



# Executive Summary

Over the last decade, many developing countries have experienced strong economic growth, typically accompanied by falling levels of poverty. The private sector has been a key contributor to this growth, mainly through new capital investment, but also through fostering innovation and entrepreneurship, helping to create jobs, and opening up new markets.

Developing countries with the highest levels of private investment and those that have made the biggest strides in bridging knowledge and technology gaps with the developed world—from India to the Baltic States—have generally grown the quickest.

The current global financial crisis places many of these hard-won gains under severe threat. The crisis began in the developed world, but has since spread to the developing world, and has particularly affected countries with economies more connected to global markets. Import demand from developed countries is falling, and companies in developing countries, both large and small (particularly small), have also found that funds for new investment have dried up, or have become much more expensive and more difficult to obtain. Private capital flows to developing countries in 2009 are expected to be, at best, about half their level in 2007 (of \$1 trillion). Past crises suggest that it may take some years for these flows to return to their precrisis levels. More generally, the crisis has led policy makers and analysts to reevaluate the role of markets and the private sector, particularly where the value of effective regulation, prudential oversight, and fiduciary management was wrongly deemphasized or ignored.

In times like these, IFC's dual role as a financier and as a provider of knowledge (together with the

World Bank) assumes particular importance. Concerning the first role, IFC's founding articles state that the Corporation should invest in viable private sector projects in developing countries for which "sufficient private capital is not available on reasonable terms."<sup>1</sup> In such crisis times, the onus is on IFC to ramp up its financing efforts. But IFC's second role as a knowledge provider (together with the World Bank) is also important, particularly as policy makers and administrators focus on business regulations, good governance, and the environmental and social sustainability of growth. IFC provides advice that helps to shape the conditions for sustainable private sector development—for example, through promoting more effective regulation—and to enhance the capacity, skills, and behavior of actors involved with private sector enterprise in the field (including effective management of the social and environmental effects of private activities).

This *Independent Evaluation of IFC's Development Results* (IEDR) looks at each of these roles in turn: IFC's effectiveness in financing development through its growing portfolio of investment operations, with an emphasis on IFC's experience during previous crises and in helping clients mitigate investment risks (Part I); and—for the first time and as the main theme of this report—the Corporation's experience organizing and delivering its Advisory Services (AS) interventions, that

is, knowledge services the IFC provides to either private companies or governments in support of private sector development (Part II). In terms of results, the report focuses on IFC investment operations that reached early operating maturity between 2006 and 2008, and IFC AS projects with Project Completion Reports during the same period. The review of AS development effectiveness comes with certain caveats, given that the monitoring and evaluation system was only introduced in 2006, and considering the often intangible nature of knowledge transmission. Nonetheless, the report, for the first time, provides a combined account of both arms of IFC's business—investments and AS—including situations where these instruments have been offered to the same client. The report also complements a recent IEG evaluation of the effectiveness of World Bank economic and sector work and technical assistance, which was completed in 2008.<sup>2</sup>

### Financing Development

IFC's portfolio of investment operations (loans, equity, and other financial products) continued to grow in the last year. The cumulative volume of active investment activities increased by about a quarter, from \$32.7 billion in fiscal year (FY) 2007 to \$40 billion in FY 2008. The number of investments rose by a lesser order (8 percent), reflecting a general preference for larger investment operations (increasingly involving corporate finance rather than project finance), and a more wholesale approach to reaching small and medium enterprises (SMEs), that is, through financial intermediaries and larger companies.

A growing portfolio provides opportunities to extend the Corporation's development reach. IEG's evaluations of investment operations that reached early operating maturity between 2006 and 2008<sup>3</sup> show that IFC's project development results improved overall. More specifically, 72 percent of evaluated projects (85 percent by volume) achieved outcomes that, on balance, met or exceeded project financial, economic, and environmental and social benchmarks and standards, and made positive contributions to private sector development beyond the project. This compares with 63 percent of projects (75 percent by volume)

achieving high outcomes in 2005–07. On a cumulative basis, since independent evaluation started in 1996 and up to and including 2008, 62 percent of projects (70 percent by volume) have achieved high development outcome ratings.

Stronger overall results in recent years reflected several factors: i) the exit of a particularly weak performing cohort of projects, which matured in 2005 (51 percent of projects maturing in 2005 realized high development outcomes, compared with 75 percent maturing in 2008); ii) more favorable economic conditions in much of the developing world (until late 2008, by which time most evaluated projects had been substantially implemented); iii) improvement in IFC project appraisal and structuring quality; iv) the conscious move by IFC toward larger projects, which have been likely to achieve higher ratings than smaller projects, due in part to greater internal scrutiny; and v) especially strong performance in Europe and Central Asia, and in Latin America and the Caribbean, where the majority of mature operations are located. In these regions, business conditions were most supportive and IFC work quality was strongest. South Asia exhibited improving performance, with higher IFC work quality than in the past.

Performance lagged considerably in East Asia and the Pacific, and in the mainly low-income Middle East and North Africa, and Sub-Saharan Africa—with barely half of the projects in these regions meeting or exceeding specified benchmarks and standards. External conditions were partly responsible—projects in Sub-Saharan Africa and Middle East and North Africa generally featured high levels of country, sponsor, and product competitiveness risks—but the quality of IFC's work and contribution to the project tended to have a larger impact. This was especially the case in East Asia and the Pacific, where nearly 40 percent of projects exhibited low quality of IFC additionality. There is evidence of better screening and appraisal work in Middle East and North Africa and improved supervision quality in Sub-Saharan Africa.

Among IFC's strategic sectors, project performance showed continued improvement in health

and education, it was better in agribusiness, and remained strong in infrastructure and financial markets. At the same time, performance lagged in nontelecommunications information technology (software and Internet).<sup>4</sup> In other sectors, oil, gas, mining, and chemicals projects achieved relatively poor ratings. Risk exposure was clearly a factor in weak nontelecommunications information technology projects, most of which were small operations involving inexperienced sponsors and unclear product competitiveness. However, work quality in this sector was also well below par, with high ratings in just 40 percent of cases. Improved work quality was in evidence in the health sector, where IFC showed that it had learned lessons from past experience, but the portfolio has not achieved much diversity. Oil, gas, mining, and chemicals projects did not meet benchmarks for a number of reasons: technical weaknesses of the sponsor; higher than expected asset acquisition cost; and in one case, unsatisfactory environmental compliance. Environmental and social effects ratings were stable for real sector projects, but remained weak in financial intermediary operations, reflecting the need to strengthen client capacity and securing their commitment, as well as addressing shortfalls in IFC supervision and additionality.

The development results reported above do not yet reflect the sharp deterioration in global economic conditions, which has just now begun to affect investment returns in most developing countries. The development results reported here largely reflect project experience during 2003–08, a period of unprecedented growth in emerging markets. Most evaluated projects had been substantially implemented, and some had been closed by late 2008 when the crisis started to affect the developing world.

The development results of maturing operations are, however, expected to decline in the coming years. Past evaluation shows that projects approved in the years prior to the crisis (and being implemented during the downturn) are most at risk from a development perspective. Approximately 40 percent of IFC's portfolio (62 percent by volume) falls into this category, thus the Corporation is exposed to considerable downside

development risk. At the same time, IFC has considerably strengthened its internal risk management processes and its capacity to bear and manage financial risks appears to have improved significantly in recent years. Importantly, evaluation suggests that investments approved in the wake of the crisis (i.e., at the bottom of the business cycle) will tend to have better development results. Thus, there are also upside opportunities that need to be grasped.

The experience of past crises underlines two key responses by IFC: first, careful portfolio risk management, particularly projects in early implementation; and second, IFC additionality. The latter is particularly important in two respects: i) in acting as an honest broker in restructurings; and, ii) in pursuing a well-timed and targeted approach to new operations, particularly through the signaling effect IFC interventions can provide to other investors.

### **Knowledge for Development**

IFC AS have been growing rapidly, with an active portfolio approaching \$1 billion and employing 1,262 staff, a sevenfold increase in the last seven years. As a result, the nature and face of IFC has changed significantly: AS staff now make up the majority of the Corporation's presence in the field in developing countries.<sup>5</sup> The rapid growth of AS has happened in a largely unchecked manner. This is well illustrated in the emergence of more than 50 AS products, 18 regional facilities covering seven regions, 13 global business units, and about half of AS work being contracted out to short-term consultants.

Important strategic questions need to be addressed. These include whether, in grafting such a substantial knowledge business onto a financing institution, IFC has the appropriate balance of efforts between AS and Investment Services (IS) to ensure maximum development impact. Quality trade-offs are also possible, given substantial organizational change, a high reliance on relatively new staff (60 percent have been with IFC less than three years), and outsourcing work through some 1,300 short-term consultants each year. There is also increased possibility of conflict of in-

terest or market distortion—where AS is offered together with financing, or is provided at less than market value.

IFC deploys its AS in the pursuit of general objectives that are common with those for IFC investments. These objectives include focusing on frontier markets (including International Development Association, or IDA, countries and frontier regions of non-IDA countries, as well as SMEs and agribusiness), strategic sectors, such as finance, infrastructure, health, and education, and support for environmental and social sustainability (including climate change). The allocation of AS resources has been largely aligned with these priorities. That is, IFC AS has generally targeted high-need destinations, such as IDA countries and Africa in particular.

Relevance, however, does not guarantee impact. Fifty-two percent of IFC's AS projects, where ratings could be assigned, were rated high on achieved development impact. Projects rated substantially higher on other dimensions of performance, such as strategic relevance, output, and outcome achievement, with an overall development effectiveness success rate of 70 percent. Ratings did not change significantly for projects that began before (as opposed to projects initiated after) the major organizational changes in 2005/06. By region, ratings have been substantially better in Southern Europe and Central Asia, and weaker in Latin America and the Caribbean. Evaluated global projects also did not perform well. By business line, while the variation in results is less pronounced than by region, infrastructure, business enabling environment, corporate advice, and access to finance tend to perform better than environmental and social sustainability.

Key drivers of results have been client commitment (as evidenced by contribution to project costs and especially so for environmental and social sustainability projects), strong project design and implementation, IFC's proximity to the client as defined by IFC's local presence and involvement, programmatic (rather than one-off) interventions, and effective M&E. Strong additionality

has been fundamental for achieving results, and has been particularly noticeable among business enabling environment operations in IDA countries with high business climate risk, and in some packages of services, such as SME linkage projects in agribusiness, manufacturing and extractive sectors. Such packaging raises potential conflicts of interest, which must be tackled effectively, and needs appropriate pricing. Intrinsic constraints in capturing the impact of AS are compounded by the relatively weak application of M&E guidelines to date by IFC staff.

Over the last five years, IFC's management has taken action to enhance its AS effectiveness through efforts to strengthen AS organizational alignment and delivery processes. Efforts to bring greater structure and clarity include: categorizing AS activities into five business lines; consolidating some global and regional facilities; classifying products by level of maturity; developing AS staff competencies; AS training; and establishing an AS vice presidency. IFC's attention to the delivery of AS has focused on establishing mechanisms and systems to ensure: adequate, sustainable funding; client commitment; sound project design and implementation; and robust M&E of performance. IFC's efforts in these areas appear to compare favorably with measures taken by other multilateral development banks, for example, in the introduction of a pricing policy (which broadly seeks to build client commitment and reduce possible market distortion by limiting any subsidies to public goods), and an M&E system, which seeks to capture outcomes and impacts, as opposed to just outputs. The momentum of transformation continues with the recent introduction of new policies, procedures, and guidelines related to pricing, conflict of interest, funding, and governance.

The professionalization of AS, however, remains a work in progress and significant organizational issues still persist: overlapping and parallel implementation structures in several regions (Sub-Saharan Africa, East Asia and the Pacific, and South Asia); few well-established products outside of finance and infrastructure; lack of clarity about how AS and IS are best integrated in different

contexts; limited consideration of IFC's comparative advantages relative to other knowledge service providers at the strategic and project levels; and no umbrella AS strategic framework to weave different strands together.

There are also substantial gaps in delivery that need to be addressed—particularly in matching corporate intent with consistent implementation on the ground. This applies with respect to the execution of the pricing policy, as well as ensuring good quality project design and implementation, and effective collaboration with other actors, including the World Bank. Getting the right staffing mix has been a particular challenge, with a heavy reliance on short-term consultants and relatively new staff (as compared to those involved with investment operations). The chosen mix has major implications for the quality and continuity of IFC's AS, and the preservation of global knowledge leadership. At all stages of delivery, M&E data provided by staff and short-term consultants (in particular) has remained unreliable. Relatedly, IFC-commissioned reviews of AS facilities, products and projects, while offering insights into the organization and delivery of AS, have exhibited shortcomings in independence and design.

Charging effectively for IFC's AS is perhaps the most important step going forward. Effectively charging clients for services will introduce a market test for AS and is likely to have a positive impact on all aspects of the business, such as creating incentives for: greater client buy-in, stronger project design and implementation, stronger M&E, development of products that best meet demand, and ensuring IFC additionality. In the immediate term, IFC would need to strictly implement the current pricing policy, which is largely cost-based (i.e., the price the client is expected to pay is a proportion of the cost of the project). Over time, efforts should be made to move to a market value-based approach to pricing, so that IFC does not run the risk of crowding out other knowledge providers. IFC investments are priced according to this principle for the same reason. The current economic crisis, and its likely effects on donor and IFC

funding, is an opportunity for the Corporation to push harder in the direction of value-based pricing, and to encourage other development institutions to do likewise.

## Recommendations

This review comes at a time of deep distress in financial markets and a severe downsizing in private economic activities. It reminds us of the critical importance of sustainable development in the private sector, for which regulatory frameworks are important and excessive deregulation costly. In these circumstances, this review provides further findings on what IFC might do to enhance development effectiveness and additionality:

### *Operations during the Crisis:*

- **Effectively manage the tension between protecting the portfolio and responding to opportunities during crisis.** In the past, this tension has not always been managed adequately and IFC has missed opportunities to have a deeper impact. Experience suggests the importance of arrangements to isolate portfolio problems from new business development, to mitigate conflicts of interest that may impede effective collaboration with the World Bank and the IMF, and to establish clear rules of engagement in crisis response, particularly for staff in the field. Experience also indicates the important role IFC and the World Bank Group must play in promoting sound frameworks for prudent financial risk management and safeguards to ensure sustainable private sector development. This is especially relevant today, as the world reexamines the roles of governments and markets in the wake of the financial crisis.

### *IFC Advisory Services:*

- **Set out an overall strategy for IFC AS that addresses the need for a clear vision and business framework, and is closely linked with IFC's global corporate strategy.** Following years of unchecked growth and recent organizational changes, the role of AS in IFC's business model needs to be addressed. The

strategy would need to better articulate IFC comparative advantages in AS, as well as objectives and goals for AS in different contexts (a source of confusion among staff), and to consider the best staffing combinations (internal or external, global or local staff), delivery unit organization, incentives, and performance measures to help realize these objectives and goals.

- **Pursue more programmatic AS interventions.** Evaluation shows that IFC has achieved better results in AS projects that have been carried out in conjunction with other AS interventions. One-off activities have been less effective. However, programmatic efforts of this kind have been in the minority (about a fifth of all AS projects), and IFC should accordingly seek to expand this type of intervention.
- **Improve execution of the AS pricing policy through greater client contributions.** Over the longer term, it would be important to seek client contributions that reflect value and impact (i.e., not just cost) to create a true test of client demand, to promote incentives for better AS delivery, and to ensure IFC is being additional.
- **Strengthen AS performance measurement and internal knowledge management.** In the short term, it would be important to have more hands-on M&E support in the field, post-project completion follow-up, better lessons-capture (including from dropped or terminated projects), and more arms-length

facility, product, and project reviews. In the medium term, it would pay to introduce an Expanded Project Completion Report system (akin to the Expanded Project Supervision Report system for investment operations, and carried out later than the Project Completion Report to better capture impacts), more programmatic impact evaluation and impact research, the setting of results-based targets for AS in its corporate scorecard, and regular benchmarking of IFC AS activities and systems with other providers of knowledge services, including other multilateral development banks and commercial providers. In the longer term, the aim could be to establish a specialized research unit focused on generating and bringing together private sector development knowledge work.

This report was reviewed by an advisory panel of international experts in the area of knowledge and development. Panel members were: Carl Dahlman, Luce Associate Professor of International Relations and Information Technology, Georgetown University School of Foreign Service; Acha Leke, Partner, McKinsey & Company; and Laurence Prusak, founder and former Director, Institute for Knowledge Management. In a joint statement, included in this publication, the panel agreed with the above recommendations, and suggested additional steps IFC may take in the same direction.