



Advisory Panel Statement

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We found the IEG's ***Independent Evaluation of IFC's Development Results 2009: Knowledge for Private Sector Development*** to be an excellent and timely report. The report successfully takes on the very challenging task of evaluating not only IFC's investment operations but also, for the first time, IFC's advisory services (AS). This task was made all the more challenging by two unrelated aspects. The first is that IFC's AS has been growing very rapidly, and that it is only recently that IFC has begun to put in clearer objectives and procedures to approve, manage, monitor, and evaluate this line of business. This has limited the coverage and the quality of the data that can be used to assess the wide range of AS. The second is the severe global financial and economic crisis that has spread and deepened, while the evaluation was being undertaken, and which has not bottomed-out yet. The authors are to be commended for beginning to incorporate some of the implications of the crisis for both IFC's investment operations and AS.

In this note, we will make some general comments on the report, and then complement the

analysis and recommendations, particularly regarding AS because this is the main focus of the report.

Comments on the Report

Overall, the report is very good, and is both detailed and fact-based. It contains concrete and actionable recommendations. Here we comment on the conceptual framework and the methodology.

Conceptual framework: The report does a good job of outlining the importance of knowledge for development. It also emphasizes the role of the private sector and of private sector knowledge in development. IFC contributes to private sector development through its investment operations, as well as through its advisory services. IFC transfers quite a lot of technical and organizational knowledge to individual companies (firms, as well as financial and non-financial intermediaries) as part of its regular investment operations. This is recognized in the report, but is not treated explicitly. Instead, the focus on knowledge transfer in the report is explicitly on AS. This typically consists of broader policy knowledge directed primarily to government (more

than 52 percent of IFC's AS by value), although it also goes to financial and non-financial intermediaries, large commercial firms, and small and medium enterprises. While the knowledge that IFC transfers through its investment operations may be hard to quantify, the important development impact of that knowledge should not be glossed over. It could be argued that this knowledge transfer is as important as that transferred through AS. In addition, there should be more evaluation of the quality of that knowledge transfer, as well as some analysis of how the value of that transfer can be increased through more explicit attention to management of that knowledge. Addressing this may be an issue for the report next year.

Methodology: We found it very appropriate that the report complemented the database on project completion reports, particularly regarding AS, with extensive internal and external interviews, including with clients and other development organizations. This allowed it to compensate the still relatively new and incomplete monitoring and assessment instruments for AS, and to overcome some of the biases of self reporting by staff involved in the projects being assessed. This allowed the authors to provide some very important and critical insights and to put their findings in perspective. A few additional analyses in critical areas (e.g., pricing) would have been helpful to understanding the crux of the issue better, and as a result, strengthen the overall recommendation. We would recommend drilling a bit deeper into critical areas in future reports.

Performance of IFC's Investment Operations

The report clearly demonstrates the significant improvement of IFC's investment operations over the years and focuses on projects that reached maturity in 2006–08. It notes that part of the improvement has been due to the exit of a particularly weak cohort of projects that matured in 2005, more favorable conditions in the developing world (until late 2008), improving IFC appraisal and structuring quality, and the move to larger projects. It appropriately notes that the performance of projects will likely deteriorate as

a result of the growing global financial and economic crisis.

In its recommendations, the report notes the importance of managing the tension between protecting the existing portfolio and responding to opportunities during the crisis. We fully agree and stress that this will require careful attention. We would emphasize that as the depth and breadth of the crisis is expanding, IFC needs to do more to manage the risk to its current portfolio, including not only the balance between its current portfolio and new investment opportunities, but also mitigating conflict of interest that may impede collaboration with the Bank and the IMF as noted in the report. Furthermore, we would add that IFC is likely to face a lot of demand for additional financial restructuring of existing operations, given the global liquidity constraints and the drying up of credit markets. In addition, there will be increasing demand for restructuring specialists. IFC should begin to staff up for the expansion of this type of work. Moreover, on the AS side, there is also likely to be increased demand for the design of more appropriate regulatory structures, starting with finance (banking system, non-bank financial sector, stock markets), but extending to many sectors, as well as for financial restructuring and consolidation of business. This has strong implications for the type of expertise and staffing that will be necessary. It also gets at the issue of how much of this is to be market driven and market priced, vs. a public-good contribution to development of better systems.

Performance of IFC's Advisory Services

The report examines in detail the performance of IFC's AS, and shows how its rapid growth is creating challenges, which need to be addressed to ensure success and sustainability of this business line. It also outlines four concrete recommendations: develop a global strategy for the group, pursue more programmatic AS interventions, improve execution of the pricing policy, and strengthen performance measurement and internal knowledge management. We generally agree with the thrust of the recommendations. However, we would like to make a general observation and then some specific suggestions.

We were surprised that the AS staff has grown by a factor of seven since 2000, and that it now accounts for roughly 45 percent of the total staff of IFC. With AS expenditures of \$245 million in fiscal year (FY) 2008 (roughly twice that in FY05 and a tenfold increase since 2001), it certainly is an area that needs explicit attention and appropriate management. The relative size of this effort is quite impressive. According to the IFC FY08 financial statement, total IFC administrative expenses were \$549 million. It is not clear whether the expenditure for AS is included in this figure, since the financial statement shows a separate expense line of \$123 for AS. In any event, the expenses for AS are anywhere from one-third to one-half the total administrative expenses for IFC, which is certainly a large share, whichever way it is counted. IFC has *de facto* become a hybrid finance and consulting organization. This is a very substantial shift, and one that no organization that we know of has ever done before. The closest one we can think of that has somewhat of a similar role is Goldman Sachs.

Many of the challenges described in the report are typical of rapidly growing organizations—balance between different operations, internal and external alignment, organization and delivery of services, staffing, quality, monitoring and evaluation (M&E), and results. What makes these particularly challenging in the case of IFC is the very rapid and seemingly uncontrolled growth of AS, complex interaction between AS and investment operations, and the broad and somewhat difficult measure of results. The last, as defined in the IEG report, includes relevance, development effectiveness, and additionality. All three of these measures go beyond a clear summary indicator such as profitability, which is the typical performance indicator in commercial enterprises. IFC's three result indicators are difficult to quantify because they include a large element of public goods and broader social and non-market objectives. An additional complication is that half of the funding for advisory services comes from donor funds, and that these are targeted at particular development objectives and or regions. All of this makes evaluation of results very difficult.

Therefore, our general comment is that in order to have a better evaluation of results of IFC's AS it is necessary to have a clearer articulation of the strategy and plan for those services. The reason for this is that there are very strong interdependencies between the objective and overall strategy for IFC's AS—how IFC is to organize and operationalize that model, and how results are to be measured and evaluated. Therefore, we would like to reinforce and highlight the critical importance of the first recommendation in the IEG report—that “IFC set out an overall strategy for IFC advisory services addressing the need for a clear vision and business framework and link with IFC's corporate strategy.”

There is a strong and urgent need to develop a robust and integrated plan beyond just the strategy. This plan should cover five key areas:

- a. The vision/mission:** What does the IFC really want to accomplish with this business? To do this, IFC needs to sort out three different objectives of advisory services:
 - i. supporting its investment operations¹
 - ii. providing public goods for the development of the private sector in developing countries
 - iii. operating as a profitable fee-based consulting service at market prices
- b. The strategy**
 - i. Which clients to focus on (e.g., governments, investment operations clients, others unrelated to investments)?
 - ii. What service lines to offer them and how to deliver them? Where is there a true gap? Where can the IFC be distinctive? And thus, how to streamline the current offerings?
 - iii. What geographical areas to prioritize?
- c. The operating model**
 - i. What key processes to put in place?
 - ii. How to leverage learning from other knowledge organizations?
 - iii. What partnership opportunities to pursue? Who is good at what? Whom to partner with and for what? (Here more attention needs to be given to how to partner more effectively with the World

Bank, as well as with other multilateral development organizations that provide AS, as well as with think tanks, academic institutions, consulting firms, and business associations.).

d. The financing model

- i. What should be the combination of donor and IFC funds for different products and programs?
- ii. What should be the pricing model for services to different clients?
- iii. What implications does the use of donor funds have for pricing of services targeted by donors?
- iv. How big are each of the bottlenecks in applying the agreed pricing policy?
- v. How big a risk does the IFC face in enforcing the pricing policy?
- vi. What do the financials look like under a few different scenarios?

e. The organizational model

- i. Organization structure: How to pull together the various units into a robust organizational structure?
- ii. Collaboration: internal (e.g., with the WBG) and external organizations
- iii. Staff mix: What's the right model to ensure sustainability in the long term? (The current mix relies very heavily on short-term external consultants and appears to be unsustainable and incompatible with high-quality services and effective knowledge management)
- iv. Skills/experience of the internal staff.

Developing this plan quite urgently is critical. IFC should dedicate the required resources as soon as possible. Bringing in an experienced and objective external firm to drive this should be considered.

We would also like to highlight four critical issues: pricing, knowledge management, staff mix and skills, and M&E.

Pricing is an important issue to address, and should be included in the plan as suggested. We agree with the need to move to a more value-based pricing policy over time. This could also help attract and provide more attractive compensa-

tion to experienced consultants and help address some of the staff mix and experience issues. However, more work needs to be done to understand how to transition from the current free model to the current cost-recovery pricing policy, and then to a value-based model. Quantifying and assessing the risks to the business will be a critical component of this work stream.

This is far from an easy task because an effective unit of analysis for working with knowledge would have to be developed. Few organizations have effectively de-coupled knowledge from other parts of a consulting assignment, such as a construction project, a finance system, or a marketing strategy. By not doing this, they can charge for the knowledge they have developed as incorporated in their overall charges. However, to charge just for knowledge itself may prove a difficult thing to gain acceptance in the marketplace. All of these things would need to be thought out and established before any sort of value charging could occur.

Charging for these knowledge services on a value basis would involve the IFC in entering a marketplace that has some very established players. While many of these players may call their offerings in this area by different names, they all are interested in this sort of work and they would show up in any bidding situation. This would include the major management consulting firms, the large systems integrators, and many investment banks (when they get back on their feet) and even law firms, foundations, as well as many other nongovernmental organizations. This market is very large. Depending on how it is measured, there have been estimations of between \$5 billion and \$100 billion in expenditures per annum. The most-valued organizations are able to command fees that are significantly higher than their costs, and in exchange deliver multiple of these fees in terms of value to their clients. For the IFC to effectively capture part of this market, it will need to: (a) clearly define its focus, strategy, and competitive advantage, (b) better understand the real bottlenecks and risks in enforcing the current pricing model, (c) quantify the true value of its AS to its clients, (d) agree on how much of this value

to charge as fees to clients, and (e) put in place a robust process to transition over time to a value-based pricing model.

Knowledge management: The IEG report notes the very disorganized way in which AS are provided with very little interaction and sharing of knowledge across the different regional offices, insufficient blending of global best practice with local knowledge, and lack of coordination with other knowledge providers. The plan needs to consider in greater detail the very different processes that are at the heart of any knowledge-based organization. These usually are understood as specifically focusing on knowledge development, knowledge retention, and knowledge transfer. Each of these has particular work routines and practices that are well understood and pretty much universal among knowledge-intensive organizations. In order for IFC AS to be effective in these roles, it will have to institute these processes in a much more established and systematized way than currently exists.

Strong advisory service organizations have developed very robust knowledge management processes. As such, there is indeed a clear need for the IFC to strengthen its internal knowledge management. As recommended in the report, we would encourage benchmarking of not only other MDBs but also, and perhaps even more importantly, of world-class commercial knowledge organizations—both McKinsey & Company and Goldman Sachs come to mind.

Organizations like McKinsey, which are based on these processes, have knowledge-intensive cultures that are overtly managed. These processes are well integrated with the overall work processes of the organization. There are many analyses and descriptions of these types of cultures but they are generally based on things like strong internal cultures, incentives, social norms, management signals and symbols, and explicit and overt strategic directions. Again, these are all significantly different from what one would find in organizations more focused on financial routines and operations. How do these organizations manage and share knowledge? What is relevant for the types of

knowledge and services provided by IFC? What works? What lessons have they learned? These should be analyzed as part of the integrated plan. We recommend that IFC set up a small advisory board (with perhaps three members) who have extensive experience in knowledge-based organizations and also have some background in finance or with nongovernmental organizations. They could help keep IFC AS abreast of work processes and technology developments in knowledge management, as well as theoretical developments in this area

Staffing and skill mix: That the current ratio of external consultant to internal staff is roughly one to one, and three to one in the field vs. headquarters, raises issues of how to ensure quality, how to share relevant knowledge, and how to keep IFC expertise up to date. The current model, which relies extensively on short-term external consultants and less-experienced internal staff, is clearly not sustainable. There is a strong need to upgrade skills internally; the best way to kick start the process is to hire experienced senior consultants from other firms, who will help put in place the required best practices and properly train the junior staff. There will likely be a need to complement them with external consultants in the short to medium term, but the medium- to long-term aspiration should be to rely primarily (and even almost exclusively) on experienced internal staff, while leveraging external consultants for very specific in-depth expertise/knowledge in critical areas. To reduce the variability in the quality of external consultants, IFC should consider entering into partnerships with a few external firms/individuals and work primarily (and if possible, exclusively) with them.

Monitoring and evaluation: We fully agree with the recommendation of the IEG report for the need to strengthen performance measurement. IFC introduced a new M&E system in 2006 “including standardized project approval, supervision, and completion reports.” However, the IEG report states that actual staff compliance in properly filling in the report was poor. This reflected poor training, as well as constant changes in the criteria to be used in the evaluation and too much reliance

on self-assessments. The IEG report also notes that unlike the case for investment operations, the M&E system for advisory services does not have targets on development impact or established M&E indicators of impact on a programmatic level, reflecting the immaturity of the system. Thus, it is clear that M&E needs to be strengthened and that it is necessary to go beyond project completion reports to independent field assessments. We would also stress that developing an effective M&E system also depends on having a clear fix on the purpose and objectives of the advisory services. Hence the importance of the need to develop a clearer over-

all vision and plan for the role of advisory services as emphasized above.

We would like to thank IEG for giving us the opportunity to review the report and provide our perspectives. As mentioned at the beginning of this statement, we think overall the report is very good. We would like to commend the IEG team for a job well done. We have attempted to complement the report by highlighting some of the issues that it has raised, and making some suggestions for the consideration of IFC Management and of the Board as IFC moves forward.