

IFC ROAD MAP, FY09-11

**Creating Opportunity:
Doing Our Part for an Inclusive and Sustainable World**

**Released in accordance with IFC's Policy on Disclosure of Information,
following discussion by IFC's Board of Directors on March 27, 2008.**

International Finance Corporation

IFC Road Map, FY09-11

Table of Contents

EXECUTIVE SUMMARY	i
I. INTRODUCTION	1
II. CREATING OPPORTUNITY: DOING OUR PART FOR AN INCLUSIVE AND SUSTAINABLE WORLD	1
Context	1
Highlights of Achievements	2
IFC's Contribution to the World Bank Group's Strategic Themes	8
Strategy Developments.....	10
Moving Forward: Strategy Implementation	13
III. CHALLENGES	21
Introduction	21
Counter-Cyclical Preparedness	21
Risk Management and Financial Capacity	23
Human Resources.....	26
Managing Global Knowledge.....	28
IV. CONCLUSION.....	30
Chart II-1: IFC Additionality (as a % of total projects) – FY05-07 Commitments	6
Chart II-2: IFC's Business Model – Illustrative Framework.....	12
Chart II-3: Illustration of Resource Intensity of IDA and Non-IDA Projects	17
Chart II-4: Commitment Projections (mid-points)	20
Chart III-1: IFC and S&P One Year One Year Default Rates (FY86 – FY07).....	24
Chart III-2: IFC Income Volatility (FY93 – FY07)	25
Table II-1: Summary of Progress on Key Development Impact Indicators Compared to Targets .	3
Table II-2: Commitments in IDA Countries and Frontier Regions.....	4
Table II-3: Compound Annual Growth Rate of IFC Commitments.....	20

Note to Readers: This paper is accompanied by a Background Paper which discusses the external environment and provides a progress update on IFC's five priorities and regional strategies. The Background Paper also has a section on IFC's Approach to Climate Change and attaches the list of frontier regions in non-IDA countries and the full Corporate Scorecard.

"Globalization has become the defining mark of our time. It has lifted barriers and boundaries, and unleashed movements of ideas, goods, capital, and people. It has created opportunities where there were none.

Yet globalization has not embraced all. Many remain on the fringes, and some are falling further behind. Exclusion, grinding poverty, and environmental damage create dangers. The ones that suffer most are those who have the least to start with - indigenous peoples, women in developing countries, the rural poor, Africans, and their children.

It is the vision of the World Bank Group to contribute to an inclusive and sustainable globalization - to overcome poverty, enhance growth with care for the environment, and create individual opportunity and hope."

Robert B. Zoellick

"Despite strong growth in the past decade, challenges remain in emerging markets, and these are driving IFC's strategy.

Many millions of people in IDA countries, in smaller, less developed markets, and in conflict-affected countries have not yet shared in the benefits of private sector growth. Poor infrastructure, lack of access to financing for smaller businesses - to name just two - are significant challenges that require innovative and bold approaches.

IFC is able to play a bigger role and tackle these challenges because we have made a strategic decision to take a larger number of well managed risks, as a member of the World Bank Group. "

Lars H. Thunell

EXECUTIVE SUMMARY

1. IFC is a leader and innovator in private sector development. At a time when a strong private sector is vital for sustained growth and when the needs in developing countries are still significant, it is important for IFC to send the right signals by maintaining the momentum of its achievements while also standing ready to respond to counter-cyclical demand. As the largest global development institution focusing on the private sector and, as part of the World Bank Group, IFC has a unique role to play in promoting development of a strong private sector, doing its part for an inclusive and sustainable world.
2. *IFC has reached the development impact targets of its three-year plan.* IFC has met the Board-endorsed targets and benchmarks in all the key priority areas of the Corporate Scorecard agreed with the Board in 2005: commitments in frontier countries; in Sub-Saharan Africa; in micro, small and medium enterprises; in infrastructure, health and education; and in the financial sector. IFC's strong development results have been supported by leadership in development results measurement, with the launch of the Development Outcome Tracking System in 2005, as well as increased focus on additionality and reaching those most in need in its client countries.
3. *Scaling Up Impact.* These successes and IFC's overall growth place IFC in a strong position to build on the momentum of its achievements as it plans for scaled-up impact over the next three years. Adapting to market needs, IFC last year adopted new approaches in pursuit of its key corporate Goal of greater development impact, and has continued to build on these: (i) reaching the underserved through innovation and increased focus on poorer markets, in particular IDA countries; (ii) programmatic approaches to extend IFC's activities and impact beyond the individual project; and (iii) becoming more client-centered through further decentralization and other means in order to meet the needs of the increasingly local client-base and reach further into frontier markets. This year, recognizing the extent of the challenges and opportunities posed by climate change, IFC is proposing to add addressing climate change to its priorities as part of a World Bank Group approach. With this proposed new area of emphasis, IFC's key priorities remain as relevant as ever. They will guide IFC, working together with other members of the World Bank Group, to continue to promote inclusive and sustainable globalization in pursuit of IFC's vision that people should have the opportunity to escape poverty and to improve their lives.
4. *Balancing Developing Country Needs.* Despite strong overall growth in developing countries, there is persistent poverty, and income inequality has increased for many countries over the past two decades. Although private capital inflows continued to be strong in 2007, most international loan syndications to the private sector in developing countries were still going to non-IDA countries. International financial institutions (including IFC) have further scaled up their private sector activities, but there remain large financing gaps particularly for poorer markets and in key areas such as infrastructure investment. However, the uncertainty in many markets points to (i) the increasing likelihood that IFC will be asked to assume its counter-cyclical role, and consequently (ii) the challenges ahead in balancing demands on multiple fronts while also maintaining IFC's financial strength.
5. *Managing Growth.* IFC's compound annual growth rate over the three-year plan period (FY05-FY08) is estimated to be 23-25%, greatly exceeding what was envisaged in 2005. IFC has achieved this while increasing its focus on development impact and additionality, remaining profitable, growing its portfolio, significantly decentralizing operations,

increasing staff and adapting to emerging needs. Nonetheless, while IFC's portfolio remains strong, the growth has highlighted several areas which need strengthening, particularly in the context of IFC's shifting business mix and worsening market conditions. IFC therefore plans to devote additional resources to areas such as risk and portfolio management.

6. *Maintaining Momentum.* IFC Management thinks that the best way to meet the significant needs and challenges in developing countries and preserve IFC's ability to respond in a counter-cyclical situation is to maintain the momentum of its growth while simultaneously addressing the relevant aspects of its internal infrastructure. This Road Map presents a growth path that would enable IFC to address internal infrastructure needs, as well as compensate for the weak dollar, while keeping momentum with regard to its past achievements, and continuing the strategic shifts to greater investment in poorer frontier markets and to climate change business.
7. *Challenges.* As IFC moves increasingly to frontier markets, adds climate change activities to its areas of focus and strengthens its internal infrastructure, it remains clear that the key constraint for IFC to scale up its impact continues to be the measured pace of resource expansion, which is outpaced by increases in demand. This constraint could also impact IFC's ability to address other challenges, such as the need to assume its counter-cyclical role as markets deteriorate and to manage its human resources in a decentralizing institution. IFC is confident that, with the Board's guidance and support, it will be able to address these challenges and remain a leader in the delivery of development impact where it is most needed.
8. *Conclusion.* As IFC continues on the path of greater development impact in pursuit of its vision, it does so in the belief that maintaining the momentum of its growth is critical to its success. In this regard, Directors are particularly requested to give Management their views on the following elements:
 - a. Do Directors agree with Management's recommendation that IFC undertakes the growth path as outlined in this Road Map?
 - b. Do Directors continue to support the thrust of IFC's priority areas as described in this Paper?
 - c. What guidance would Directors give Management on the appropriate focus between counter-cyclical work and the push to the Frontier?

I. INTRODUCTION

1.1 This paper consists of two parts and a conclusion. The first presents IFC's approach to increasing its impact over the coming three-year period, building on the achievements of the past three years. The second discusses the main challenges IFC faces and the approach to meeting those challenges. This paper is accompanied by a Background Paper which discusses the external environment and provides a progress update on IFC's performance, and in particular on achievements in its five priorities and regional strategies. The Background Paper also has a section on IFC's proposed approach to climate change and attaches the list of frontier regions in non-IDA countries and the full Corporate Scorecard. Readers are encouraged to read both documents together and to take into account the rich information presented in the Background Paper when reviewing the proposed IFC strategy in this Road Map.

II. CREATING OPPORTUNITY: DOING OUR PART FOR AN INCLUSIVE AND SUSTAINABLE WORLD

"When a well-run business applies its vast resources, expertise, and management talent to problems that it understands and in which it has a stake, it can have a greater impact on social good than any other institution or philanthropic organization."

*Michael Porter and Mark Kramer
Harvard Business Review, December 2006*

CONTEXT

2.1 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. 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. A strong private sector is now widely recognized as an essential part of the development agenda. Both the opportunities and needs for constructive private sector engagement have never been greater. 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.

2.2 Opportunities for IFC to make a difference are significant, and the needs and demands of clients in lower income markets remain strong. The Corporation is also being asked to place an increasing effort on addressing global public goods, such as climate change. IFC's response must be seen in the context of the current increased market risks, and IFC is already seeing signs from some clients that their financing opportunities are being adversely affected. A downturn or adverse event would lead to 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. This is discussed in more detail in Section III.

2.3 At this stage in the economic cycle, and in light of its increasing decentralization, IFC must also consolidate and strengthen its internal support infrastructure. This will ensure that

IFC is ready to: (i) meet the challenges of market downturns and (ii) at the same time address the pressing needs of the poorest markets, which are riskier for private business, and tackle important development challenges such as climate change, as well as (iii) maintain the momentum of its growth. IFC must also become more efficient in order to work effectively in the more resource-intensive frontier markets. Thus the demands on IFC's capabilities and resources are expected to be substantial. 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.

2.4 In response to the considerable needs and opportunities in developing countries, in 2005 the Board endorsed IFC's ambitious three-year growth plan, which has been re-affirmed and extended by the Board in subsequent years. As discussed below and shown in Table II-1, IFC has already met or exceeded most of the development impact targets set in 2005.

2.5 The scaling-up was guided by IFC's five priorities, which had been in place since 2004 and have been consistently endorsed by the Board (with some evolution) since then. This year, in support of the overall World Bank Group focus on climate change issues, IFC is proposing to add climate change to its third pillar. It is also proposing to define frontier countries more specifically as IDA countries in order to be better aligned with World Bank Group priorities.

IFC'S FIVE PRIORITIES

Pillar 1: Strengthening the focus on frontier markets, including small and medium enterprises (SMEs) and agribusiness

Pillar 2: Building long-term partnerships with emerging players in developing countries

Pillar 3: Addressing climate change, and environment and social sustainability activities

Pillar 4: Addressing constraints to private sector growth in infrastructure, health and education

Pillar 5: Developing local financial markets through institution building, the use of innovative financial products and mobilization

2.6 With the areas of emphasis proposed to be added this year (continued expansion in IDA countries and climate change) and in previous years (agribusiness), these priorities remain as relevant as ever. Along with the corporate Goals discussed in paragraph 2.24 below, they provide the necessary framework for IFC to continue its growth and, together with other members of the World Bank Group, continue to do its part for an inclusive and sustainable world, by creating opportunities for people to escape poverty and improve their lives.

HIGHLIGHTS OF ACHIEVEMENTS

2.7 As IFC approaches the end of its first three-year growth plan, it is an opportune time to review IFC's performance.

2.8 **Development Impact.** Development impact is core to IFC's mission, and two years ago IFC formalized its importance by making greater development impact its principal corporate Goal.

2.9 *Corporate Scorecard.* Following formulation of the five priorities in 2004, IFC introduced a Corporate Scorecard with Board-endorsed FY08 development impact targets to enable Management and the Board to track progress under the priorities. As discussed in last year's Strategic Directions Paper, IFC was already on track to achieve many of these development impact targets by the end of FY07, and FY08 will see these results improve even further. Success in meeting these targets places IFC in a strong position to build on the momentum of its achievements as it plans for scaled up impact over the next three years. Table II-1 summarizes the main results achieved in FY07, estimates for FY08, and the FY08 targets originally agreed with the Board in 2005. Paragraph 2.14 describes highlights of progress with

the five priorities, which are discussed in more detail in the Background Paper. The full Corporate Scorecard can also be found in the Background Paper.

Table II-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 <i>ex-post</i> 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	63-71% ⁴	-
Ex Ante Development Impact Measures			
Commitments in Sub-Saharan Africa	\$1,379m	\$1,100-1,400m	\$735-857m
Commitments in MSME ⁵	\$2,501m	\$2,000-2,500m	\$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 Commitment Volume ⁶	37%	34% - 38%	-
Commitments in IDA Countries as % of Total Project Count	44%	43% - 47%	-
Commitments in Middle East and North Africa	\$1,217m	\$1,250-1,500m	-
Number of projects with new sponsors ⁷ as % of total number of new projects	48%	45-50%	Larger than 50%
Renewable Energy / Energy Efficiency ⁸		(actual, half-year)	
- IFC Commitments in RE/EE Component	\$477m	\$260m	EIR target for the World Bank Group
- Total Cost of RE/EE Component	\$2.0 bn	\$1.2bn	
Infrastructure; Information and Communications Technologies (ICT), Health & Education Commitments	\$1,533m	\$2,430-3,250m	\$1,500-1,800m
Financial Sector Commitments ⁹	\$3,374m	\$3,300-3,700m	\$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

2.10 *Development Outcome Tracking System (DOTS)*. In order to support greater development impact and coordinate efforts to measure IFC's development impact, IFC established a new Development Effectiveness Unit in July 2005 and launched DOTS in October 2005. The results, together with those of the Independent Evaluation Group's (IEG) 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. Learning from implementation and feedback, IFC adjusts the internal scorecards to ensure that this continues to be the case.

2.11 DOTS has allowed IFC to expand development results tracking from once-in-a-lifetime for a roughly 50% sample of projects to continuous and contemporaneous tracking of development results for the entire portfolio. Since DOTS tracks projects from inception against targets, initial results are available earlier, allowing more timely feedback into strategy and new operations. DOTS also allows IFC to articulate better 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. Soon IFC will also be able to start articulating changes over time,

and eventually achievements against initial targets, which will help IFC to refine its strategy further.

2.12 DOTS results show that in FY07, 63% of IFC's investment operations (based on rolling average for projects approved in CY98-03) 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 work done by IEG also show that in IFC's projects development impact and financial success are closely interrelated and that there is little tradeoff between financial and development results in IFC projects. Financial success of IFC's investments is crucial in order to spur private sector development, both through the sustainable success of the projects themselves as well as their demonstration effect.

2.13 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, as 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.

2.14 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 (IDA countries plus frontier regions of non-IDA countries). IFC's alignment of its frontier country definition with IDA countries should further enhance its focus on the areas of greatest need.

Table II-2: Commitments in IDA Countries and Frontier Regions

	FY05 (Actual)	FY06 (Actual)	FY07 (Actual)	FY08 (Estimates)
Total IFC Commitments (\$ million)	5,373	6,703	8,220	10,000-10,500
IDA Country Commitments	1,106	1,661	3,019	3,400-3,900
<i>As a % of Total IFC Commitment</i>	21%	25%	37%	34%-38%
Non-IDA Frontier Regions Commitments ¹	440	536	838	900-1,155
<i>As a % of Total IFC Commitment</i>	8% ²	8% ²	10%	9%-11%
IDA + non-IDA Frontier Regions Commitments	1,546	2,197	3,856	4,300-5,150
<i>As a % of Total IFC Commitment</i>	29%	33%	47%	43%-49%
Total IFC Commitments (# of projects)	236	284	299	320-350
IDA Country Commitments	76	99	132	138-165
<i>As a % of Total IFC Commitment</i>	32%	35%	44%	43%-47%
Non-IDA Frontier Region Commitments	20	23	30	29-35
<i>As a % of Total IFC Commitment</i>	8%	8%	10%	9%-10%
IDA + non-IDA Frontier Regions Commitments	96	122	162	163-200
<i>As a % of Total IFC Commitment</i>	41%	43%	54%	51%-57%

¹ For FY07 and FY08, frontier Regions have been identified for IFC's top 21 non-IDA countries (in terms of recent commitments). These Regions are listed in the Background Paper. Frontier regions were identified based primarily on per capita income with adjustments by IFC staff to reflect prevailing business risk issues in the country.

² The percentage is for actual commitments for FY05 and annualized for FY06 based on the first half results as this initial analysis was on a pilot basis for the top 9 non-IDA countries.

- *IDA Countries*. As a result of both favorable market conditions and a shift in focus, IFC has been able to increase commitments in IDA countries and frontier regions. 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). The pace particularly picked up in FY07, when IFC almost doubled its commitments in IDA countries to \$3 billion (\$1.6 billion in FY06). On the advisory services side, 44% of spending was in IDA countries.

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. Over the same period, IFC increased the number of Sub-Saharan Africa countries in which it is active with investment and advisory services from 13 in FY05 to 27 by the end of FY07.

- *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 extends its impact beyond its direct investments (which increased to \$628 million in FY07 from \$456 million in FY06), by using its convening power to promote global public goods, such as the “Better Management Practices” for commodities launched in FY04. 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. This is evidenced by IFC’s continued growth in South-South business, with a total of \$1.3 billion committed in South-South projects in FY07 (\$673 million in FY06 and \$484 million in FY05). IFC aims to achieve a balance between nurturing existing clients and working with new clients, as both offer the potential for significant development impact; development results from both DOTS and IEG indicate that repeat investments with the same client tend to have better development results. IFC aims to enhance the development impact of its investments and provide greater additionality by getting closer to its clients through decentralization, which will allow more effective service, as well as through programs such as Linkages and IFC Against AIDS, and corporate governance advisory services. 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. Decentralization will also help IFC to respond more effectively in a counter-cyclical situation.

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. 56 banks and financial institutions have now adopted the Equator Principles (45 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 is proposing to make climate change one of its areas of strategic focus, and, in collaboration with the World Bank, is formulating a climate change strategy (see Background Paper Section IV: IFC’s Approach to Climate Change).

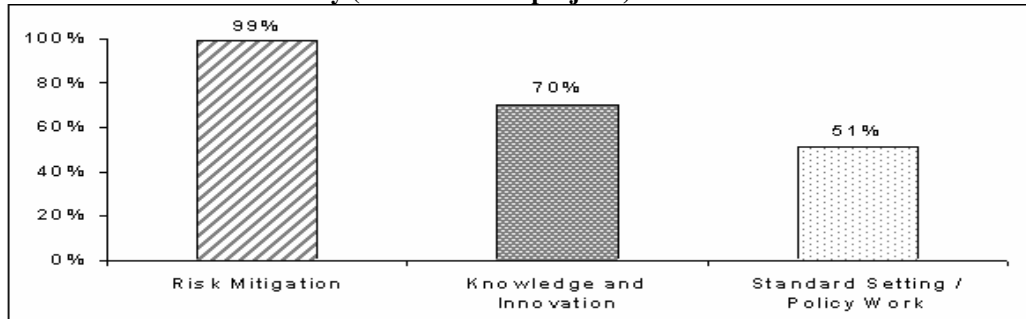
2.18 *Infrastructure, Health and Education.* Over the past three years, IFC’s commitments in these sectors have increased steadily, from \$880 million in FY05 to more than \$1.5 billion in FY07. This number is expected to increase further in FY08. IFC has recently concluded a number of landmark transactions, and is developing innovative ways to address the significant needs in these sectors, such as the new InfraVentures fund (approved by the Board in the Net

Income Paper¹ as the Global Infrastructure Project Development Fund – a \$100 million early stage equity fund in IDA countries). 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.* Access to finance and a robust financial sector are essential for sustainable private sector 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. Total commitments of IFC’s trade finance program reached \$767 million in FY07, with the issue of more than 560 guarantees, which supported \$1.2 billion of trade.

2.20 **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, but the overriding importance of additionality remains. In recent years, IFC has responded to Board feedback by further increasing the emphasis on additionality in its projects, and refining what constitutes additionality to reflect changes in IFC’s business and markets. The Additionality Technical Briefing held in November, 2007, which focused on investment projects, laid out IFC’s current thinking and also showed the strength of IFC’s additionality from various perspectives (project review, client characteristics, client surveys, IEG review and benchmarking with other IFIs). Chart II-1 shows IFC’s additionality in its FY05-FY07 commitments along the revised categories of additionality.

Chart II-1: IFC Additionality (as a % of total projects) – FY05-07 Commitments



2.21 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, as it may well be called upon to do in the near future, its additionality is particularly strong as it can swiftly provide liquidity and subsequently longer-term financing in situations where no viable financing alternatives exist.

2.22 Despite these achievements, IFC acknowledges that more needs to be done to ensure that all projects are assessed through the additionality lens, especially given the recent growth in

¹ Use of IFC’s FY07 Net Income: Retained Earnings and Designation of Retained Earnings (IFC/R2007-0275)

staff. To this end, IFC staff have prepared an Additionality Primer, which has been rolled out to staff and will be supported with training.

2.23 *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. IFC's Advisory Services business is growing rapidly, but at the same time the growth is being targeted at areas that increase the Corporation's overall additionality. This is being accomplished through a rigorous program to focus advisory work into core product areas where IFC has strong comparative advantage and by building business and human resources systems to strengthen these comparative advantages. These areas include 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 programs with strong comparative advantages are also often in areas closely tied to current or potential IFC investments, such as in infrastructure and the financial sector. Advisory services are particularly important for evolving programmatic approaches, which often include advisory work to develop the investment climate and provide technical expertise to intermediaries and ultimate clients. Advisory services also enable the Corporation to reach locations and sectors where it would be difficult to provide investment services alone.

2.24 *Corporate Goals.* IFC has set itself several corporate Goals in order to sharpen the focus on its five priorities. These Goals, first formulated in 2006, have now been rationalized into the following six: (i) greater development impact; (ii) greater client satisfaction; (iii) disciplined growth, both for IFC's account and through mobilization; (iv) greater World Bank Group cooperation; (v) maintenance of sound finances; and (vi) high quality, diverse employees who are motivated and engaged.

2.25 *Advisory Services.* IFC 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 companies, as discussed in paragraph 2.23. In FY07, AS expenditure increased 28% over FY06 and of this 44% was spent in IDA countries (see the Background Paper for more detail on Progress on AS).

2.26 *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. Plans are underway to improve further the level of cooperation. For example, as part of IFC's strategic planning exercise, in January 2008, all IFC investment departments were asked to develop action plans for greater World Bank-IFC cooperation. These covered a range of topics, including information exchange, strategy development and incentives for recognition of cooperation efforts.

2.27 Over recent years, steps have been taken to maximize the organizational synergies available. 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) 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. Cooperation is further discussed in the Background Paper.

2.28 *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, as set out in the Net Income Paper. 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 investments and advisory activities in IDA countries, this will enable IFC to increase its impact where the needs are greatest and contribute substantively to overall World Bank Group activity in these markets. A Director for the newly established IDA-IFC Secretariat is now in place and work has started to bring a greater private sector focus to World Bank Group operations in IDA countries.

2.29 Strategic Communications. In FY08, IFC recognized the importance of strategic communications by creating a Corporate Relations department with three main functions: (i) external communications; (ii) internal communications; and (iii) brand marketing. IFC is aligning its communications function to deliver on the Corporation's priorities, in particular to support an enduring corporate culture and brand, minimize reputation risk, and support decentralization and staff development.

2.30 IFC continues to develop and implement its one brand strategy, which positions IFC as the brand within the World Bank Group that focuses on the private sector as a key to development impact. IFC works closely with the World Bank External Affairs and other World Bank Group colleagues generally to ensure a shared approach on stakeholder outreach and civil society engagement.

2.31 Growth and Profitability. In FY07, IFC's program remained strong, with commitments of \$8.2 billion, compared to a high-end projection of \$7.5 billion at the time of last year's Strategic Directions Paper. Similarly strong performance is expected in FY08. These direct investments raised \$1.8 billion through the B Loan program and mobilized around another \$2.1 billion through structured finance transactions, bringing to a total of \$12.1 billion IFC's own account funding and mobilization.

2.32 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 net income reaching \$2.5 billion (\$1.2 billion in FY06 and \$2.0 billion in FY05). IFC's Return on Equity was 19%, up from 13 % in FY06.

IFC'S CONTRIBUTION TO THE WORLD BANK GROUP'S STRATEGIC THEMES

2.33 IFC contributes to and supports the World Bank Group's six strategic themes². IFC has been engaged with the Six Themes working groups, and its inputs have been reflected in their work. Examples of IFC's contributions to these Six Themes are described in the following paragraphs.

2.34 Poorest Countries. IFC pursues all its priority areas in the poorest countries. In IDA countries in particular, this means a focus on infrastructure, microfinance, housing finance, support for micro and small businesses and serving the underserved populations. IFC responds to the needs in poorest countries by listening to its clients and generating new ideas. Initiatives

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

such as the Africa Health Initiative³, InfraVentures and the proposed equity funds for SME risk capital in IDA countries (see paragraph 2.45) are aimed at scaling up IFC's activities in the health, infrastructure and SME sectors respectively. IFC uses its financial strength and global expertise to bring investments and advisory services to where they are needed most, especially to frontier markets. For example, in FY07, IFC's investments in Africa doubled to almost \$1.4 billion (\$700 million in FY06) and are expected to increase further over the coming years, focusing where the need is greatest and the challenges are toughest. The Global Trade Finance Program is allowing IFC to reach small and difficult IDA countries such as the Gambia, Rwanda and Sierra Leone.

2.35 In addition to IFC's designation to IDA mentioned in paragraph 2.28, IFC is bringing its private sector expertise to bear on joint World Bank Group strategies for IDA countries. The establishment of the joint IDA-IFC Secretariat should spur innovative joint products and services for the private sector. On the ground, IFC is working with the World Bank on business enabling environment (BEE) programs, infrastructure, SMEs and extractive industries.

2.36 Partnerships, public and private, are central to IFC's activities in IDA countries. For example, in Liberia, IFC is working with the government to address investment climate constraints. At the regional level, IFC is collaborating with the African Development Bank on advisory services programs focusing on women.

2.37 **Fragile/Conflict-Affected Countries.** IFC is innovating in infrastructure development especially in conflict-affected countries where the needs for regional integration are great. IFC has developed PPPs, such as the Moatize project in Mozambique, as traditional sources of finance are lacking and governments are recognizing the comparative advantage of the private sector. IFC is making strong efforts to develop bankable projects for future investment, and the InfraVentures fund is an example of these efforts. Collaborating with the World Bank, MIGA and other partners has been key in delivering results in these difficult markets. In terms of sectors, IFC is expanding its investment and advisory services in infrastructure, agribusiness, financial market products targeting women and SMEs, and health and education in countries affected by conflict. IFC is on the ground in post-conflict countries, in Democratic Republic of Congo (DRC), Lebanon and Liberia, and is focusing on advisory work that improves the business enabling environment. For example, in DRC, the IFC Linkages Program is working closely with investment teams to identify opportunities and design interventions which will enable local businesses to benefit from economic growth. Greater discussion of IFC's post-conflict initiatives can be found in the Background Paper – Progress Update.

2.38 **Middle Income Countries.** IFC is committed to being a long-term partner, prioritizing innovation and client satisfaction in meeting the needs of emerging players in developing countries and helping them cross borders through South-South investments. IFC is exploring further South-South investments with companies in Brazil, China, India, the Gulf States and North Africa. In addition, the joint World Bank-IFC team is scaling up subnational finance across the World Bank Group. This is a crucial source of finance for infrastructure development as 90% of infrastructure projects in developing countries are undertaken by regional and municipal governments. IFC is using its Advisory Services to strengthen the business enabling environment and unlock opportunities at the subnational level in Western China and conflict-affected regions of the Philippines. In addition, IFC is introducing innovative investment and advisory services products in housing finance and PPPs.

³ IFC/R2007-0315.

2.39 Global Public Goods. It is estimated that 80% of all financing needed to tackle climate change will come from private sources. The private sector has the ability to innovate and lead in addressing the challenge and IFC is a strong partner in that effort. IFC is proposing to adopt climate change as a priority throughout its operations and is focusing on investments and mobilization of private sector resources in developing countries. IFC is finalizing its approach to climate change in coordination with the World Bank (see Background Paper – IFC’s Approach to Climate Change). As already noted, IFC’s Trade Finance Program is growing, and IFC is planning to scale up the program significantly in the poorest and middle income countries (see Background Paper – Progress Update).

2.40 Arab World. IFC intends to raise \$100 million (from its own funds and donors) by FY09 to support advisory activities in the Middle East and North Africa (MENA) region over the next five years that focus on financial markets, small businesses, infrastructure and improving the investment climate. IFC is supporting cross-border investment in MENA, helping regional companies as they invest in neighboring countries, bringing in capital, technology and management expertise, and creating jobs. In FY07, cross-border investments within MENA made up over half of all IFC investments in the region. IFC is also developing a program to scale up its work on Islamic Finance.

2.41 One focus of IFC’s work in the region is women entrepreneurs. Commercial International Bank of Egypt, an IFC client, was the first MENA bank to join the Global Banking Alliance for Women, whose secretariat is housed at IFC. IFC is engaged in talks with two other commercial banks in the region to join the alliance. IFC has worked with the Center of Arab Women for Training and Research on a project to support businesswomen associations in five MENA countries in their efforts to better understand their members’ needs (see Background Paper – Progress Update).

2.42 Knowledge and Learning. IFC is committed to delivering development impact by helping the growth of the private sector in emerging markets and by leading in measuring results. In 2005, IFC introduced DOTS as a tool to measure development impact and learn from experience. IFC is continuing to develop and strengthen corporate practice groups and corporate training initiatives to build up core skills and leadership in order to better support World Bank Group goals. Through client surveys, workshops and other tools, IFC is learning directly from clients how to be a more effective partner. IFC continues to disseminate knowledge and best practices to its clients through training and toolkits as well as by leading in standard setting (e.g. Corporate Governance and Performance Standards).

STRATEGY DEVELOPMENTS

2.43 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.

2.44 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 its increased focus on IDA countries. In addition, IFC is formulating special initiatives for many of these challenging markets.

2.45 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 those set out in IFC's Net Income Paper:

- Recognizing the critical need for infrastructure, IFC InfraVentures is a \$100 million early stage equity fund for infrastructure project development, aimed at increasing the supply of bankable infrastructure projects in the most challenging markets, and in particular the volume of PPPs (see paragraph 2.18 above).
- The SME equity funds for risk capital in IDA countries are pilot initiatives aiming to fill the financing gap faced by SMEs in these countries through provision of financing combined with advisory services and training. These SME funds are currently being structured and IFC will return to the Board for formal approval when appropriate.

2.46 *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.

2.47 *Bottom 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. IFC's Grassroots Business Initiative was one such innovative approach, and this has now reached a stage where it makes sense to restructure this program to give it more independence, in order to help it grow, invest as well as make grants, and also attract more and better partnerships and funding, while keeping strong synergies with IFC. This will be separately discussed with the Board in March.

2.48 **Programmatic Approaches.** Last year's Strategic Directions Paper introduced programmatic approaches as a way to increase the development impact and additionality of IFC operations. These can be implemented in different ways, but they all have a common theme: extending IFC activities beyond the individual project into a program of projects and advice, often with partners. By greatly extending IFC's reach these approaches can significantly increase the breadth and depth of development impacts. There are four major types of programmatic approaches under development.

2.49 *Wholesaling and Cross-Sector Approaches.* IFC is combining its financial sector and industry expertise to enable the wholesaling of industry products through local banks. This will allow it to reach smaller clients in smaller, harder to reach countries, in many cases IDA countries, and thereby address the market imperfections which lead to the financing gaps faced by such clients. As compared to traditional investments, these programs target specialty financial products and markets requiring the combination of financial and industry expertise, and are usually linked with advisory programs. Plans for these types of programs are underway in the infrastructure, subnational, agribusiness, and health and education sectors. Similar approaches are envisioned and being discussed in the oil, gas, mining, information technology and general manufacturing sectors. Some of these wholesaling projects will be done via companies as well as banks (e.g. with agribusiness trading companies) and the product range can extend into short-term finance as well as traditional longer-term products. Successful examples of these wholesaling types of programs include the student loan program in Indonesia, and infrastructure projects in Indonesia, Jordan and the Latin American Region.

2.50 *Country/Sector Strategies with Advisory Services.* IFC departments are increasingly developing sector strategies, in many cases for different sectors within an individual country. This allows for a detailed consideration of approaches to yield IFC's highest potential for additionality and development impact in a sector and country, building on a series of investments and combining investments with advisory services and work with the World Bank. Advisory work may include upstream work on the business enabling environment to encourage downstream private sector investments in which IFC participates. Strategies for infrastructure, PPPs, and the financial sector are the most common sectors to date with these approaches. Examples include financial sector strategies in China, Russia and India, and a strategy for infrastructure in Colombia.

2.51 *Multiple-Project Client Strategies.* Some programmatic approaches involve working in a long term partnership with clients for multiple projects, often in more than one country. This includes development of South-South programs where IFC helps emerging developing country players reach out to new locations. Examples include multi-project programs in hotels and cement.

2.52 *Combined Advisory/Investment Programs to bring Enhanced Value-Added to Projects.* A number of programs are being developed to promote combined investment and advisory services to increase IFC's value-added to projects. Examples include targeted investment programs with linkage components to develop small business suppliers of IFC clients, and cleaner technology programs with a combined investment and advisory product.

2.53 The matrix in Chart II-2 helps to explain IFC's additionality as it moves into these more programmatic approaches. This Chart illustrates the range of activities from firm-level to programmatic interventions (bottom to top).

Chart II-2: IFC's Business Model – Illustrative Framework

Programmatic ↑ Systemic Implementation ↓ Firm Level	WORLD BANK		
	IFC	Frontier Markets	Non-Frontier Markets
	Business Enabling Environment	<ul style="list-style-type: none"> •Business Edge •PEP Facilities •FIAS Advisory •Doing Business 	<ul style="list-style-type: none"> •Municipal Administration Simplification
	Standards	<ul style="list-style-type: none"> •Corporate Governance •E&S 	<ul style="list-style-type: none"> •Equator Principles •Corporate Governance •E&S
	Access to Finance	<ul style="list-style-type: none"> •MSME Finance •Trade Finance •Housing Finance 	<ul style="list-style-type: none"> •Capital Markets Development •Sustainability Finance •Housing Finance
	Infrastructure (incl. Health & Education)	<ul style="list-style-type: none"> •Early Stage Project Development •Investments •PPP •Privatizations 	<ul style="list-style-type: none"> •Direct Investments •PPP •Sub-national Finance •Privatizations
	Firm-level Interventions: Direct Investments & Advisory Services	<ul style="list-style-type: none"> •Direct investments •SME Training and Advisory •Introducing South-South Investments 	<ul style="list-style-type: none"> •Direct investments/ Linkages •E&S and Corporate Governance •Originating South-South Investments

2.54 **Becoming More Client Centered.** As IFC has targeted more frontier markets and second tier clients, and as a greater proportion of its clients has become local rather than international (64% in FY07), the need for increased field presence and a different and more efficient operating model has become clear. In the most recent client survey, while overall satisfaction was high at 85%, the areas most quoted as needing improvement were response times and pace of decision-making. By being closer to its clients, IFC is better able to understand and serve their needs as well as strengthen risk management. This will enable IFC's projects to deliver greater development impact and IFC to maximize its additionality. Management believes this decentralization can also make IFC more sensitive and responsive to the specific needs of

individual member countries. Taken together, decentralization also fosters innovative solutions for development originating from the ground up.

2.55 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. The decentralization pilot in Asia (covering both East and South Asia), which began in 2006, marked the start of the next phase of IFC becoming more client-centered, as it involved internal delegation of decision-making to the field and placing more specialists in the field alongside the investment staff. IFC has found that being close to clients and better understanding their needs and markets yields not only increased levels of business, as seen in Africa, for example, but brings other important benefits, such as the ability to:

- engage more effectively with governments and the World Bank;
- improve monitoring of projects, particularly where there are environmental and social issues, and address problems swiftly, which will be important in a counter-cyclical situation; and
- offer proactive support to clients, and in particular less sophisticated clients.

2.56 IFC has now had the opportunity to assess progress and lessons learned. Building on these and given the results in terms of increased business and reach, IFC now intends to roll this model out to the remaining regions.

2.57 In addition to getting closer to its clients, IFC is implementing a more rigorous client relationship management framework. This will enable staff to segment clients more effectively, understand their needs and then engage with them more strategically to develop the client engagement plan. This more strategic approach will help to ensure that IFC is selecting the kinds of clients who will deliver development impact on the ground in line with IFC's priorities and that IFC is providing the additionality they need in order to do so.

2.58 Clients strongly value IFC's global expertise, and maintaining this global perspective as IFC grows and adds local staff in the field is critical. IFC is working to strengthen its global knowledge networks to ensure clients continue to have access to the best of IFC's global expertise, irrespective of location. Building on knowledge management initiatives already in place in some areas, the new initiatives will focus on codifying and sharing sector and product information through practice groups, on-boarding programs and learning notes.

2.59 IFC has also taken steps to enhance its responsiveness through improvement of its internal business processes. Several of the recommendations of the Business Process Review concluded last year have been implemented, and IFC is now looking at the next phase of business process improvements. Increasing delegation of decision-making to the field will be an important aspect, as highlighted at the recent Technical Briefing on decentralization. Adjusting IFC's risk management processes to a more decentralized business with authority delegated to the field will also be important, and IFC intends to devote additional resources to this area.

MOVING FORWARD: STRATEGY IMPLEMENTATION

2.60 **Private Sector Development as a World Bank Group Comparative Advantage.** As the development plans of many countries now focus on private sector development, the leadership of the World Bank Group in private sector activities has become an important comparative advantage. The World Bank Group's broad strength in private sector development presents an important area of opportunity for its leadership in the coming years. Emerging

planning under the current Six Themes working groups has emphasized in many cases the importance of the World Bank Group activities related to private sector development.

2.61 Among development institutions, IFC remains the largest source of private sector finance and the most global institution, and provides leadership in innovative activities such as PPPs, environment and social issues, and results measurement. The World Bank provides strong leadership in investment climate diagnostics, regulatory improvement programs, and supporting public sector investments. MIGA provides additional strength with political risk insurance. Programs such as Gemloc (see Box 1 in the Background Paper) and Doing Business are highly visible examples of the World Bank Group's private sector strengths.

2.62 **IFC's Comparative Advantage.** IFC has been focusing for many years on enhancing its unique strengths that provide comparative advantages and additionality compared to other financial institutions. IFC's comparative advantage starts with special abilities in risk mitigation, a role it provides along with other development institutions. IFC's special status as a public institution supporting the private sector, with accompanying preferred creditor status, political immunities, and relationships to governments, allows it to: (i) provide comfort to other investors – helping them invest where they would not go alone; (ii) change the risk perception of projects by providing a “stamp of approval”; (iii) provide financial products beyond what the market would provide on its own; (iv) take a longer term view than other market participants; and (v) play a counter-cyclical role.

2.63 Building on this risk-mitigation core, IFC has been enhancing knowledge-related capabilities that are very important to lead in private sector development in today's environment. These capabilities include: (i) technical/market/industry knowledge; (ii) ability to help develop innovative solutions such as in housing finance, SMEs, or public-private infrastructure programs; (iii) leadership in environment, social and corporate governance capabilities; (iv) ability to lead in standard setting; and (v) assistance, along with the World Bank, in improving the investment climate to help build a thriving private sector.

2.64 These knowledge-related activities are being improved through many of the current focus areas of the Corporation, such as: (i) enhanced presence in the field; (ii) strengthened human resources development and training; (iii) a growing and focusing global advisory services business; (iv) stronger World Bank Group cooperation; (v) programmatic approaches; (vi) leading edge measurement systems; (vii) stronger client management and knowledge management; and (viii) a scaling up of capabilities in sectors (e.g. agribusiness, microfinance) and locations (e.g. in IDA countries) that are particularly important for development.

2.65 Finally, IFC has been building up an enhanced range of financial products to address the modern private sector development challenges. These include products in structured finance, local currency finance, wholesaling, output-based aid, and infrastructure and SME venture capital.

2.66 This combination of special risk-mitigation capability, knowledge services, and innovative financial products drives IFC's comparative advantages. Its position as the largest global development institution focusing on the private sector, its membership of the World Bank Group, and its global brand and convening power, provide a unique opportunity to lead in these areas. A critical continuing task of the Corporation is to maintain and enhance these advantages.

2.67 *Comparative Advantage by Sector.* IFC's comparative advantage in particular investments varies depending on circumstances in different countries, sectors and projects, and

becomes the basis for the additionality IFC provides in each investment. Examples of the ways IFC provides additionality in specific sectors include:

- IFC's infrastructure business provides additionality through the development of innovative projects and public-private partnerships in difficult markets and sub-sectors, providing risk mitigation, and leveraging specialized financial structuring, policy, environmental, and social capabilities. Effectively dealing with climate change issues is likely to become an important part of IFC additionality in this sector.
- In agribusiness, besides risk mitigation, IFC is providing additionality through its expertise in the safety, environmental, and social standards that are now critical to export markets; through linkage programs that help integrate farmers into global supply chains; and through innovative agricultural wholesale products that target smaller agricultural companies.
- In the financial sector, IFC provides additionality through integrated financial and advisory products in sub-sectors such as microfinance, housing, trade, and sustainability finance; via innovative wholesaling products that combine specialized financial and advisory services in agribusiness, education and other sectors; and by providing and facilitating long term-finance that is increasingly scarce as a result of recent global credit conditions, in areas such as MSME and housing finance.
- In oil, gas and mining projects, IFC's specialized policy, environmental and social capabilities - often with World Bank support - are key aspects of IFC additionality, along with risk mitigation. Projects are increasingly in frontier countries and regions and a number are now with smaller, junior companies.

2.68 Looking Ahead. 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. Subject to resource constraints, it will continue to adjust its business mix towards the focus areas of frontier markets and climate change, but must also be ready to play its counter-cyclical role. In order to support IFC's efforts in these important areas, IFC intends to devote resources to strengthening its internal support infrastructure.

2.69 Key Lessons. In realizing its strategic and growth objectives over this period, IFC has greatly benefited from having a rolling medium-term planning horizon of three years, rather than the one-year planning which IFC had traditionally used. This has enabled the Corporation to plan resources more effectively and to be more responsive to emerging needs, such as the progressive increase in activities in frontier markets, the post-conflict initiatives and decentralization.

2.70 Building on Results. IFC's achievements of the three-year plan period provide a strong basis to continue with the next phase of its growth, allowing IFC to do its part for an inclusive and sustainable world.

- *Managing Growth.* As a result of the demand from its clients, IFC's compound annual commitment growth rate⁴ over the period FY05 to FY08 is projected to be 23-25%, greatly exceeding what was envisaged in 2005 when the growth strategy was first endorsed (12%, using the high point of the ranges given in the June 2005 Business Plan and Budget Paper). This growth has enabled IFC to reach a scale where it can create more opportunities for people to escape poverty and improve their lives and, together with other members of the

⁴ Compound annual growth rate (CAGR) is the year-over-year rate of growth over a specified period of time: in the context above it describes the rate commitments would have grown if they had grown at a steady rate each year.

World Bank Group, have greater and more systemic impact. IFC has achieved this growth while strengthening its focus on development impact and additionality, working with more and more local clients (64% in FY07 compared to 51% in FY04), growing its portfolio, remaining profitable, significantly decentralizing operations and increasing staff by 32% (and field-based staff by 53%)⁵, all of which leads IFC's Management to be confident in IFC's ability to manage the next phase in IFC's growth and development. IFC has also shown the capacity to adapt as it grows, for example by pushing further into frontier markets, developing more programmatic approaches and linking better its advisory services to its investment strategy.

- *Market Presence.* IFC is present in more countries than at the start of the three-year period, with 98 offices in 73 countries planned for the end of FY08 (excluding Part I country offices), compared to 91 offices in 66 countries in FY06. Eight new offices established over this period are in IDA countries while one office was closed in a non-IDA country. The increased level of business and the new offices have been supported by the significant increase in staff in the field, increasing from 44% (1,082 staff) in FY05 to 52% (1,657 staff) at the end of 2007.
- *Productivity.* As both the number and volume of commitments have grown, IFC has been able to improve its productivity on a number of measures. The dollar volume committed per investment staff and per \$1 million in regular budget both improved in FY07. IFC is also becoming more efficient in terms of the time taken from early review of a project to commitment: 278 days per project in FY07, compared to 339 days in FY06.

2.71 *Business Mix.* IFC is proposing to build on the important strategic shifts of recent years in the mix of its business, as well as how this business is conducted, in particular:

- *IDA Countries and Frontier.* For IFC to fulfill its role and maximize its additionality and development impact, it must increase further the focus on smaller and more challenging markets, in particular IDA countries, and on reaching the underserved wherever they are. IFC would also aim to be more selective in non-frontier markets investments, focusing on those which are strategically important or innovative, such as related to climate change or infrastructure, those which have strong development impact, and on areas where IFC's additionality is particularly strong, such as second tier clients.

While the focus on frontier markets is a cornerstone of IFC's strategy, IFC must also balance the increased costs and risks of these investments with the need to remain financially strong and maintain capacity to respond in an effective counter-cyclical fashion in other countries. As IFC reaches further into the frontier, the costs of projects in IDA countries are only likely to increase and the average size of projects, and therefore aspects of IFC's productivity, decrease. Some of the issues IFC is taking into account in this regard are described below.

- Using the Ease of Doing Business Index as an illustration of the likely resource intensity of projects in more challenging markets, IDA countries represent 69% of the bottom half performers. In order to gain a better understanding of the costs of doing business in IDA countries, IFC has analyzed why the costs of financial markets projects in these countries are so high. The reasons include: under-developed regulatory environments; the lack of data availability and weaker understanding of IFC's prudential standards and requirements; weak operational skills of client staff who therefore require more IFC support;

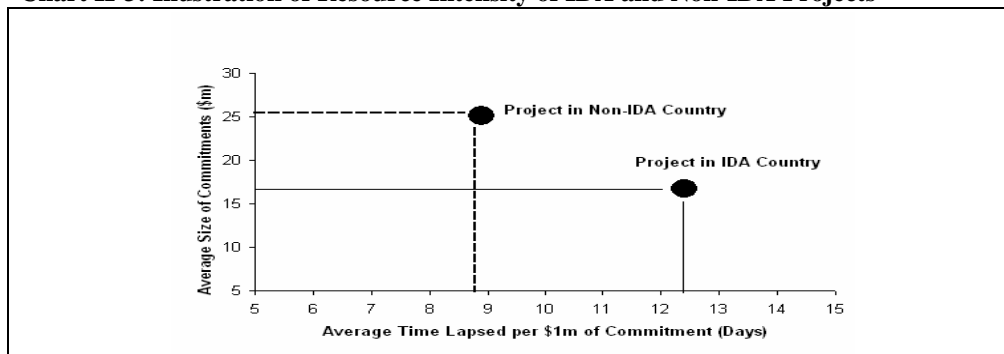
⁵ Staff numbers compare end-FY05 numbers with the end of calendar year 2007.

often difficult travel and country situations which hamper staff effectiveness; reputation risks, as local sponsors are not as well known as in larger economies leading to more complex sponsor due diligence; dealing with multiple counterparties, as donors and government authorities are more often involved in these projects; and consequently large project teams are needed relative to the size of the project to address these various aspects. There are also internal constraints as IFC's policies and processes do not sufficiently distinguish between the size and complexity of projects. By way of example, a recent small project covering several African countries took a core team of eight staff two years, and the team is still devoting substantial time and effort to guide the sponsor through the implementation of an institution building plan to mitigate some of the risk factors. Likewise, a \$3.2 million project in a small IDA country took three years from initial client discussions to disbursement.

- The average size of IFC's commitments in IDA countries over the period FY06 to first half FY08 was \$17 million, compared to \$25 million in non-IDA countries. In order to maintain the momentum of its growth and therefore its capacity to address the significant demands in its markets, IFC would therefore need to do more projects, with resulting cost implications.

- As illustrated in Chart II-3, per dollar committed, projects in IDA countries take longer to complete than projects in non-IDA countries, in particular taking account of the time needed for project development. More dedicated resources are therefore required to reduce this time and increase the number of such projects.

Chart II-3: Illustration of Resource Intensity of IDA and Non-IDA Projects



- Loans in IDA countries are riskier than loans in non-IDA countries, with both higher risk ratings as well as higher reserve levels. IFC must ensure that as it increases the proportion of business in these countries, it is also able to dedicate sufficient additional resources to risk management.
- *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 this year proposing to add climate change to its priorities, and an increasingly significant amount of business, for example 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. While still evolving, key features of IFC's approach to climate change include proposals for the near term on: (i) enhanced support for renewable energy and energy efficiency investments (RE/EE) and other mitigation opportunities; (ii) partnerships to address climate change mitigation and adaptation; and (iii) extending carbon finance activities. IFC will review further: (i) its role in adaptation to

climate change; (ii) measuring the Greenhouse Gas emissions in IFC's portfolio; and (iii) the use of carbon shadow costs in project appraisal. The extent to which IFC can increase significantly its RE/EE investments and mainstream carbon finance support will depend on the availability of sufficient resources and strong advisory support. A summary of IFC's evolving approach to climate change can be found in Section IV of the Background Paper and will be discussed with the Board at an upcoming Technical Briefing.

- *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. 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, and its consequent effects on IFC's portfolio and balance sheet. (IFC's strategy for possible downturns is discussed in more detail in Section III.)
- *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, as discussed above. 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.

2.72 *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 systems; (ii) portfolio management and systems; (iii) support functions such as legal and environment; (iv) ensuring that IFC has the desired number and quality of staff in the right places and the incentive and career frameworks to support them; and (v) adopting processes to support future growth of, and new types of, business, such as appropriate delegation of authority. Devoting resources and attention to these aspects now may imply slower growth initially, depending on resource constraints, but will equip IFC to continue its growth in activity thereafter and thus meet more effectively the tremendous needs in its markets, while also maintaining its sound financial position.

2.73 **Growth Path.** For the period FY09-11, IFC is proposing a growth path that would enable it to: (i) focus on internal infrastructure improvements; as well as (ii) maintain the momentum of growth it has achieved over recent years; and (iii) further accomplish the strategic shifts to greater investment levels in poorer frontier markets and to developing its climate change business. Progress in these areas would require undertaking more projects, both overall and in the areas of focus, and this will require appropriate resources. The proposed growth path is projected to lead to a compound annual growth rate of around 7%-12% over FY08-FY11 (commitments of \$13-\$14 billion in FY11 – see Chart II-4), with an emphasis on greater reach in IDA countries, frontier regions in other countries, and significant increase in the volume of climate change-related investments. These projected results would be subject to market conditions and the demand for IFC to play its counter-cyclical role.

2.74 Over the three-year period the proposed growth path, would enable IFC to:

- Build up local presence in all regions, and focus more of the decentralized resources on frontier markets. This includes opening several new offices, most of which would be in IDA countries or frontier regions.
- Reach more IDA countries and increase the volume of its commitments there. IFC has set itself a stretch target of 50% of projects in IDA countries by FY11, and a goal of at least maintaining the FY07 level of IDA country investments. However, IFC's capacity to reach these targets could be impacted should there be a significant counter-cyclical event in IFC's markets.
- In Africa, continue to scale up and do business in more countries. This will build on the considerable achievements of the past three years, during which IFC's investments in Africa increased from \$445 million in FY05 to \$1.4 billion in FY07.
- Implement the Africa Health Initiative presented to the Board in December. This is still in the planning phase, but it is currently envisaged that over the three-year plan period (FY09-11) this would deliver up to \$110 million to \$145 million in investments, as well as significant advisory services.
- Continue to scale up in Middle East and North Africa, with focus on job creation, gender, education and increasing IFC's Islamic Finance offerings. Increased resources would be devoted to conflict-affected countries, including Lebanon, Afghanistan and, as the security situation permits, Iraq. IFC would also develop innovative approaches in West Bank and Gaza.
- In East Asia, meet IFC's strategic goals for the region of increasing impact in and moving more resources to IDA countries, including Mongolia, the Pacific Islands, Laos, Cambodia and Vietnam, and move towards becoming a leader in climate change.
- Scale up in South Asia, where 45% of the world's poor⁶ live, as well as focus on climate-change-related investments.
- In Latin America and the Caribbean, implementation of the Caribbean Islands initiative, and the special initiative for Central America, as well as the Amazon Initiative (which would be subject also to renewal of the Latin America Advisory Services Program).
- In Central Asia, implementation of the special initiative. The expected results would include an increase in investments in the SME sector as well as an added focus on investments in the housing and microfinance sectors and possible advisory pilots in the infrastructure and logistics sectors. When fully implemented, this initiative is projected to lead to additional IFC investments of up to \$120 million per year, together with delivery of significant advisory services. The realization of this program would depend on the budget allocation, availability of donor funding, market conditions, and continuing improvements in the severely constrained business environment.
- In Eastern Europe, while overall growth would be limited, focus would be on the two IDA countries of Armenia and Georgia, as well as Belarus. Climate change-related investments and projects in frontier regions would also be important.
- Growth in the non-IDA markets of the 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.

⁶ Population living on less than \$1 per day

- Increase climate change-related investments from \$1.1 billion invested in RE/EE in FY05-07 to double to triple this amount in FY09-11.

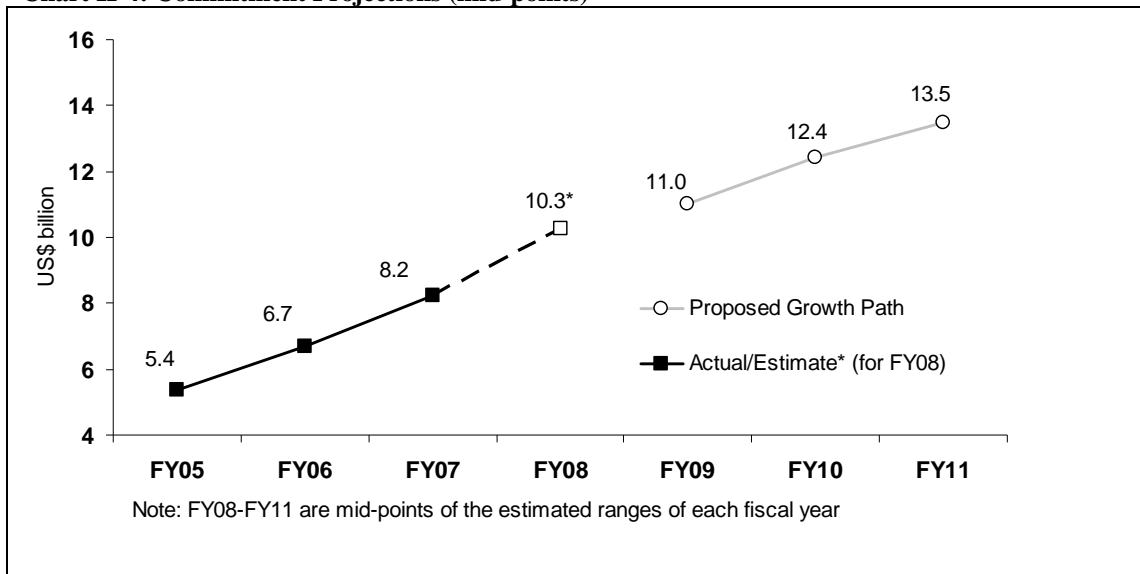
2.75 In terms of sectors, the focus would continue to be infrastructure, including information and communication technologies, health and education, agribusiness, financial markets and certain sub-sectors of general manufacturing.

2.76 . *Summary of Growth*. The growth projections (compound annual growth rate of 7-12%) are in line with the historical averages (see Table II-3), but are lower than the compound annual growth rate of 23-25% for the first three-year growth plan (FY05-08 estimated). Chart II-4 shows the dollar commitment projections.

Table II-3: Compound Annual Growth Rate of IFC Commitments

Fiscal Years	CAGR % (Actual)
1960-1970	16.8
1970-1980	16.4
1980-1990	8.3
1990-2000	10.2
2000-2007	19.2
2005-2008 (estimated)	23-25

Chart II-4: Commitment Projections (mid-points)



III. CHALLENGES

“Aid agencies should become increasingly concentrated in the most difficult environments. That means that they will need to accept more risk and so a higher rate of failure. They should compensate by increasing their project supervision, which means higher administrative overheads.”

*Paul Collier
The Struggle for the Bottom Billion, 2007*

INTRODUCTION

3.1 The need for IFC to play a significant role in promoting strong private sectors in developing countries is clear, and IFC’s achievements and financial strength place it in a strong position to meet the challenges. As IFC moves increasingly to frontier markets, reaching critical mass in capacity in these markets will be crucial to maximizing its impact there. IFC is also proposing to move forward on its climate change-related activities. However, these activities come at a cost, and it is clear that the key constraint for IFC to scale up its development impact continues to be the measured pace of resource expansion, which is outpaced by increases in demand. There are also other challenges which IFC will need to address for the next three-year planning period, such as human resource management, strengthening risk management and responding to counter-cyclical demand. However, IFC Management is confident that, with the Board’s guidance and support, it will be able to address these challenges and remain a leader in the delivery of development impact where it is most needed.

COUNTER-CYCLICAL PREPAREDNESS

3.2 The current uncertain global economic situation poses challenges and opportunities for IFC. While previous financial crises have been more at a country or regional level, it is possible that the next economic downturn will be more widespread across the globe. 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. At the same time, as the prospect of a global slowdown becomes more prominent, IFC would have to balance competing demands in assuming its counter-cyclical role, depending on the timing and magnitude of the downturn, and its consequent effects on IFC’s portfolio and balance sheet. For instance, IFC’s efforts to increase activity in IDA countries and frontier regions might be compromised in the event of a rapid global financial sector meltdown. There would be scarcity of private sector investment in markets affected by a crisis and increases in demand for IFC’s liquidity support, while, at the same time, IFC’s portfolio could be impacted significantly.

3.3 **Past Experience.** IFC has faced several financial crises since the mid-1990s and has responded by providing liquidity and advisory services first to the financial sector and then others, and subsequently longer-term financing as the recovery took off. The most notable cases in the past were in Indonesia and Argentina, where IFC engaged closely with existing portfolio clients through a strong team of dedicated professionals in the field. In Brazil, when trade finance liquidity declined dramatically in 2002, IFC redeployed existing credit lines with clients from project finance uses to trade finance funding, and mobilized significant funding relative to IFC’s own direct credit exposure. Other examples have been in Korea, Lebanon and Mexico⁷.

⁷ See “IFC in a Counter-Cyclical Situation” in “IFC Strategic Directions: FY08-FY10 – Creating Opportunity, Additional Information”, IFC/R2007-0063/1.

3.4 **Recent Initiatives.** Learning from its past experience IFC has already strengthened its preparedness in a number of areas, including:

3.5 *Structured Approach in Portfolio Management.* In order to detect problems early, IFC has taken a more structured approach in the management of its portfolio. In addition to the quarterly project risk reviews, which set provisions, IFC changed the frequency of the comprehensive portfolio reviews from semi-annually to quarterly. Particular emphasis for these regional meetings is on projects that are facing problems.

3.6 *Equity Department.* In order to help guide IFC's equity investment decisions, in 2007, IFC set up a central Equity Department. This department provides analysis of market conditions and provides strategic portfolio recommendations for IFC's equity portfolio. It also proactively advises staff on global, country, and sector trends, and is working with investment departments to create asset allocation tools to help manage their exposure as well as identify new equity opportunities.

3.7 **Preparations Underway.** In addition to implementing the lessons learned from past crises, IFC has already put in place several measures, both defensive and pro-active, to prepare for economic downturns. In general, IFC's initial response to a crisis involves assisting existing clients by providing liquidity, both directly and through mobilization, often immediately or shortly after the start of the crisis. Such liquidity support in turn sends a strong signal to banks to keep their credit lines in place to help re-build the strength of the financial sector. Subsequently, as the market starts to recover, IFC would provide risk capital and longer-term funds to existing and new clients.

3.8 *Defensive Measures.* In light of the current deterioration in many markets, IFC has strengthened further its portfolio management at the department level, focusing on portfolio supervision of potentially vulnerable investments and identifying potential counter-cyclical roles to support existing clients. Decentralization has helped these efforts, as portfolio managers or client relationship managers in the field are able to monitor the situation and address any problems swiftly.

3.9 *Pro-Active Measures.* IFC has begun mapping priority companies for possible equity support in downturns. Some of these plans go beyond individual companies and are more programmatic. For instance, in response to the tightening of credit in the Russian banking system, IFC has developed a systemic and staged approach to assist and provide opportunities for existing clients to continue their businesses.

3.10 *Enhanced Human Resources Management and Policies.* IFC has also begun to implement human resources management practices to ensure the organization is able to move appropriate staff to where they are most needed, whether for short or longer term assignments. IFC is also examining how best and most flexibly to use the clusters of staff now decentralized in several regions, and who have particular sector expertise, such as infrastructure, to improve its response capability. Furthermore, IFC would be able to mobilize staff within each region who are well equipped to work with clients in difficulty and in markets suffering downturns, should the need arise.

3.11 *Corporate and Departmental Counter-Cyclical Plans.* As a part of the annual strategy exercise, investment departments were asked to draw up counter-cyclical plans. These plans include: (i) more proactive risk-taking, such as providing equity or quasi-equity instruments in order to continue to support existing clients; (ii) developing hedging strategies; and (iii) utilizing advisory services such as risk management and non-performing loans management for

financial sector clients, and receivables management for real sector clients. These departmental-level plans will be supplemented by a Corporate-level exercise, where a group of key individuals will monitor global economic developments and prepare a corporate-wide counter-cyclical plan.

3.12 *Regular Stress Tests*. IFC conducts regular high-level stress tests for its entire portfolio. The results indicate that IFC has sufficient capital to withstand downturn events similar to those experienced in the last decade, but it is unlikely to be adequate in the event of more extreme shocks⁸.

3.13 *Global Facilities*. IFC already has in place several global facilities that could directly support IFC's counter-cyclical role, with some modification, including its Global Trade Finance Program. In addition, clients are increasingly requesting IFC to provide stand-by facilities in anticipation of liquidity constraints.

3.14 **Factors Impacting IFC's Effectiveness**. Several factors may impact IFC's effectiveness in undertaking a counter-cyclical role on a greater scale.

3.15 *Flexibility*. Past crises have seen rapid deterioration in macroeconomic conditions as well as unexpected policy responses. Any detailed simulation exercise would not be able to cover such "blind spots". The key for IFC is to be prepared for the unexpected, with utmost flexibility in all aspects of operations, including resource allocation, staff, portfolio, and capital.

3.16 *Balancing Risks*. To provide clients with the assistance needed to weather economic downturns, IFC must continue with prudent balance sheet management in order to ensure that it has sufficient capacity to take additional risks for selected companies, even when the downturn has affected its financial position.

3.17 *Portfolio Exposure*. IFC has significant exposure in several countries. Should these markets be affected by an economic downturn and the need arises for IFC to provide liquidity support, IFC will need to reorient its strategy and rebalance its portfolio. IFC is currently undertaking an effort to manage exposures in these countries even more effectively, through mobilization at origination and a programmed divestment of loans and equity to create financial capacity to play its counter-cyclical role when the need arises.

RISK MANAGEMENT AND FINANCIAL CAPACITY

3.18 As IFC scales up its activities and decentralizes further, management of risk, including maintenance of a sound financial structure and appropriate risk management practices, will become an even more critical issue. IFC will need to focus considerably more resources on this area.

3.19 **Risk Management**. The Risk Management function is being upgraded to facilitate improved client service and efficiency while retaining appropriate checks and balances on decentralized decision-making. In addition, IFC's strategic response to global and macroeconomic volatility will involve: (i) more stringent portfolio risk management and supervision, as discussed above; (ii) planning to meet demand for IFC's traditional counter-cyclical role; and (iii) earlier engagement of the Special Operations Department⁹ to identify and

⁸ Use of IFC's FY07 Net Income: Retained Earnings and Designation of Retained Earnings (IFC/R2007-0275)

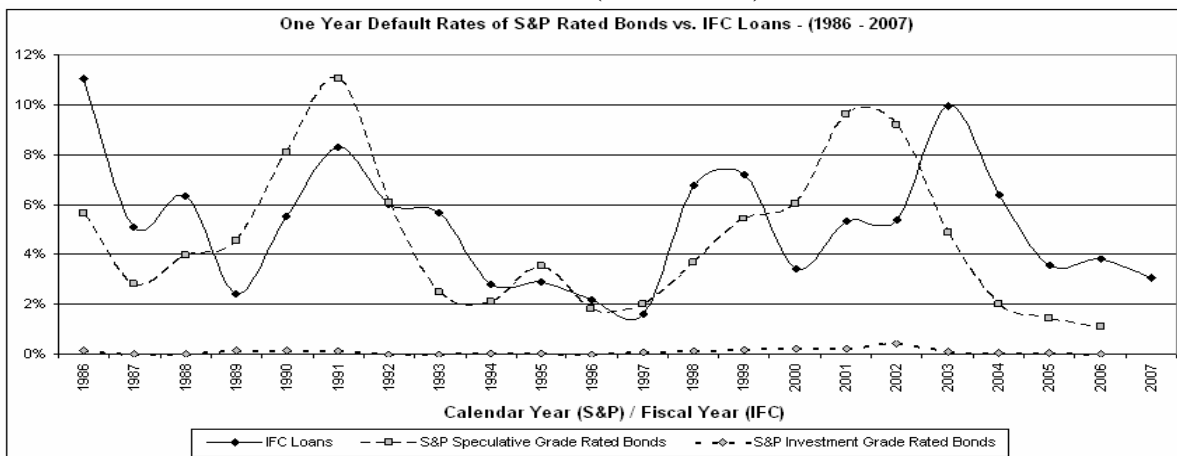
⁹ The department is comprised of a small number of workout professionals who have extensive experience in handling jeopardy projects.

address problem investments quickly. IFC is also enhancing Corporate Tools for Risk Management. These tools include economic capital allocation, early risk rating systems and higher portfolio supervision that allow for greater decentralization and enhanced accountability for pricing, performance measurement and portfolio management. Other steps to enhance risk management are described in the Background Paper.

3.20 International Financial Reporting Standards. As discussed with the Audit Committee on February 14, 2007, IFC has set a revised target date of FY10 to resume presentation of its financial statements using International Financial Reporting Standards (IFRS). In the interim, IFC's FY07-09 financial statements will be prepared using accounting principles generally accepted in the United States. Among other changes, this will require the Corporation to make expanded use of fair value accounting, principally in debt securities and equity investments, as well as derivatives associated with the loan, debt securities and equity portfolios. This will imply significantly greater volatility in net income reporting, including the possibility of sizeable net losses due to market downturns in any given quarter as well as greater volatility in IFC's capital position.

3.21 Financial Capacity. IFC is by its nature and mandate a risk-taking institution. Economic theory postulates that there is a direct link between risk and reward and IFC's experience bears out this relationship: it has traditionally made some of its largest returns in investments considered among the most risky at the onset. As an indication of the significant risks inherent in its portfolio, an analysis of IFC's one year default rates shows that they are comparable to Standard and Poor's speculative ("junk") grade default rates (Chart III-1).

Chart III-1: IFC and S&P One Year Default Rates (FY86 – FY07)

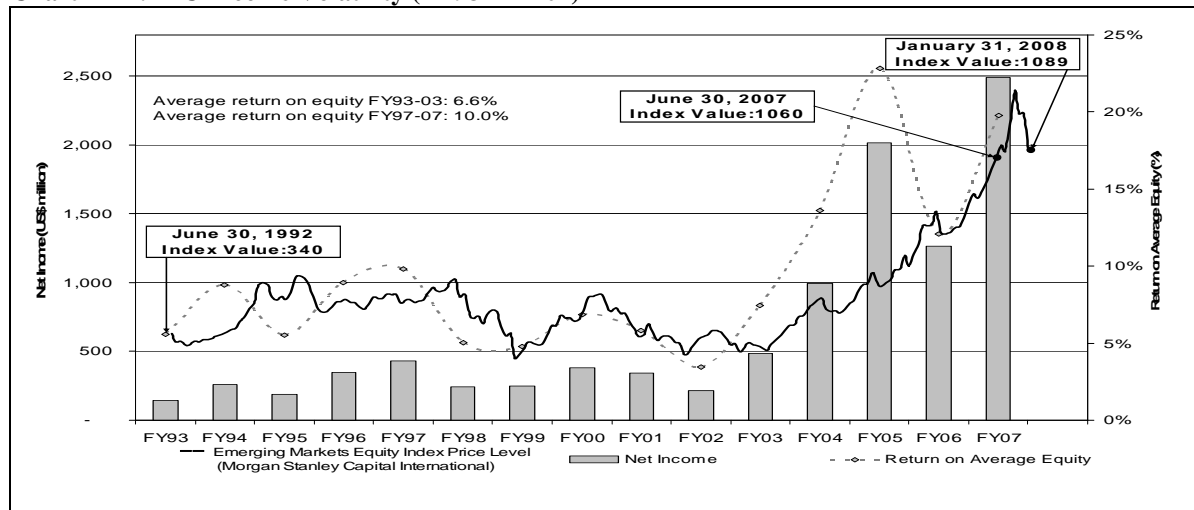


3.22 Likewise, while IFC has in recent years benefited from capital gains on equity, these should be recognized as the returns for the significant risks taken by IFC (as evident in the volatility of returns on equity shown in Chart III-2 comparable to the Morgan Stanley Capital International (MSCI) emerging market equity index) and the additionality it brings to its investments. The period from FY02 to FY07 has been characterized by an unusual "synchronized boom" in equity and commodity markets as well as global liquidity, all of which have been extremely favorable for IFC's investments. However, since May 2007, the market environment has deteriorated due to the U.S. sub-prime market and liquidity crises, the potential for a recession, and heightened investor risk aversion. The hypothesis of emerging markets having "decoupled" from the U.S. is now being questioned and there is fear that a serious U.S. downturn would in fact have strong negative implications for many of the markets

in which IFC operates. Indeed, notwithstanding positive long-term prospects, with increased globalization, a medium-term "synchronized bust" triggered by liquidity or other events cannot be ruled out. It should also be noted that there have been very large movements in the price level of the MSCI emerging market equity index during the first seven months of FY08 as depicted in Chart III-2.

3.23 Despite this inherent volatility, IFC maintains its AAA credit rating by: (i) diversifying its investments, giving it exposure to a range of risk profiles; (ii) maintaining a strong financial structure and capital base; (iii) being a long-term investor particularly for its equity investments; and (iv) engaging in rigorous due diligence, accumulated knowledge and experience in developing countries and sound risk management practices.

Chart III-2: IFC Income Volatility (FY93 – FY07)



3.24 Given the inherent risks and the volatility of its income, IFC requires a strong capital base to support its growth and frontier market focus. Furthermore, given IFC's need to play a countercyclical role in times of stress, it is necessary for IFC to maintain resources to preserve its AAA rating during and immediately after a stress event. This is a very high standard and not one followed by commercial institutions. As evident from current market events, commercial institutions typically scale back investments during times of crisis, sell assets and raise capital or accept a downgrade in ratings. Furthermore, unlike most other major multilateral development banks, including the European Bank of Reconstruction and Development, IFC does not have callable capital.

3.25 Accordingly, IFC assesses its capital adequacy by measuring growth needs and the risk profile of its current and projected investments and first establishing minimum capital adequacy for these needs. The minimum capital adequacy requirement is determined using the new CAPRI (or economic capital) framework which differentiates assets based on statistical measures of risk. Under this approach, equity is substantially more capital intensive than loans, for example. Likewise, the approach enables IFC to distinguish among countries and sectors in terms of capital intensity. In coming months, these tools will also be used to inform judgments on maximum exposures to equity, countries and sectors. In view of the uncertainty in markets and the potential for unanticipated or extreme events (as for example in the sub-prime and bond insurance market), IFC also augments these minimum capital requirements with stress tests. The stress tests are informed both by historical experience as well as judgmental assessments of potential scenarios. A preliminary analysis shows that IFC has adequate capacity to support the

proposed growth, subject to some limits on equity exposure and exposures in some countries and sectors where there is either actual or emerging concentration, or where the portfolio composition is such that it is more capital intensive. In light of the strategy to encourage diversification and increased focus on IDA countries, a limit on aggregate exposure to the top five exposure countries is also being considered. A more detailed analysis of financial capacity and stress tests will be presented in the Annual Report on Financial Risk Management.

HUMAN RESOURCES

3.26 IFC's human resource (HR) strategy has evolved to support the decentralized business model with the objective of building IFC's impact on the ground. Since FY99, IFC's HR strategy has been centered on building a high-performance, merit-based organization that can effectively and efficiently help the Corporation achieve its business goals. There are three pillars to the HR strategy: (i) differentiation of staff based on performance; (ii) accountability of managers for people management and results; and (iii) recognition of behaviors that model excellence, teamwork, integrity and commitment to IFC's mandate. While the HR strategy remains consistent, operational emphasis is adjusted annually based on business needs. The 2008-2010 HR Strategy emphasizes managing growth and decentralization in support of a more client-centered IFC.

3.27 **Managing growth.** In response to client and business demands, IFC has grown and has expanded its reach globally. At the end of calendar year 2007, IFC's workforce totaled 3,196 staff, reflecting a 32% increase since FY05. The most significant increase in staff is in country offices. The total country-office based staff is 1,657 (52% of all IFC staff) compared to 1,082 (44% of all IFC staff) in FY05. While the majority of the growth in country staff has come in advisory services (which grew from 555 staff in FY05 to 904 staff today), staffing in investment operations has also grown in the field from 527 staff in FY05 to 753 staff today.

3.28 To meet the needs of a growing workforce, there is a renewed emphasis on the onboarding of new staff, which includes mentoring and training. It is critical for IFC's effectiveness to have new staff integrated quickly into regional departments, as applicable, and into sector groups, to sustain and enhance the Corporation's global knowledge management. More than 70% of the new staff orientation course offerings (six out of nine offerings in FY07 and seven out of nine offerings in FY08) are held in the field. Similarly, about 60% (five out of nine offerings in FY07 and four out of seven offerings in FY08) of the core credit training course offerings have been held in the field.

3.29 **Decentralization in Support of a More Client-centered IFC.** IFC's goal is to create critical mass of staff in the field to serve clients more efficiently. The Corporation strives towards this goal two ways: it is moving senior staff with global knowledge from Washington to the field and is recruiting highly skilled staff with deep understanding of local market conditions into the field. This two-pronged approach is designed to build both sector expertise in the regions and to build functional capacity in all aspects of the project cycle.

3.30 *Global Career Framework.* A key HR priority is the development and implementation of a new global career framework for client-facing investment and advisory services staff. The new framework supports a single corporate culture and provides clear guidance to staff on career paths and what is required to succeed and advance at IFC. It also clarifies the responsibilities for career management, for managers and staff alike, and provides departments increased flexibility in a decentralizing organization. The career framework outlines new corporate competencies for all IFC staff as well as job stream competencies that apply to all

staff in the investment and advisory streams. The new emphasis on role-specific competencies encourages specialization of skills as staff progress.

3.31 In the new framework, staff hired in any location are expected to be of the same caliber. They can then progress to senior jobs within their own region and/or may relocate to other regions. An important feature is that new managers in operations are required to have had a field assignment before taking on this leadership responsibility. Key aspects of the implementation include developing and enhancing tools to encourage mobility, providing staff better access to information about opportunities that are available, and enhancing the performance assessment process and the managers' role in providing staff career guidance.

3.32 *Mobility.* Moving senior staff from Washington to the field has been challenging in some regions. Although more staff have been relocating to the field since FY05 (an average of 40 staff per year compared to 27 in previous years), net transfers of senior staff to the field have remained steady (around 10 per year). Beginning with East Asia and South Asia, IFC has competitively selected vendors to provide relocation and destination services to IFC staff. Over the next two years, enhanced mobility support will be provided to the remaining regions.

3.33 *Recruitment.* As IFC's operations move closer to clients, it is critical that the right people be hired and placed in the right place to meet client needs. IFC recruited 1,981 new staff since July 2005, including 1,292 staff (or 65% of the total) in the field. Most recruitment in country offices occurred in Advisory Services (66% of field-based recruitment). While the recruitment strategy is clear, a major challenge facing IFC is the highly competitive employment market worldwide for finance and investment professionals. Turnover for Investment Officers has averaged around 7.5% over the last three years, compared to 3.6% for the period FY01-FY05. Turnover remains particularly high for those investment officers who have 5-9 years of experience, with 30% of those staff having left IFC. IFC is losing core staff just as they become more productive as team leaders. IFC is also experiencing a higher rate of offer rejections than in recent years: about 18% of the offers to finance/investment professionals were rejected in FY07 (excluding another 15% based on verbal offers) compared to less than 8% of offers rejected over the previous five years.

3.34 Recruitment of diverse talent has been a key factor in growing IFC's business. Despite market pressures, since FY05 the Corporation increased its representation of professional level women from 38.2% to 43.4% and developing (Part II) country staff from 45.7% to 49.4%. In addition, the number of Sub-Saharan Africa and Caribbean region staff on international appointments has increased from 7.0% to 9.0% in the same time period. Nationalities of Focus (NOF) are also now part of IFC's recruitment efforts and there are plans to increase NOF representation over the next few years through targeted recruitment efforts.

3.35 *Compensation.* The comprehensive review of the World Bank Group's compensation framework provides an opportunity to implement a more performance-based and market-based approach, which could help IFC mitigate its staffing challenges. Within a decentralized business model, IFC has a business imperative to ensure that its core talent pool is deployed effectively across regions, with equal standards for staff quality regardless of location. As a result, IFC endorses the elimination of the current distinction between international and local staff in the World Bank Group employment framework. The compensation framework should reflect the market, and annual increases should be performance-driven. IFC has already implemented a number of initiatives that differentiate staff based on market and performance (such as the Long Term Performance Awards program) and experience shows that such tools can be effective when managed systematically and with discipline. The use of such approaches

is driven by business imperatives – for example, the market for investment/ finance professionals with African experience/backgrounds in particular is at a premium, and constraints to hire and retain such talent continue to limit IFC’s ability to operate and deliver effectively in Africa.

3.36 IFC also endorses the implementation of differentiated functional pay among distinct career streams for The World Bank Group, an approach already used by organizations such as EBRD and critical to recruit and retain top talent. Today, a market-based “pay-line” for experienced finance/investment professionals has emerged, with salaries closely within range in cities such as Moscow, Delhi, Johannesburg and Sao Paolo – all key areas for IFC’s business. Given the existing World Bank Group compensation framework, IFC is severely limited in its ability to attract and retain these core professionals. Based on current reality, IFC is therefore supporting the implementation of a global pay-line for seasoned finance/investment professionals (including Treasury) for the World Bank Group overall, while other professionals should have a different pay line, to reflect the external market.

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

MANAGING GLOBAL KNOWLEDGE

3.38 As IFC becomes more decentralized and client-focused, maintaining and growing its global knowledge becomes a critical challenge. Local clients in particular are keenly interested in learning from IFC’s global experience to improve their own businesses. Global clients value IFC’s knowledge of countries and regions that may be new to them. And both local and global clients value IFC’s ability to apply the lessons of its past experiences to replicate and innovate new products and services in their markets. As more staff are located outside of Washington, often in frontier offices, it becomes more important to connect them to the global knowledge that can help them serve their clients. IFC has undertaken many *ad hoc* knowledge management initiatives in the past, but now looks to ensure staff can more systematically tap into the knowledge base that exists.

3.39 Much of the knowledge management work underway focuses on ensuring client-facing staff have access to core sector and product knowledge regardless of where they sit. Practice groups are being created to provide a channel for ensuring staff can access and contribute to IFC’s specialized knowledge, and develop their career as part of a specialized global community. To supplement IFC’s corporate on-boarding program, IFC is developing industry-specific on-boarding programs to ensure that new staff, especially those hired in the field, can get up to speed quickly on IFC’s global experience. Efforts are also underway to improve codification of lessons of experience and disseminate them in a way that people can easily access the information when they need it. Finally, job descriptions are being re-worked for most operational streams to highlight the importance of individual staff contributing to, and using, IFC’s global knowledge. A robust knowledge management process, coupled with

appropriate tools to attract and retain high performing talent, will substantially help IFC deliver its development mandate more effectively.

IV. CONCLUSION

4.1 IFC has achieved significant results, in terms of development impact as well as growth. It has reached the Board-endorsed development targets of the Corporate Scorecard, while building the financial strength needed to support its strategy for the years ahead, and in particular its increased focus on the most challenging markets. It has also shown flexibility by adjusting to changed circumstances along the way, such as the need for post-conflict initiatives and getting closer to its clients.

4.2 However, the likelihood of a counter-cyclical situation as well as IFC's continuing shifts in business mix and mode of operation, mean the coming years, and in particular FY09, should be years of consolidation as well as growth: continuing the momentum of IFC's growth while also strengthening its internal support infrastructure.

4.3 The needs in IFC's markets are great, and the private sector is critical to meeting these needs sustainably. It is therefore also important to recognize that as IFC grows, so does its responsibility to send the right signals to its clients and developing member countries by building on its achievements and continuing to support the advances in private sector development. This is particularly important at a time when market downturn risks are increasing.

4.4 The growth path proposed by IFC Management will allow IFC to maintain momentum while also ensuring that appropriate internal mechanisms are in place to address the challenges it faces and support the path ahead, and thereby enable IFC to do its part for an inclusive and sustainable world.