speed, capacity and quality while reducing the cost. This project began in FY07 and is projected to complete by the end of FY08. To date, 40 out of the planned 45 offices have been successfully migrated to MPLS. The remaining 5 offices will be converted by the end of June 2008. Total estimated cost for this project is $2.1 million of which $1.5 million was spent in FY08 for the MPLS installations.

- *Country Office IT Infrastructure Upgrade*. Continued upgrade of the IT infrastructure of selected country offices with data acceleration devices (Peribit) which make it easier and faster for staff to transfer voluminous files between Country Offices and HQ. The installation in 45 offices will be completed by the end of this fiscal year with $0.4 million expended in FY08.

- *iDESK 3.0.* Upgraded the underlying platform software and redesigned the constituent applications resulting in improvements in system performance, functional capacity, and availability at a cost of $4.5 million.

- *Project Management Platform.* IBRD-IFC joint initiative. Procured a commercial project management product to be used for IT Governance, Development Outcome Tracking, and Advisory Services Project Management. Implementations totaling $5.3 million are planned for FY09.

- *Capital Pricing and Risk (CAPRI).* Deployed the Risk Adjusted Return on Capital (RAROC) and Product Costing (PCA) modules at a cost of $0.8 million, thus completing the phased implementation begun in FY06.

- *Advisory Services*. Deployed new budgeting tool, project management and supervision functionality, and a new information delivery component at a cost of $2.5 million, providing integration and facilitating standardization of processes and systems across all DFOs.

- *Corporate Value at Risk (CVaR)*. Deployed the first module, Liquid Asset Management Phase 1, at a cost of $1.1 million. The CVaR system will enable IFC to measure and understand the market risk across the entire Corporation with a common yardstick, efficiently allocate IFC's capital and improve risk-adjusted returns, hedge undesired risk exposures and reduce potential losses, identify offsetting risks and allow IFC to achieve a higher potential return for the same aggregate risk exposure, and reduce hedging costs by monitoring and hedging risk exposures on a Corporate-wide instead of on a transaction-specific basis.

9.12 **Performance Metrics.** Delivery of IT services at IFC is benchmarked annually to other International Financial Institutions (IFIs) and the financial services sector[8]. Results indicate that IFC's IT spending per staff of around $11,900 p.a. compares well to that of other IFIs which range from $5,200 to $57,400, while commercial industry averages range from $11,700 to $25,000. IFC's average headcount ratio of IT staff to total institutional headcount is at 8.3% which is also well in line with the IFI range of 4.3% to 19.6% and the commercial industry average of 10.4%. IFC's average IT spending ratio, compared to total institutional expenditures is 9.1% compared to an IFI range of 4.9 to 19.6%.

HQ FACILITIES

9.13 The FY09 capital budget for HQ Facilities of $7.2 million reflects (a) the age of the F building, now in its 11th year; (b) the rising cost of energy and IFC's focus on sustainability; and (c) the increase in the occupancy of the F building. The funding will allow for a retrofit of the cafeteria, necessary carpet replacement, further office compaction to accommodate incoming staff, energy conservation measures, and other projects.

[8] Based on data obtained from Gartner and MIT's Center for Information Systems Research.

SECTION X: TOTAL RESOURCES

10.1 The total resources used by IFC to deliver its overall operational program and development strategy are larger than the Total Budget alone. They include items such as Contributions to Advisory Services (AS), and special programs approved by the Board in addition to the Total Budget. They also include funding sources such as fees from clients (e.g., for external legal advice). In addition, there are resources such as those provided by donors which are entrusted to IFC and which are outside of its financial statements but are key in supporting advisory type developmental activity. Table 10.1 provides a comprehensive statement of the total resources that are needed and used to deliver IFC's full development impact. The table includes all items of this kind that have been approved by the Board or will be presented for Board approval this year.

Table 10.1: Total Resources
US$ millions

	FY08	FY09 Real Budget	FY09 Nominal Budget
I. Total Budget	**597.9**	**656.4**	**671.9**
II. Carry-forward of Unspent Budget from Previous Fiscal Year	**26.6**	**29.8**	**29.8**
III. Special Initiatives	**5.3**	**6.0**	**6.0**
Strategic Initiative for Sub-Saharan Africa	2.0	0.8	0.8
IDA/IFC Initiative for SME Support in Africa	0.9	0.6	0.6
InfraVentures	1.4	3.6	3.6
PBGI- Access to Infrastructure	1.0	1.0	1.0
IV. Environmental/Social Mediation and Conflict Resolution Contingency Fund	**0.0**	**0.4**	**0.4**
V. Contributions to Advisory Services (AS) Programs (FMTAAS)	**125.0**	**130.0**	**130.0**
VI. Jeopardy Expenses	**7.0**	**15.0**	**15.0**
VII. Expenses associated with IFC's Treasury & portfolio activities	**9.4**	**12.4**	**12.4**
a. Borrowing Expenses	2.5	2.5	2.5
b. Custody and Settlement Costs	6.6	9.6	9.6
c. Structured Finance	0.3	0.3	0.3
VIII. Expenses offset by fee income	**39.1**	**54.1**	**54.6**
a. Client Fees	20.0	30.0	30.0
b. Advisory Services Administrative Fees	9.4	11.4	11.7
c. Privatization Fees	2.0	4.1	4.2
d. Portfolio Supervision Fees	3.5	3.0	3.0
e. B-Loan Administration Fees	3.1	3.1	3.2
f. Mobilization Fees	1.1	2.5	2.5
TOTAL	**810.2**	**904.0**	**920.1**

Resources Not Reflected in IFC's Financial Statements	FY08	FY09	FY09
Donor Contributions to Advisory Services	**125 - 145**	**190 - 210**	**190 - 210**

SPECIAL INITIATIVES

10.2 **Strategic Initiative for Sub-Saharan Africa.** The Strategic Initiative for Sub-Saharan Africa was approved by the Board on August 26, 2003, and focuses on enhanced support to SMEs in the region, more active engagement in improving the investment climate and proactive project development to support IFC direct investments. Funding for the initiative was approved as a $15 million one-time special allocation separate from the Corporation's Regular Budget for the period FY04 to FY06, with a subsequent extension up to June 30, 2008. The expected remaining balance of funding for the initiative at the end of FY07 is $0.8 million.

10.3 Management now requests the approval of the Board to extend the term of the Strategic Initiative for an additional two year. The remaining funding for the initiative will be directed at the completion of identified priority programs, including Sector Mapping especially in the agribusiness sector.

10.4 **IDA/IFC Initiative for SME Support in Africa.** The Joint IDA-IFC Micro, Small and Medium Enterprise Development Pilot Program for Africa, presented to the Board in December, 2003, is an initiative to support private sector development in Sub-Saharan Africa through the complementary and parallel use of IDA and IFC instruments. The Program was a response to requests from IDA, African stakeholders and key World Bank Group shareholders to devote resources to innovative approaches to MSME development in Africa. An indicative program of approximately $220 million (combined IDA and IFC resources) was proposed to support seven projects in Ghana, Kenya, Madagascar, Mali, Nigeria, Tanzania, and Uganda,. The joint projects address constraints in the areas of: i) Access to Finance; ii) Business Environment for MSMEs; and iii) Access to Capacity Building Services.

10.5 To date, all seven IDA country projects have been approved and are "effective". Implementation of these projects is still progressing, as is the design and approval of the parallel IFC investments. Total Program funding (IDA, IFC & others) is now expected to be of the order of $400 million.

10.6 Implementation of the program is continuing. Funding of $3 million was approved by the Board to support project preparation and implementation activities. Currently, just over $0.6 million remains unspent, and Management proposes to use these funds beyond June 30, 2008 rather than requesting incremental budget funding. These funds are proposed to be utilized to support the final preparation and structuring of related IFC investments in Ghana, Senegal and Mali; the further development and implementation of an overall Program results measurement framework; and for support to develop new associated IDA-IFC initiatives in Africa.

ENVIRONMENTAL/SOCIAL MEDIATION AND CONFLICT RESOLUTION CONTINGENCY FUND

10.7 The Environmental/Social Mediation & Conflict Resolution Contingency Fund was established in FY03 for an initial three-year period to cover the costs incurred in resolving exceptionally complex mediation or conflict resolution cases. The costs covered by the Fund are out-of-pocket expenses directly related to a handful of specific cases. The Fund is not used to cover any of the ongoing costs of the CAO. The established practice is for the Fund to be replenished periodically to the full original amount of $0.8 million.

10.8 This year the Board is being asked for formal authorization for the continuation of the Fund for a further three-year period with replenishment each year as required. For FY09 the amount of the required replenishment is projected to be about $0.4 million.

JEOPARDY EXPENSES

10.9 IFC designates a project as being a jeopardy case when the prospects for recovery of IFC's investment are in serious doubt due to expected future loan defaults, country/industry considerations, stock market factors or other factors as determined by Senior Management. The restructuring or recovery of such jeopardy cases often generates significant out-of-pocket expenses (e.g. for travel, consultants, auditors, and legal fees). To facilitate the tracking and reporting (and often the reimbursement) of these extraordinary jeopardy expenses, IFC sets up a separate expense account for each jeopardy case. The Board has traditionally recognized jeopardy expenses as being off-budget since, in the majority of jeopardy cases, IFC's ultimate recovery on its investments amounts to many times the expenses spent in the recovery process. The ceiling for FY09 is proposed to increase to $15 million to allow greater flexibility in the event of stress on IFC's portfolio given the current uncertainty in global financial market.

EXPENSES ASSOCIATED WITH IFC'S TREASURY & PORTFOLIO ACTIVITIES

10.10 **Market Borrowings.** Expenses associated with IFC's market borrowings comprise three major elements: i) costs incurred in direct connection with specific market borrowings – outside legal counsel fees, auditor fees, travel costs, prospectus printing costs, press notification costs, etc.; ii) rating agency fees; and iii) non-liquid asset management market communication costs (Bloomberg, Reuters, etc.).

10.11 **Custody and Settlement Costs.** Earnings from IFC's liquid asset portfolio (LAM) are used to pay custody fees to State Street Bank and other external managers of these portfolios. IFC pays custody and settlement fees to the custodians of its equity and liquid asset portfolio, State Street Bank and Citibank.

10.12 **Structured Finance.** This represents the out-of-pocket costs related to business development for IFC's structured and securitized products.

EXPENSES OFFSET BY FEE INCOME

10.13 The Corporation charges its clients fees to offset many of the out-of-pocket expenses associated with the appraisal and supervision of investment projects; these are commonly called reimbursables. The reimbursables generally include costs for travel, consultants, and legal counsel. The Corporation also receives privatization fees, and mobilization fees to offset direct expenses associated with these activities.

SECTION XI: RECOMMENDATIONS

11.1 Management recommends that the Board resolve to approve the following:

I. ADMINISTRATIVE BUDGET AUTHORITY

Administrative Budget

a) A total budget for FY09 of $671.9 million.

II. CAPITAL BUDGET AUTHORITY

Capital Budget

b) A capital budget for FY09 of $89.9 million.