

About IEG

IFC's Independent Evaluation Group (IEG) independently evaluates IFC's investment and technical assistance operations and reports its findings to IFC's management and Board of Directors. IEG is a resource for helping staff understand what IFC has learned and how IFC can do better business in the future.

About Findings

IEG *Findings* helps inform IFC and Bank Group managers and staff about new evaluation findings and recommendations. *Findings* is also available to the public. The views expressed here are those of IEG and should not be attributed to IFC or its affiliated organizations.

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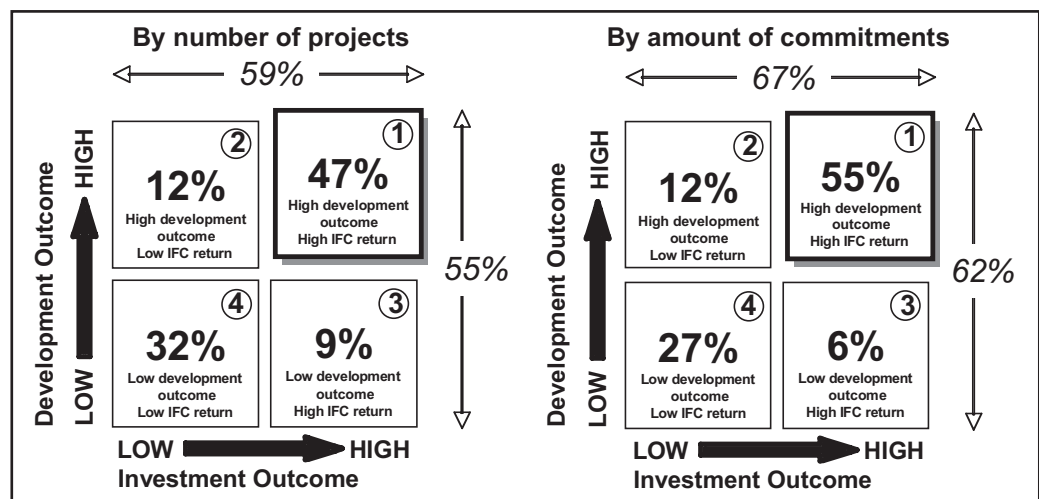
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Annual Review of FY2005 Evaluation Findings in IFC

IEG's *Annual Review* presents a meta-evaluation of IFC's self-evaluation results. This year's *Review*, IEG's ninth, covers 210 randomly selected projects approved in 1997-99 and evaluated in 2002-04. As in previous years, the *Review* assesses the outcomes and outcome drivers of IFC's investment operations in light of the operating environment during the life of the projects. Also, like in previous years, the *Review* focuses on a theme which, in IEG's opinion, is timely and relevant to IFC's current operations. This year's theme is IFC's operations in Sub-Saharan Africa (Africa) between 1990 and 2005.

The *Review* finds that IFC's results are in line with those achieved in recent years, and that IFC is generally managing the key drivers of its results well. The *Review* also finds that since 1990, high business climate risk in Africa has severely constrained private investment and has led to a relative shortage of viable investment opportunities for IFC. IFC has nonetheless achieved some development successes in Africa, notably in the infrastructure sector.

Figure 1: 47 percent of operations (55 percent by amount committed) achieved high development outcomes and high investment outcomes



To what extent is IFC supporting sustainable private sector enterprises?

This question directly assesses whether IFC is achieving good outcomes in pursuing its mission, the principal part of which is to promote sustainable private sector development in developing countries.

Based on the evaluations of a random sample of 210 operations, 53 percent of IFC's 1997-99

investment approvals that were committed and disbursed,ⁱⁱ the *Review* found that 59 percent of operations achieved high development outcomes while 55 percent achieved high investment outcomes.ⁱⁱⁱ Forty-seven percent of operations (55 percent by volume) achieved *high-high* outcomes, meaning they delivered both high development and investment outcomes (Figure 1).

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Development and investment performance is measured as follows:

■ **Development outcome:** A bottom-line assessment of the IFC-supported operation's results on the ground and contribution to the country's development, relative to what would have occurred without the project. The rating is determined case by case considering the relative importance of four underlying indicators in the specific operation: project business success, economic sustainability, environmental, social, health and safety (ESHS) impacts, and contribution to private sector development (see Box 1).

■ **Investment outcome:** The gross profit contribution to IFC's financial results of its debt and/or equity investments in a project, not including transaction costs and the cost of IFC equity capital.

There has been no material trade-off between development and investment results in that the vast majority of operations (79 percent by number) yielded either *high-high* or *low-low* outcomes.^{iv} These results are in line with those reported in recent *Reviews*.

Box 1: There are four underlying indicators of IFC's development outcomes

The development outcomes of IFC's projects are evaluated across four performance dimensions:

Project business success (44 percent success rate): Real sector - generated a project financial rate of return (FRR) at least equal to the company's cost of capital. Financial sector - associated sub-portfolios or asset growth, contributed positively to the intermediary's profitability, financial condition, and business objectives.

Economic sustainability (63 percent success rate): Where measurable, generated an economic rate of return (ERR) of at least 10 percent. This indicator also takes into account net gains or losses by non-financiers, non-quantifiable impacts, and contributions to widely held development objectives.

Environmental and social impacts (69 percent success rate): Met or exceeded IFC's environmental, social, health and safety requirements at approval.

Private sector development (PSD) (70 percent success rate): A project's PSD impact beyond the project company is positive, particularly its demonstration effect in creating a sustainable enterprise capable of attracting finance, increasing competition, and establishing linkages.

Is IFC successfully managing the key drivers of its results?

With an eye towards improving future results, the *Review* asked how effectively IFC is currently managing four key drivers of its development and investment outcomes: (i) IFC's work quality, especially in the screening, appraisal and structuring of projects and investments;

(ii) the level of a project's intrinsic high-risk intensity at approval along with the financial risk in IFC's associated financing instrument choice; (iii) IFC's strategic choices of a sector, thematic or country focus; and (iv) changes in business climate quality between approval and evaluation. Together, these factors explain the results of about two-thirds of IFC projects.

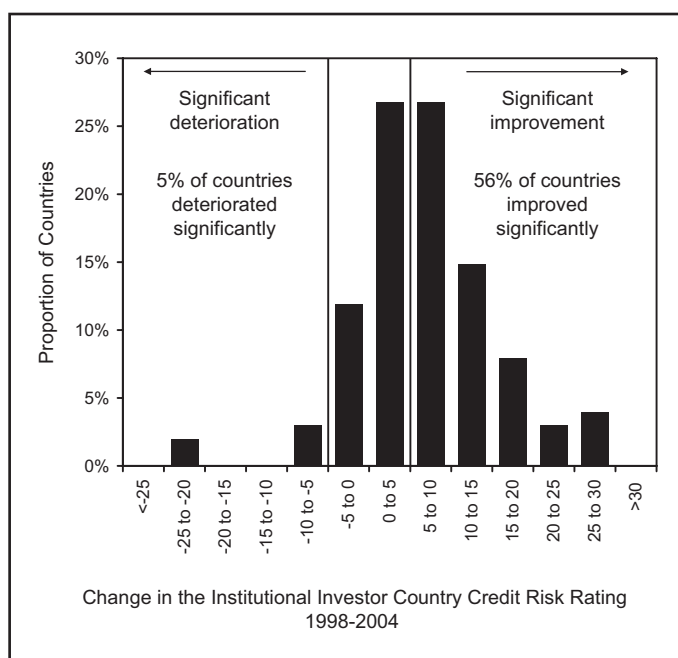
Overall, IFC is managing the key drivers of results well, with positive directional change in three of the four results drivers:

■ **Improved supervision quality:** IFC's work quality ratings have improved substantially from 45 percent satisfactory or better in 2000 to 79 percent in 2004. This contrasts with a declining trend between 1996-2000. The upward trend largely reflects improved supervision and administration, an indication that several IFC quality improvement steps (including strengthened environmental procedures in 1998, the establishment of portfolio units in 1999, and the introduction of IFC's sustainability initiative in 2001) are having a positive impact during the operational phase of evaluated projects;

■ **Better project risk mitigation in newer commitments:** Newer IFC commitments (2002-04 approvals) show more intensive credit review procedures, more realistic debt service coverage ratios, and increased use of quasi-equity instruments. This suggests improving IFC appraisal quality and the potential for better outcome quality from more recently approved projects;

■ **Beneficial strategic choices:** Better outcomes, on the whole, in IFC's strategic sectors than in non-strategic sectors. IFC has also increased its share of commitments in strategic sectors since 1998 (in both absolute and percentage terms).

Figure 2: Since 1998, 44 percent of countries have shown no material improvement in their risk ratings

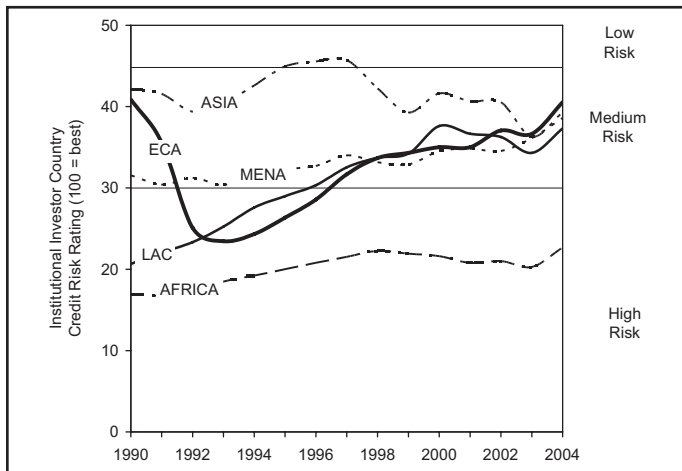


However, *business climate risk is increasing in IFC's portfolio*. The increase in business climate risk reflects the implementation of IFC's frontier strategy (first articulated in 1998), which has steered the Corporation towards increased investments in frontier (high-risk^v and/or low-income) countries, where it has the most potential additionality, and that almost half of countries in which IFC operates have shown no material improvement in their business climate since 1998 (Figure 2).^{vi} IFC has accordingly become more than twice as concentrated in frontier countries compared to foreign direct investment (FDI), and business climate risk in newer IFC commitments is higher than in projects in the evaluated sample (approved 1997-99). Given the positive impact that an improving business climate has on IFC's outcome quality, continued business climate improvements will be critical to delivering better IFC results.

Is IFC addressing the unique challenges of doing business in Africa?

While high-risk country business climates (see endnote V for definition) can be found across the world, they are particularly prevalent in Africa. On average, the region was high-risk from 1990-2004 (Figure 3). In that time, only five countries sustained medium and/or low sovereign credit risk ratings. Accordingly, private investment, a key engine of economic growth, has been very low in much of Africa (Figure 4).

Figure 3: Business climate risk is particularly high in Africa



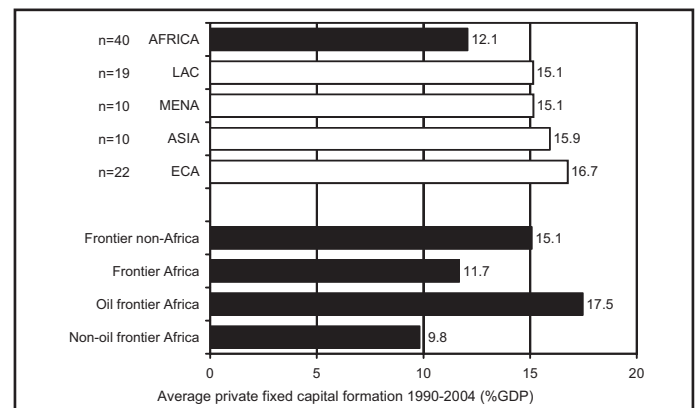
Given the unique challenges of doing business in Africa and the fact that IFC is seeking to significantly scale up its investment and technical assistance operations in the region, the *Review* places a special evaluative focus on IFC's past performance in Africa to draw out lessons and help enhance IFC's prospects going forward.

IEG assessed 66 investment operations in Africa approved during 1991-99 and evaluated in 1996-2004, as well as findings from IEG country and thematic evaluations and an analysis of IFC's Africa portfolio between 1990-2005.

IEG found that the level of IFC's committed investments in Africa has been constrained by the generally poor business climates and the

relative lack of viable investment projects supported by strong sponsors. Moreover, the development success of evaluated investment operations and technical assistance and advisory (TAAS) programs have been mixed. IFC's Africa portfolio made a net loss between 1990-2002, although it was profitable from 2003-05 as a result of a few highly successful equity investments. Overall development results of evaluated projects were good in the infrastructure sector but relatively less strong in the financial markets sector. The evaluated TAAS programs, representing over three-quarters of IFC's TAAS for small and medium enterprises (SME) in Africa, have had difficulties in meeting their objectives, although IFC was in the process of restructuring them at the time of the evaluation.

Figure 4: Private investment has accordingly been limited in Africa...particularly in non-oil producing frontier countries



For the 48 percent of evaluated investment projects in Africa that achieved high development outcomes (64 percent by committed amount), IEG estimated that each \$1 of investment provided \$1.50 of economic benefits in present value terms. Projects with low development outcomes provided economic benefits of only \$0.10 per \$1 invested.^{vii} The impacts of IFC's proposed scaling up in Africa will, therefore, be greatly enhanced if it is able to match increased volumes with better quality outcomes.

The evaluation data indicate the following as key quality challenges: (i) achieving better environmental performance by fostering greater client willingness to comply with environmental standards as well as providing adequate supervision, resources, and technical solutions; (ii) deepening IFC's reach to non-exporting SMEs through the development of local currency financing and reducing barriers to SME lending by local financial institutions; and (iii) improving IFC's work quality throughout the project lifecycle - shortfalls, which have contributed to low project success rates in the past.

IFC has recently embarked on some significant structural changes in its operations in the region, including a major revamping of its SME TAAS programs, as well as taking steps to improve project environmental supervision by locating more environmental specialists in field offices, which addresses some of these outcome quality issues. IEG's recommendations accordingly seek to reinforce these initiatives.

R E C O M M E N D A T I O N S

IEG's recommendations address some key challenges facing IFC in its efforts to scale up its operations in Africa and in similar high-risk business environments across the world. As such, they seek to supplement steps that IFC is already taking to address past performance shortfalls. In summary:

- **Enhancing the environmental performance of IFC's projects:** IFC should monitor its mainstreaming of environmental appraisal and supervision across its operations in Africa, and take essential additional steps that are necessary to address important weaknesses in environmental performance identified in project companies;
- **Improving the development impacts of IFC's financial sector projects in Africa:** In expanding its financial markets portfolio in Africa, IFC will need to follow through on its intention to develop appropriate products that will expand the availability of term local currency financing. This will be critical if IFC is to enhance its reach to non-exporting SMEs in other countries in Africa besides South Africa and Nigeria;
- **Improving business climates and increasing private sector investment:** IFC should deepen its strategic engagement with the World Bank and other development partners towards improving business climates in Africa and increasing private sector investment. In addition, IFC management might consider whether IFC should take the institutional lead in championing private sector development in Africa (as it has done with sustainable development through the Equator Principles), for example by promulgating an overall target or targets for private investment in the region (such as levels of private fixed capital formation as a percent of GDP).

End Notes

ⁱ Unless specifically noted, "IEG" means "IEG-IFC" in this document.

ⁱⁱ IFC's investment departments execute project self-evaluations using corporate guidelines, and IEG independently verifies (or re-rates) each of the components and bottom-line outcome ratings in these evaluations.

ⁱⁱⁱ Due to numerical rounding, the sum of the high IFC return boxes do not add up exactly to the aggregate high IFC returns of 55 percent (by number) and 62 percent (by amount of commitments).

^{iv} The 21 percent of operations that produced high-low or low-high outcomes (squares 2 and 3 in Figure 1) occurred not by design but were due to IFC's choice of financing instrument (loan, equity, quasi-equity) and to emerging market and other conditions. For example, a project with a high development outcome could have a low equity investment outcome in U.S. dollar terms due to a major local currency devaluation.

^v IFC defines a country as high-risk if its Institutional Investor Country Credit Risk Rating (IICCR) is less than 30 (out of 100, with 100 corresponding to the lowest chance of sovereign default on its foreign currency debts).

^{vi} In terms of IFC risk classification, 81 countries were high-risk in 1998 and 73 countries were high-risk in 2004.

^{vii} These figures are approximations based on the actual ERRs, project sizes and investment amounts of 41 investments in Africa with ERR calculations at evaluation. Benefits are quoted in nominal terms.

IEG-IFC is an independent unit directly accountable to IFC's Board of Directors through the Director General, Evaluation, World Bank Group (WBG). The views expressed here are those of IEG-IFC and should not be attributed to IFC or its affiliated organizations.

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