



Chairperson's Summary: Committee on Development Effectiveness (CODE)

On August 29, 2007 the Committee on Development Effectiveness (CODE) considered the report *Financing Micro, Small, and Medium Enterprises: An Independent Evaluation of IFC's Experience with Financial Intermediaries in Frontier Countries*, and the draft IFC Management Response.

Background

CODE discussed *A Synthesis Evaluation of Four IFC-supported Small and Medium Enterprise Facilities* together with the Draft Management Response on August 30, 2004. The main thrusts of IFC's strategy were considered on April 11, 2007 at a joint Budget Committee and CODE meeting to review *IFC Strategic Directions: FY08–FY10, Creating Opportunities*. On July 25, 2007 the Committee also considered the *Evaluation of IFC's Private Enterprise Partnership Advisory Services Program (PEP) in Eastern Europe and Central Asia (ECA)* and the draft IFC Management Response.

Main Findings and Recommendations

The IEG report assesses IFC's strategies, investment projects, and advisory services operations

from fiscal years (FYs) 1994–2006 to support micro, small, and medium enterprises (MSMEs) in frontier countries. The report also includes an evaluation of the MSME financial intermediaries (FIs) and their performance in implementing IFC's environmental, health, and safety (EHS) requirements. The evaluation concludes that IFC's strategy for supporting MSMEs through FIs, and providing capacity-building advisory services to the intermediaries, has been relevant and broadly effective. IEG recommends that in order to substantially enhance the development impact of MSME-FI projects, IFC should reinforce and modify the strategy by implementing the following three initiatives: (i) take a more proactive approach in encouraging other development partners to promote the establishment of prudential regulatory frameworks for microfinance intermediaries (MFIs) to facilitate their transition out

of donor dependency; (ii) enlarge the scope of its advisory services to MSME-FIs to help selected MSME-FIs better meet the need for savings and other banking services (for example, remittances) by poor households and small businesses; and (iii) give a high priority to improving the EHS supervision and compliance of MSME-FI projects.

Draft IFC Management Response

IFC Management agrees with the main thrust of the IEG findings and recommendations. Management also appreciates the study's discussion of IFC's significant role in the success of the MSME-FIs, in particular, its role as a long-term equity investor and proactive shareholder in MFI projects. IFC, mostly through its donor-funded facilities and in collaboration with the Consultative Group to Assist the Poor (CGAP), has been selectively involved in a high-level dialogue with governments to help develop a favorable regulatory environment for microfinance. At the same time, Management believes that this is a role that CGAP is best positioned to fulfill. Since May 2006, under the new IFC Sustainability Policy Framework, a number of important measures to improve compliance with the EHS standards have been taken (for example, engagement with the client FI upfront, one-on-one guidance to high-risk clients, moving standardized training to an e-learning platform for greater efficiency, and so forth). Management believes that the implementation of the above measures will lead to a substantial improvement in the EHS performance of FIs.

Overall Conclusions

CODE welcomed the IEG report for its valuable recommendations and encouragement toward IFC's strategy and operations going forward. CODE was pleased by the IEG findings that IFC's approach to financing MSME in frontier countries through FIs has been relevant and largely successful. Accordingly, members commended IFC for its efforts, and were also gratified to note that Management broadly agreed with the recommendations and appeared to be already acting on them. They also expressed broad support for the IEG recommendations that IFC should promote

the establishment of specific regulatory frameworks for MFIs, enlarge the scope of its advisory services to diversify their activities, and improve the EHS supervision. Members stressed the importance of World Bank Group (WBG) synergy in developing prudential microfinance regulations, cautioned against a simplistic approach to diversification of micro FI activities, and emphasized the need to increase compliance with EHS performance standards. In addition, speakers raised a number of specific questions (for example, gender aspects) and made particular suggestions (for example, on local currency operations).

The following main issues were raised during the meeting:

Development of an appropriate regulatory framework. While appreciating and supporting IFC's value added in establishing prudential regulatory frameworks, most speakers felt this recommendation needed to be directed more to the WBG as a whole, and to IBRD/IDA in particular, for a number of reasons including, among others, managing real or apparent conflicts of interest. Some members noted that IFC can be very successful in building capacity of microfinance institutions as well as MSME-FIs through knowledge sharing. A remark was made that IFC should provide advisory services on improving the regulatory framework to local financing institutions, to ensure they have adequate capacities to work with governments and public authorities. Additionally, one speaker stressed that provision of advisory services should always be done in parallel with provision of investments. *Management pointed out that IFC is actively involved in the dialogue with CGAP and the WBG on expediting the regulatory frameworks in countries, based on its global experience in this area.*

Diversification of MSME-FI services. The scope of MFI activities also drew several comments, particularly broadening it beyond the provision of credit. Most members cautioned against an oversimplified interpretation of this recommendation, noting both the value of maintaining a strategic focus as well as the complexities of local regulation, for example, regarding deposit-

taking institutions. A few members stressed that client countries need strong regulatory bodies for diversifying MSME-FI services.

Compliance with EHS performance standards. A few members welcomed IFC's work on improving EHS compliance but expressed concerns about its sustainability because of FIs' weak capacity. At the same time, one speaker felt that Management was not fully responsive to IEG recommendations on this particular issue. *Management explained that IFC has started implementing its new decentralized business model, which will bring staff closer to clients. Management believes staff in the field will help improve EHS supervision, which should result in better compliance with EHS performance standards.*

Regional disparities and local conditions. Some members emphasized the importance of considering Regional disparities and specific, local, financial-market conditions for successful implementation of IFC's strategy to support MSMEs through FIs. *Management remarked that IFC is focusing its MFI activities in the Africa Region,*

which has been lagging behind the others. Management also believes that political and financial crises have to be taken into account when evaluating the success of MSME-FI programs in the different Regions.

Other issues. Some speakers stressed that IFC's involvement with MFIs should be broadly consistent with the WBG Financial Sector Strategy. A member noted there was no reference to gender aspects in the report even though, in most frontier countries, access to microfinance for women is limited. *Management informed that IFC has a program with the banks, which provide gender-focused credit lines to FIs. An independent entity is analyzing the impact of this program; the results of the analysis will be available later this year.* One speaker encouraged IFC's involvement in building capacity of financial institutions for the local currency loans provision. Such an approach would facilitate the transition of MFIs out of donor dependency.

Jiayi Zou, Chairperson