



IFC Management Response to IEG-IFC Independent Evaluation of IFC's Development Results 2007: Lessons and Implications from 10 Years of Experience*

Management greatly welcomes IEG-IFC's tenth, independent, annual review of evaluation findings. This year's annual review takes stock of eleven years of project approvals, from 1991 to 2001 (evaluated in 1996–2006).

Introduction

Management notes that IEG-IFC's independent evaluation found that IFC had positive development impacts and profitable investment operations. The report indicates that most of IFC's projects have consistently performed well in terms of financial, economic, environmental, and social aspects, and have had good impacts on private sector development. This performance was achieved while IFC's projects were exposed to all the risks that are associated with private sector investments in the developing world.

We are encouraged by IEG-IFC's independent finding that IFC has generally made sound corporate-wide strategic choices. The report found that IFC has successfully scaled up its investment and ad-

visory operations in frontier counties (high risk and low income) and in priority sectors, such as infrastructure. More importantly, the report shows that investment operations have largely yielded above-average development results in these priority areas.

We also note that the report indicates that impacts on private sector development of IFC's projects have been strong and reached well beyond the project company. Among other results, these projects had broad positive demonstration effects, stimulating follow-on investments by other investors, downstream and upstream business linkages, and increased competition. Some contributed to domestic capital markets development by providing increased access to finance and introducing new financing instruments.

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The report also found a consistently strong positive correlation between development and investment results. This supports IFC's long-standing

operating principle of pursuing projects that are both developmentally and financially viable over the long term.

IFC takes on more risks than other investors, catalyzing private investments where the private sector would not go alone. In some markets, such as in Sub-Saharan Africa, IFC took on higher country risks, in line with its development agenda. The evaluation findings should be interpreted in this context, recognizing that success rates will reflect the higher risks the Corporation undertakes.

The 1991–2006 period in which the evaluated projects operated saw major financial crises, including those in Asia, Argentina, Mexico, Russia, Turkey, and Brazil. IFC remained focused during these years of high risk and market volatility, quickly responding to crises through countercyclical investments, as well as enhanced portfolio operations to support its existing clients. This allowed IFC to mobilize scarce capital for the private sector in difficult times and help boost liquidity in affected economies. At the same time, IFC remained forward-looking by pursuing a strategy to reach markets and sectors where it can deliver greater development impacts and strong additionality.

Looking forward, Management welcomes IEG-IFC's finding that more recent commitments are poised to have greater development impacts. The report indicates that IFC's overall work quality, a key driver of success, is on the uptrend and project risks are better mitigated. In addition, the improving investment climates in many countries where IFC operates suggests greater development results, given IEG-IFC's finding that development impacts are better when investment climates are improving. Nevertheless, as IFC continues to take on significant project risks, actual results will depend on many factors, including market performance.

Management recognizes that there may be opportunities for IFC to enhance its development effectiveness and finds this report valuable in informing IFC in this regard. Management agrees with the general direction of the report's recommendations. Specific responses to each recommendation follow.

Responses to Specific Recommendations

IEG-IFC Recommendation: Develop a deeper, more differentiated country approach.

As IFC decentralizes, it has the opportunity to adopt more tailored country strategies, to complement its strong sector and regional approach. This strategy might include, in consultation with the Bank and country governments, the development and pursuit of a set of country specific private sector development indicators (such as for the level of private, gross fixed capital formation; banking sector capacity; and private provision of infrastructure).

Management Response

Management agrees with the recommendation to develop a more differentiated country approach. Current IFC strategic processes already involve developing country level strategies that feed into Country Assistance Strategies (CASs) and into IFC's regional strategies that form part of IFC's Strategic Directions Paper. Because of the commonality of certain characteristics, regional departments are also able to group countries with similar needs and issues for the purpose of developing a coordinated approach. For example, in Sub-Saharan Africa, countries are grouped in four categories: (i) post-conflict (such as the Democratic Republic of Congo and Liberia); (ii) natural resource rich (such as Nigeria and Tanzania); (iii) middle income (such as South Africa and Mauritius); and (iv) others (such as Mali and Niger). Similar approaches are used in other regions.

Building on this base of activity, IFC is seeking to strengthen its country focus. As discussed in *IFC Strategic Directions, FY08-10: Creating Opportunity* (chapter 2), IFC is working to develop greater systemic approaches to its activities, which will be done at the country or sector level. In addition, increased IFC staff country presence through its phased decentralization should also facilitate a more country-focused strategic approach.

With respect to the suggestion to develop macro private sector development targets, we need to study this more carefully to determine what is feasible and meaningful, considering the difficulty in attributing country-wide macro indicators to IFC

operations. IFC could also benefit from IEG-IFC findings on which private sector development target indicators have worked in other institutions.

In the meantime, IFC is working on advancing its metrics on outcomes and impacts that can clearly be attributed to IFC's projects, advisory activities, and systemic approaches. These metrics could serve as IFC targets, but they will have to be tried on perhaps one or two countries on a pilot basis. There may be some issues with respect to the burden on clients for certain types of reporting. Therefore, IFC will need to assess the feasibility of this approach.

In addition, IFC has on-going work with the World Bank in providing broad indicators that countries may use to track private sector development. The joint World Bank/IFC annual *Doing Business* report is one example which has been increasingly used by many countries in setting targets in their reform agenda for improving investment climates.

Another joint World Bank/IFC initiative in indicator-setting is the on-going development of the "Private Sector at a Glance" tables. These one-page per country tables cover almost 60 key private sector indicators encompassing: (i) economic and social context (such as inflation rate and size of labor force); (ii) investment climate (such as ease of doing business ranking and number of procedures to start a business); (iii) private sector investment (such as private participation in infrastructure and net private FDI); (iv) regulation and taxes (such as time dealing with government officials and corporate tax rate); (v) finance and banking (such as total financial system deposit and bank branches per one hundred thousand people); and (vi) infrastructure (such as paved roads and electric power outages).

IEG-IFC Recommendation: Place an emphasis on rural development.

In its country strategies, IFC may consider flagging opportunities to work on the nexus of rural poverty and sustainable natural resources, on which poor people depend, and to identify and develop high-impact agribusiness and rural microfinance projects with widespread demonstra-

tion effects, while simultaneously providing leadership in promoting socially and environmentally sustainable practices.

Management Response

In the FY08–10 Strategic Directions paper, IFC incorporated agribusiness into the five strategic priorities. Over the past five years, IFC's commitments in the agribusiness sector have grown significantly and development outcomes have also improved. IFC is now intending to further increase its involvement in this sector by, for example, developing wholesale financing solutions using financial intermediaries, processors, and traders.

IFC is also doing some rural microfinance. However, beyond agribusiness and a few rural microfinance projects, further study is needed to understand how to be effective in rural areas, given that the results so far appear to be mixed. Management would welcome IEG-IFC's input on lessons learned from successful models of private sector rural finance to inform this recommendation.

With respect to the suggestion of providing leadership to promote socially and environmentally sustainable practices, IFC addresses this through its sustainability pillar. Following Board approval and formal launch of the performance standards in 2006, IFC's focus has been on sound implementation of the performance standards. To maintain its environmental and social sustainability leadership, IFC will continue to provide support for the further adoption and implementation of the Equator Principles. In addition, IFC is committed to scaling up its activities in renewable energy and energy efficiency sectors.

IEG-IFC Recommendation: Pursue new incentives and mechanisms to enhance cooperation with the World Bank in areas of synergy.

To enhance cooperation with the World Bank in areas of synergy, IFC could (i) consider new incentives and mechanisms to complement the CAS process (with the Bank); and (ii) identify investments at approval that were facilitated by Bank policy or regulatory assistance and track them throughout the project cycle (through the

Development Outcome Tracking System (DOTS) or other means) in order to judge their success.

Management Response

Management agrees with the recommendation of enhancing cooperation with the Bank. Leveraging the strengths of the whole World Bank Group will become more important as IFC aims to increase its development impact and increase its systemic interventions. In past years, IFC has taken several steps in this direction, from increased focus by IFC Senior Management (including inviting senior World Bank staff to IFC's strategy discussions), to including World Bank Group cooperation as part of the performance appraisal for managers in Sub-Saharan Africa, to a World Bank Group review of advisory services to assess synergies. In addition, the World Bank and IFC have a joint Vice Presidency Unit (VPU) for Financial and Private Sector Development; the Vice President of this VPU is also IFC's Chief Economist. There are also joint departments in a number of core sectors: oil, gas, mining, information and communication technology, and subnationals.

Going forward, IFC envisages increasing cooperation with the World Bank as the Corporation adopts systemic and programmatic approaches to scaling up activities. Typically, a systemic approach to a sector would start with upstream advisory work on the business-enabling environment and/or privatization, often building on efforts of the World Bank and the government. IFC can then participate in the financing of associated projects, as appropriate. In addition, IFC and World Bank cooperation will be enhanced by the implementation of IFC's phased decentralization program. This should provide more opportunities for increased World Bank-IFC staff contacts in the field.

With respect to the recommendation to identify and track performance of investments with World Bank/IFC cooperation, IFC will consider this along with the other work it is doing on metrics, such as DOTS, systemic metrics, and advisory metrics. An important issue to consider is the extent to which the performance of projects can be partly attributed to good World Bank Group cooperation.

IEG-IFC Recommendation: Manage the trade-offs inherent in the decentralization process to achieve the highest possible work quality.

IFC will need to monitor the decentralization process closely to ensure that its work quality remains robust, and support this with a rigorous training program for new investment staff.

Management Response

Management agrees with the recommendation of ensuring that work quality remains high as IFC implements its phased decentralization. IFC is taking a number of steps to help ensure sustained work quality. More experienced/senior industry staff will be located in regional operations centers to mentor and provide leadership to more junior investment staff. Credit officer(s) will similarly be stationed in operations centers and will be involved in field-based investment decisions. Field presence of environment and social specialists will be increased to further mainstream sustainability into IFC's investment work, mitigate environmental and social risks, and ensure sustainability in clients' operations. In addition, as discussed below, IFC is undertaking several steps to enhance its risk management function in connection with the decentralization. Finally, the decentralization is being undertaken in a phased approach, first in Asia, and then in other regions over three years. This approach allows IFC to learn from experience and revise implementation processes, as needed, based on these experiences.

IFC is also developing a knowledge management initiative to maintain global expertise as decentralization deepens. This would include department-level training at entry (on-boarding) and structured activities for sharing knowledge. This initiative would complement the current IFC induction program and credit courses, which have proven to be effective.

IEG-IFC Recommendation: Ensure sound risk-management systems and develop risk-mitigation products.

IFC will need to make continued efforts to improve its risk-management systems and to prepare for the next correction in the international mar-

kets, including perhaps the extended use and development of new risk-mitigation products.

Management Response

Management agrees with this recommendation. IFC has in the past responded well to such crises by supporting its portfolio projects and undertaking countercyclical investments such as trade financing, as well as debt and equity funding. IFC's FY08-10 Strategic Directions paper acknowledges that current conditions in markets where it operates could change should there be financial crises. IFC's growth strategy takes into consideration the need to maintain financial capacity to accommodate the impact of possible financial crises. IFC stands ready to play a countercyclical role, with instruments such as trade lines and other support, including advisory services, to select clients.

IFC is undertaking several steps to improve overall risk management and thereby better prepare IFC for the next crises. As part of the decentralization initiative, the risk-management function will be transformed to facilitate improved client service and efficiency, while retaining appropriate checks and balances on decentralized decision making. Steps in this direction include: (i) the ongoing Business Process Review to streamline and strengthen operational procedures; (ii) shifting credit review and, eventually, most aspects of risk management decision-making to the field; (iii) enhanced corporate tools for risk management, including improved risk-rating systems; (iv) integration of development-impact metrics with financial risk-return metrics; (v) enhanced reporting of all metrics; and (vi) strengthening of information technology (IT) for more efficient and effective document processing and management.

IEG-IFC Recommendation: Strengthen the capacity for evaluation and its application.

As it deepens its self-evaluation and monitoring systems, IFC could, with IEG-IFC's assistance, ad-

vance its metrics to better understand (and derive lessons about) the wider sector and the country-level impacts of its operations.

Management Response

IFC agrees with the recommendation of deepening its evaluation and monitoring system in consultation with IEG-IFC. In the past, IFC has consulted with IEG-IFC on the development of its monitoring and self-evaluation system, that is, DOTS for investment operations and the project completion report (PCR) for advisory services. Both DOTS and PCRs are already contributing to increased development focus through clear objective-setting and tracking of outcomes. The PCR for advisory services, which is in the pilot stage, is being supplemented by thematic impact evaluations.

As the report mentions, DOTS is starting to supplement expanded project supervision reports (XPSRs) by providing results that cover IFC's entire portfolio (rather than a sample) and are more up-to-date. DOTS provides an earlier, preliminary indication of results, and takes into account developments after the XPSR is written. The data from DOTS feed into IFC's strategic decision making. Both XPSRs and DOTS already cover broader impacts beyond the client company.

On evaluating country and sector-wide impacts of IFC's operations and drawing lessons from them, IFC already routinely considers the results of its projects, including impacts beyond the client company. IEG-IFC's country and sector evaluations are also providing valuable insights. Tracking country and sector-wide metrics will, however, not make sense in all cases, because IFC's investments are often a relatively small share of private investment, making attribution of country-level results to IFC's activities difficult or even meaningless. However, as noted earlier, there could be scope for a pilot test.