



IFC Management Response to IEG-IFC

*Independent Evaluation of IFC's Development Results 2009: Knowledge for Private Sector Development**

Management welcomes IEG's *Independent Evaluation of IFC's Development Results 2009*. The report reviews the development results of Investment Services (IS) projects evaluated from 2006 to 2008 that were approved between 2001 and 2003 and Advisory Services (AS) operations evaluated between 2006 and 2008 that were approved between 1996 and 2008. It is the first IEG report that includes evaluations of both IS and AS operations.

Introduction

IFC is operating in an unprecedented and challenging environment today. The financial crisis that started in the developed economies has now become a global economic crisis, adversely affecting our clients to varying degrees. Private capital flows are down significantly, global financial institutions are curtailing lending and exports are falling, leading to an expected overall contraction in economic growth. The crisis is still unfolding, and the extent of its impact on development results is

still unknown. Under these conditions, IFC is increasingly proactive in protecting its portfolio clients and innovating new business models to respond to the crisis. A third party assessment of IFC's experience in development, such as this report, plays an important role in informing IFC's strategic response during this crisis.

While we are pleased that the independent evaluation found that IFC achieved strong development results in both IS and AS, we note that the ongoing global slowdown and sharp decline in market conditions are not yet reflected in these results. Development outcomes of IS operations are at a record high at 72 percent (85 percent by volume), i.e., nearly three-quarters of operations

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met or exceeded market, financial, economic, environmental and social performance benchmarks and standards, and made positive contributions to private sector development beyond the project. IFC's performance in health and education, while based on a relatively small sample, is noteworthy, achieving high development outcome in 100 percent of evaluated operations. This confirms that appropriately structured private participation in social sectors is good for development. IFC work quality has improved again. Results of initiatives IFC undertook to strengthen appraisal and supervision, such as increased decentralization and enhanced risk management, are becoming more evident in IFC's development performance. IFC is taking advantage of this momentum by further deepening its initiatives such as in environmental supervision and client capacity building in the financial sector, especially in more difficult regulatory conditions. Going forward, IFC expects to stay focused on both portfolio and new business opportunities and challenges in light of the current global crisis.

In AS operations, 70 percent of evaluated projects achieved a satisfactory or better rating in Development Effectiveness (DE)—a synthesis rating of five development dimensions comprising strategic relevance, output, outcome, impact, and efficiency. Significantly, most of the projects evaluated by IEG were designed and, in many cases, implemented before Management fully implemented the raft of recent actions intended to strengthen the impact of our AS business. Those actions have included: organizing the business into five business lines; establishing rigorous project review, approval, and supervision processes; creating a rigorous monitoring and evaluation system; instituting a pricing policy to strengthen client commitment to implementation and ensure any subsidies are justified by the balance of public and private benefits involved; reviewing products based on performance and categorizing them by level of maturity; establishing protocols to promote effective World Bank Group coordination when engaging with government clients; strengthening financial management systems; developing AS staff competencies and training; and launching a major knowledge management ini-

tiative to capture and disseminate lessons of experience across IFC. The momentum continues, and in the last year alone management has established a dedicated Vice Presidency for Advisory Services; strengthened policies, procedures, and guidelines dealing with matters from the administration of trust funds to the management of records; and undertaken a second major review of our AS product offerings. We will also shortly be announcing refined organizational arrangements with clearly defined accountabilities that are consistent across the business. These measures augur well for even stronger development results going forward. As the report acknowledges, IFC's efforts in these areas compare very favorably with measures taken by other multilateral development banks (MDBs).

The report also indicates that IFC's responses to past crises were relevant and effective. While private sector investors generally hold back in times of crisis, IFC remained committed to its development role. IFC's investments in high-profile strategic companies and restructuring of major existing projects sent powerful positive signals at a time when market confidence was waning in crisis countries. Demand for IFC was strong, especially for its risk mitigation, knowledge, and innovation. Overall, projects approved in the wake of a crisis achieved better results than pre-crisis projects. Existing projects that were in the early stages of implementation were most vulnerable and were hit hardest by the crisis. The nature, quality, and speed of IFC's portfolio and new business responses proved crucial in the success of IFC's operations in past crises.

We agree with the overall direction of the report's recommendations. Our responses to the recommendations are set out below.

Response to Specific Recommendations

Recommendation 1: Effectively manage the tension between protecting the portfolio and responding to opportunities during crisis.

Response. Management agrees with providing appropriate focus on both protecting our portfolio and responding to opportunities during the cri-

sis. IFC has crafted separate but coordinated responses to the current crisis.

IFC's first priority is to work with its portfolio clients to help them weather the crisis and at the same time protect IFC's portfolio. Portfolio work capacity has been enhanced where it is most needed. Nearly all portfolio managers are now based in the field because this is critical to understanding client issues quickly and resolving them expeditiously. More investment and corporate services staff have been assigned to portfolio work and IFC is further strengthening its human resources to ensure that it has adequate requisite skills in complex restructuring and recovery operations. IFC has undertaken several initiatives to closely supervise its portfolio, including:

- Deepening of portfolio stress testing by developing structured stress-testing methodologies and disseminating them throughout the Corporation;
- Assembling a new team dedicated to portfolio oversight and compliance testing. This team will monitor portfolio management processes and activities globally in order to ensure best practice and will be developing a portfolio scorecard for investment departments on all aspects of portfolio management;
- Enhancing portfolio intelligence activities to develop finer methodologies for all portfolio valuations as well as single and group exposure aggregation.

Non-investment departments are also increasingly engaged in helping meet the needs of our portfolio clients. For example, the Special Operations Department has started to get involved early in the investment project cycle to coach Investment Officers and teach lessons learned from restructuring. Along with the central Portfolio Management Department, the Special Operations Department is currently being reinforced with more senior-level resources and an expanded and more proactive mandate to allow for early risk identification and heightened portfolio supervision.

In terms of new business opportunities during the crisis, IFC has established a number of program-

matic initiatives that are clearly separate from portfolio operations. These initiatives are being structured for greater development impact and are targeted at specific liquidity and other financing needs, as well as advisory demands arising from the current crisis. Initiatives already starting to gain traction include:

- *Bank Recapitalization Fund*: A global equity fund to recapitalize banks, for up to \$5 billion from IFC and other investors.
- *Trade Initiatives*: Global Trade Finance Program: doubling to \$3 billion. Continued focus on banks in IDA/frontier markets; other initiatives are also being developed.
- *Microfinance Liquidity Facility*: A \$500 million facility to instill confidence in the microfinance industry, jointly with KfW. Initial contributions (IFC \$150 million) will focus on short-term debt.
- *Infrastructure Crisis Facility*: Facility to support viable privately funded infrastructure projects facing financial distress. IFC expects to mobilize between \$1.5 billion and \$5 billion.
- *Sovereign Fund Initiative*: A fund of at least \$1 billion, of which IFC would provide up to \$200 million to invest in frontier markets.
- *Advisory Services*: Refocusing existing programs on financial sector and infrastructure; new programs in risk management, loan portfolio workout/non-performing loan management; scaling up select programs.

IFC has established a new investment subsidiary, the IFC Asset Management Company, LLC, which will initially carry out both the Sovereign Fund Initiative and the Bank Recapitalization Fund. Such a move clearly separates these specific new business initiatives from IFC's portfolio operations.

As the IEG report acknowledges, IFC-World Bank cooperation will continue to play an important role in IFC's goal of achieving greater development impact. Significant progress has been achieved at the level of strategy, policies, systems, and projects. In developing the crisis response, for example, IFC has coordinated with the Bank in developing its special initiatives, e.g. the Infrastructure Crisis Facility Fund and the Bank Recapitalization Fund. Going forward, IFC will track

its performance in strengthening Bank Group cooperation through its Corporate Scorecard.

Recommendation 2: Set out an overall strategy for IFC Advisory Services, addressing the need for a clear vision and business framework that is more closely linked with IFC's global corporate strategy.

Response. Management agrees on the importance of a clear strategy and business framework for our AS business. As noted above, IFC has been working intensively over the past few years to strengthen the strategic and operational effectiveness of our AS business. This has included a raft of actions at the policy, system, process, product, and organizational levels. Each of these actions reflects the exercise of strategic judgment about the kind of advisory services IFC intends to provide in order to fulfill our mission. We have chosen to develop an integrated strategy for both our investment and advisory businesses, believing that this is the most promising path to maximize our development impact. At the corporate level, this is reflected in our overall strategy. Individual regional, country, and industry strategies also reflect the complementary nature of our investment and advisory instruments, and are developed and honed through intensive annual bottom-up and top-down strategy exercises that include full engagement of investment and advisory staff. As noted above, advisory services are also an integral part of our strategic response to the unfolding financial and economic crisis.

Recommendation 3. Pursue more programmatic AS interventions.

Response. Management agrees that programmatic AS interventions often promise more substantial development impact than more limited interventions. In recent years this has become the hallmark of our approach in areas such as corporate governance and small and medium enterprise financing, where interventions at the level of individual firms are complemented by measures that embrace a broader pool of firms and the overall enabling environment. In some cases

this approach is implemented by a single project encompassing interventions at all three levels. In other cases, the approach is implemented through a series of projects sequenced to address priority constraints or to ensure strong client commitment. In yet other cases, IFC interventions are designed to complement the activities of the World Bank or other development actors, and focus on IFC's area of comparative advantage. In all cases, however, the goal is to maximize our development impact. IFC proposes to continue to emphasize programmatic approaches wherever feasible and appropriate.

Recommendation 4. Improve execution of the AS pricing policy.

Response. Management agrees that our pricing policy is an important tool to strengthen the impact of our AS interventions, but differs with IEG on parts of their analysis and recommendations. As context, IFC has been charging clients for some of its advisory products for many years. Since January 2007 this approach was broadened to embrace the full range of our advisory services. Importantly, the policy is not intended to raise revenue *per se*, but rather, it aims to strengthen client commitment to implementation of our advice, and to ensure any subsidy is justified by the balance of private and public benefits involved. Reflecting these aims, the policy recognizes not only client payments direct to IFC, but also in-kind contributions and payments to third parties (e.g. consultants). Moreover, since our AS is focused on addressing market failures, including the generation of public goods, pricing approaches based on the value or impact of our AS will often not be relevant or practicable. Indeed, if advisory products could be priced on a full commercial basis, questions might arise about why IFC, rather than a private consulting business, should be providing the advice. These considerations mean that fees received directly by IFC (the metric chosen by IEG) provide limited insights into the extent of compliance with the policy. IFC intends to keep the operation of our AS pricing policy under regular review, and will continue to refine the implementation of the policy based on experience.

Recommendation 5. Strengthen AS performance measurement and internal knowledge management.

Response. IFC agrees on the importance of effective performance management and internal knowledge management, and is committed to improving its performance in both areas. IFC introduced its monitoring and evaluation (M&E) system for advisory services in 2005. The M&E function in IFC is decentralized, with every region staffed with one or more M&E officers. In addition to regular monitoring on core indicators developed for each advisory product, there have been a number of external in-depth project and program reviews to capture lessons and results. As noted in the report, IFC's efforts in this area compare very favorably with other MDBs. Currently, about 60 percent of project approval documents apply lessons learned from evaluations or "smart lessons." Management's emphasis on the application of lessons learned is strong and we expect to reach a 100 percent target in the next two years. Formal portfolio review processes, including M&E data, started in 2007, and in 2009 will incorporate standard corporate guidelines. Going

forward, Management would be very supportive of the development of an Expanded Project Completion Report (XPCR) instrument, the criteria to determine projects that will be subjected to a process, and a relevant guidance.

Research, development, and innovation in support of IFC's strategic priorities are an integral part of our advisory services business. Management has recently launched a major knowledge management initiative for IFC as a whole. It draws on lessons of experience with similar initiatives in the World Bank and elsewhere, and has a strong emphasis on capturing lessons of experience from our front-line staff, supported by a cadre of technical specialists for key products and M&E staff, as well as active knowledge-sharing networks for each business line. In addition, the joint World Bank/IFC Vice Presidency for Finance and Private Sector Development engages in a substantial research program with internal and external partners. Against this background, Management does not believe that a specialized IFC unit focusing on private sector development knowledge work is necessary over and above the current initiatives.