ANNEX II. REGIONAL STRATEGIES

CENTRAL AND EASTERN EUROPE

Annex II - Table 1: Central and Eastern Europe

	FY05 Actual	FY06 Actual	FY07 Plan	FY10 Indicative
Commitments ($m)	1,128	1,092	700-900	900-1,100
Advisory Services Spending ($m)[1]	18	17	25	21
Development Impact Score (%)[2]	70%	70%	75%	-

[1]Incurred by field-based or HQ-based AS programs, including pre-project, project, program management and overhead costs for regional donor-funded operations (DFOs), global facility allocation, business line envelope and stand-alone advisory services.
[2]Expanded Project Supervision Report (XPSR) – percentage of XPSRs which scored "mostly successful and above" on the development outcome measure based on a 3-year rolling average. The FY07 score is an estimate.

Strategic Context

1.1. In this region of fast growing economies, IFC has rapidly increased its activities in recent years. Most of the region's countries place a strong emphasis on private sector-led growth. The World Bank Group Country Assistance Strategies (CAS) reflect this and assign a strong role to IFC. Both the financial performance and development impact of the IFC portfolio have been strong in recent years. IEG evaluations of development impact show that projects in the region have had higher success rates than IFC's average since 1994. Whilst the share of the region's GDP in frontier countries (Armenia, Belarus, and Georgia) is small, IFC has seen an increasing number of projects in these countries, and 5% of the portfolio is currently in these countries. In terms of sectors, financial markets continues to represent about half of the portfolio, with manufacturing and services and infrastructure also representing significant portions.

1.2. **Advisory Services**. IFC has also engaged in an active advisory program through the Private Enterprise Partnership (PEP), which was established in FY01. Since its establishment, PEP has generated significant development impact[19], for example in the following business lines:

- Access to Finance (housing finance, energy efficiency finance and leasing): programs enabled $399 million in investment by local and foreign companies and a $392 million growth in the availability of lease financing;
- Value Added to Firms (primarily corporate governance and agribusiness supply chain development): programs enabled $694 million in investments in clients served, and more than 1,200 clients reported an improvement in their operations;
- Business Enabling Environment: businesses saved an estimated $45 million as a result of reforms related to permits (Ukraine), company registration procedures (Belarus) and reducing the burden of government regulation (Uzbekistan).

[19] Note that these results include all countries where PEP works, including those in the Southern Europe and Central Asia Region.

IFC's Priorities

1.3. Assuming continued growth in the financing available to the region from the private sector, IFC anticipates a leveling off of investment levels (with a greater number of smaller projects) and focus on a few high value added products in advisory services. IFC will focus on priority areas where it has strong additionality. This will include supporting local companies and building long-term partnerships with strong regional players. Across the region, IFC will continue to support financial institutions with investment and advisory services, particularly in the expansion of key financial products, including housing finance, securitization, SME finance, and sustainability financing. A relatively new priority will be the promotion of private sector investment in infrastructure and public-private partnerships.

1.4. **Geographical Priorities**. In terms of geographical priorities, in both investment and advisory services, IFC will increase efforts to reach the frontier regions of Russia and Ukraine more effectively and the frontier markets of Armenia, Georgia and Belarus. Armenia and Georgia are small markets, and Belarus has a nascent private sector, but IFC anticipates making several small but catalytic investments in these countries each year, particularly in financial markets, agribusiness, the manufacturing and service sectors, and in infrastructure. In order to benefit the SMEs of these frontier markets, IFC will provide advisory services, in particular to improve the business enabling environment and support the development of financial institutions and products.

1.5. *Ukraine*. IFC plans to increase business development efforts in Ukraine, where it sees significant opportunities. IFC's efforts to reach clients in Ukraine will extend across all sectors, particularly financial markets, agribusiness, and manufacturing and services. Investments in infrastructure and sub-national financing may also have significant development impact, although opportunities in these areas are currently limited by external factors. IFC will also increase advisory services in Ukraine, launching new projects that include alternate dispute resolution, work with municipalities on energy efficiency, and agricultural insurance.

1.6. *Russia*. Given the large portfolio in Russia, IFC expects annual investment volumes to level off and the focus will be on the areas of high impact. Financial markets will continue to be a priority area, including the introduction of new financial products and strengthening institutions in the less developed regions of the Federation. Together with the World Bank, a key area of engagement is municipal infrastructure and sub-national finance, which are central to the recent Country Partnership Strategy for Russia. Investments in transport infrastructure and high-tech sectors (such as information and communications technology and convergence) are also important to support Russia's economic development and diversification. Advisory services will remain an important part of IFC's engagement in Russia through a select number of projects, in particular through existing products in housing finance and energy efficiency, and with an opportunity to expand into cleaner production.

1.7. *New EU Member Countries*. In the new EU member countries, IFC responds to opportunities only where the Corporation has a clear role in projects that support complex privatizations, environmental improvements, the introduction of innovative financial products, or that promote inter-regional investment.

EAST ASIA AND THE PACIFIC

As discussed earlier in this paper, IFC has begun to accelerate the decentralization of operations and to streamline business processing to serve clients better and increase its development impact. The decentralization pilot in East Asia and the Pacific and South Asia discussed with the Board in last year's Business Plan and Budget Paper (IFC/R2006-0219) is the first stage of this new approach, and several projects have already been processed in the field using the increased field resources and delegation of authority.

Annex II - Table 2: East Asia and the Pacific

	FY05 Actual	FY06 Actual	FY07 Plan	FY10 Indicative
Commitments ($m)	740	982	1,100-1,200	1,700-2,300
Advisory Services Spending ($m)[1]	26	26	45	50
Development Impact Score (%)[2]	62%	59%	47%	-

[1]Incurred by field-based or HQ-based AS programs, including pre-project, project, program management and overhead costs for regional DFOs, global facility allocation, business line envelope and stand-alone advisory services.
[2]Expanded Project Supervision Report (XPSR) – percentage of XPSRs which scored "mostly successful and above" on the development outcome measure based on a 3-year rolling average. The FY07 score is an estimate. The recent development impact scores reflect the higher risks and the learning curve associated with smaller projects involving new business models largely related to the dot.com sector. This experience has informed subsequent IFC investments.

Strategic Context

2.1. **Recent Economic Developments**. In 2006, the region grew at an annual rate of a little over 8%, and growth is expected to remain at about the same rate in 2007. This dynamism is underpinned by some of the highest levels of savings and investments in the world. The region is characterized by rapid integration driven by the emergence of China. Intra-regional trade and investment flows are growing in importance. Chinese companies are becoming important investors in countries within and outside the region. IFC sees an increasing role in helping regional companies expand outside their borders.

2.2. Countries in East Asia and the Pacific are very diverse in terms of size, level of development and the challenges the private sector is facing. China is a major emerging economic power with growing regional and global influence. It has a liquid banking sector and receives the largest share of FDI to emerging markets. Vietnam joined the World Trade Organization in January 2007 and Philippines benefited from the reduction of public sector deficits and fiscal reforms. Other "transition" economies in the region, including Mongolia, Laos and Cambodia, are reforming and looking for ways to improve the business environment for their small and medium sized enterprises, whilst the market economies of Indonesia, Thailand, Malaysia and Korea have made significant progress since the 1997 Asian crisis.

2.3. **Development Challenges.** Despite these positive developments, addressing the institution-building issues of financial sector development and corporate governance is still a long-term challenge. The financial systems of economies in the region rely on weak banks, many countries suffer from weak legal institutions and most countries still present difficult investment environments for private sector growth. In addition, the region is increasingly faced with the need to cope with the environmental and social challenges of rapid growth. Economic dynamism and massive urbanization are putting pressures on physical and social infrastructure and the investment needs in this area are enormous. Although poverty continues to fall in most parts of the region, there is still widespread poverty with more than 550 million people living on under $2 a day. A large number of small, isolated and often conflict-ridden countries, especially in the Pacific, have barely grown above population growth over the last decade.

2.4. IFC's commitments in the region have increased, growing from $740 million in FY05 to $982 million in FY06. In general manufacturing, IFC supported twelve projects with local firms trying to meet international standards. Activities in transition economies have focused on supporting the growing role of the private sector, particularly local domestic private companies. In the financial sector, IFC engaged in landmark banking transactions in China, Indonesia, and Vietnam, resolution of non-performing loans through asset management companies and provided support through advisory services for institution-building. In Indonesia, the World Bank Group made a step forward in the sub-national area, with IFC supporting a sub-national borrower that had previously been supported through World Bank loans. In the frontier economies of the region, IFC's activities have concentrated on assisting the growth of SMEs through IFC and donor-funded project development facilities. The region hosts six such facilities, which are to be integrated under PEP East Asia and the Pacific: Mekong Project Development Facility (MPDF) for the Mekong region, Pacific Enterprise Development Facility (PEDF) for the Pacific countries, Private Enterprise Partnership for Philippines (PEP-Philippines), China Project Development Facility (CPDF) for the Western regions of China, Private Enterprise Partnership for Aceh (PEP-Aceh), and Program for Eastern Indonesia SME Assistance (PENSA) for the remote islands of Indonesia.

IFC Priorities

2.5. IFC's strategic priorities in the region are: (i) small states and frontier regions; (ii) financial market development; (iii) infrastructure development; and (iv) sustainability.

2.6. *Small States and Frontier Regions*. IFC will use advisory services to strengthen the business enabling environment and unlock opportunities in infrastructure. It will leverage relationships with local and regional banks active in the Pacific, Timor Leste, Papua New Guinea and other small states to expand investment activities and reach SMEs. IFC will also support investments in sectors of comparative advantage, including in resources sectors. IFC's global products, including trade and micro-finance, are particularly well suited for small and frontier countries and it will try to apply them across the region beginning with the frontier countries of Vietnam and Mongolia.

2.7. *Financial Market Development*. IFC's objective will be to strengthen financial institutions, support institution building in capital markets and build capacities and incentives to reach underserved segments. To achieve these objectives, IFC will use advisory services to strengthen the enabling environment and build supporting infrastructure, particularly in frontier markets. IFC will leverage relationships with client banks to reach underserved segments, including MSMEs, housing, trade, and energy efficiency by introducing IFC's global product expertise. To support institution and capacity building, IFC will make equity investments in existing financial institutions in strategic partnerships with other institutions or strong management teams to support good governance and better capital allocation. IFC will also use advisory services to support capital market development and build relationships with non-bank financial institutions.

2.8. *Infrastructure Development*. IFC will use advisory services to unlock investment opportunities in infrastructure. IFC's business development efforts will be focused on: (i) countries with limited local financial market capability; (ii) local and regional players seeking to leverage IFC's reputation, global expertise and advisory services capabilities; and (iii) wholesale opportunities through IFC's financial market network. To address the specific investment needs in infrastructure, IFC will introduce innovative products, including long-tenor local currency loans, credit enhancement of carbon credits and flexible quasi-equity/preferred equity structures. IFC will develop and demonstrate new models of public private partnerships and introduce IFC's new sustainability products.

2.9. *Sustainability of Growth***.** Advisory services will be used to strengthen the enabling environment for sustainable investment, particularly in frontier markets, with complementary investments to provide demonstration effects. IFC will use advisory services and investments to catalyze private investment in urban infrastructure, renewables, clean energy and energy efficiency. IFC will continue to work with financial institutions to encourage the adoption of energy efficient technologies. In natural resource industries and manufacturing sectors, IFC will align advisory and investment strategies to strengthen impact and establish models of best practice in environmental, social and corporate governance standards, including linkages programs as well as other targeted value-added services.

SOUTH ASIA

As discussed earlier in this paper, IFC has begun to accelerate the decentralization of operations and to streamline business processing to serve clients better and increase its development impact. The decentralization pilot in East Asia and the Pacific and South Asia discussed with the Board in last year's Business Plan and Budget Paper (IFC/R2006-0219) is the first stage of this new approach, and several projects have already been processed in the field using the increased field resources and delegation of authority.

Annex II - Table 3: South Asia

	FY05 Actual	FY06 Actual	FY07 Plan	FY10 Indicative
Commitments ($m)	443	507	500-530	1,000-1,200
Advisory Services Spending ($m)[1]	7	12	17	36
Development Impact Score (%)[2]	57%	46%	43%	-

[1]Incurred by field-based or HQ-based AS programs, including pre-project, project, program management and overhead costs for regional DFOs, global facility allocation, business line envelope and stand-alone advisory services.
[2]Expanded Project Supervision Report (XPSR) – percentage of XPSRs which scored "mostly successful and above" on the development outcome measure based on a 3-year rolling average. The FY07 score is an estimate. The development impact ratings in recent years reflect an increased number of projects affected by a number of factors, including the industrial slowdown in India in the late 1990s, security problems in Nepal, and the higher risks associated with investments in small IT companies.

Strategic Context

3.1. South Asia is home to 1.3 billion people, of which 30% live on less than $1 a day. In recent years, economic growth has accelerated to nearly 7% per year, reducing poverty levels. Continued strong growth offers the best prospect for further poverty reduction, but this depends on expanded provision of social infrastructure and improvements in environmental sustainability, so that the benefits of growth are widely shared, and the growth is sustainable. A long legacy of over-regulation and under-investment in infrastructure has resulted in a high-cost investment climate, which is a major impediment to attracting private investment. As a result, South Asia receives the lowest amount of FDI as a proportion of GDP of any region in the world, so growth is largely generated by domestic investment, fuelled by rising savings rates. Recently, India's strong growth and relatively well developed capital markets have attracted record inflows of portfolio capital and private equity. However, this has been focused on a few sectors. Overall, the region continues to lack both the financing and the access to global knowledge and markets that FDI would bring.

IFC's Priorities

3.2. IFC aims to help South Asia integrate into the global economy by bringing foreign investors to South Asia and taking South Asian companies to other markets; share global best practices; and provide longer tenor/subordinated debt and equity to second tier companies, whilst adding value from mobilization, sustainability and IFC's "seal of approval". As of end FY06, the committed portfolio was $1.9 billion. IFC aims at least to double this to $4 billion by FY10.

3.3. **Infrastructure**. Infrastructure continues to be the main constraint to sustaining rapid economic growth in South Asia. Lack of access to or poor quality of infrastructure services seriously affects the quality of life, especially for the poor. Regional governments are increasingly seeking private participation in infrastructure financing. The main constraints to greater private financing are the lack of bankable projects, lack of equity and availability of long tenor funding. IFC aims to scale up its support for private investment in infrastructure in close collaboration with the World Bank, with new commitments possibly reaching $500 million per year by FY10. This will be achieved through a mix of investments of long-term debt and equity in specific projects; corporate investments in local infrastructure development companies; wholesale funding through local financial institutions and investment funds; pioneering sub-national finance transactions; and advisory work to structure concessions, privatizations and PPPs. Target sectors include power, transportation, water, waste water and sanitation. IFC is improving the structure of its local currency loan products in order to provide more appropriate products for infrastructure lending. IFC is also developing a donor-funded facility to increase its capacity to do advisory work for infrastructure.

3.4. **Rural Areas.** In India, the majority of the poor live in rural areas, where the private sector has had less of an impact on economic growth. IFC is seeking ways to increase the impact of the private sector on rural growth through investments and associated advisory services in agribusiness, rural finance (especially microfinance) and rural infrastructure. IFC aims to increase investments in these three areas to $200 million per year by FY10. In addition, IFC helps investee companies link their operations to the rural economy. This year, IFC launched a major linkage program in a poor, undeveloped region of Rajasthan, India, associated with its investment in Cairn Energy.

3.5. **Financial Sector.** In the financial sector, IFC's strategy is to make investments and provide advisory services to build capacity in private financial institutions which contribute to financial deepening and expansion of financial services to underserved segments, such as SMEs. In India, IFC will focus on strengthening private sector banks through equity investments in second-tier banks and Upper Tier II capital for stronger private banks as the sector opens up to increased competition and as banks strive to meet Basel II capital adequacy standards. IFC is precluded from a larger role in the Indian financial sector by government regulations which largely prohibit external borrowing by financial institutions. In Bangladesh, Bhutan, Nepal and Sri Lanka, IFC is working with partner banks through the South Asia Enterprise Development Facility (SEDF) to increase SME financing, and also to provide trade finance.

3.6. **Industrial Growth**. South Asia is currently experiencing rapid industrial growth, especially in India, as a result of improved international competitiveness stimulated by reduced tariffs and relaxation of FDI restrictions, and strong growth in domestic consumption. IFC's strategy is to invest equity and debt in labor-intensive, knowledge-based, export-oriented, globally competitive second-tier companies to support continued industrial growth. Over the past year, IFC has undertaken extensive sector mapping and segmentation analysis. This includes supporting Indian companies investing abroad, particularly in other developing countries. Three investments by Indian companies in Africa and the Middle East are expected to be committed in FY07.

3.7. **Equity Investments**. As of end-FY06, IFC held $217 million in equity in South Asia, with a market value of $428 million, representing 19.8% of the disbursed portfolio (net of specific reserves) at cost, and 32.7% at market value. IFC plans to increase the proportion of equity in its portfolio to 25% by FY10, with a focus on smaller investments and investments in family-owned companies which find it difficult to attract public or private equity. About two thirds of new investments would be made directly, and one third through funds in segments in which IFC cannot effectively invest directly. This could include early stage technology and pharmaceuticals, SME, microfinance, infrastructure and buyout/distressed assets funds.

3.8. **Energy Efficiency and Renewable Energy**. IFC sees good prospects for promoting energy efficiency and renewable energy in infrastructure, industry and agribusiness in South Asia. To encourage companies to make energy efficiency and renewable energy investments, IFC could help monetize carbon credits. IFC will promote energy efficiency in all new projects, and expects to double the number of projects with energy efficiency or renewable energy components in FY08, and increase sustainable energy commitments to $100 million by FY10.

3.9. **Frontier Countries and Regions**. IFC is undertaking focused business development efforts to find investment opportunities in frontier countries in the region and frontier regions within India. However, IFC is constrained by exposure limits in Bhutan and the Maldives, which are small countries with limited debt service capacity. In Bangladesh, Nepal and Sri Lanka, a difficult investment climate and political instability has also limited investment opportunities in recent years, although prospects for new investments are improving.

3.10. **Advisory Services**. Advisory services for SME development are IFC's main contribution to private sector development in those parts of the region where investment opportunities are limited. The SEDF program in Bangladesh, Bhutan, Maldives, Nepal, Sri Lanka and the North-East states of India is laying the foundations for later investment opportunities, by improving access to finance in partnership with local banks, improving the business enabling environment and encouraging the growth of SMEs in key sectors. SEDF works closely with the World Bank, including joint diagnostic work such as Investment Climate Assessments and joint private sector development programs. As part of a multi-donor private sector development (PSD) program in Bangladesh, IFC is preparing to launch a $24 million advisory program (IFC Bangladesh Investment Climate Facility) to support implementation of investment climate reforms, building on work begun through SEDF. SEDF is expected to continue into a second phase when the current funding cycle is completed at the end of FY08, with a focus on access to finance and private sector development.

LATIN AMERICA AND THE CARIBBEAN

Annex II - Table 4: Latin America and the Caribbean

	FY05 Actual	FY06 Actual	FY07 Plan	FY10 Indicative
Commitments ($m)	1,398	1,747	1,700-1,800	1,800-2,300
Advisory Services Spending ($m)[1]	6	9	17	23
Development Impact Score (%)[2]	64%[3]	58%	56%	-

[1]Incurred by field-based or HQ-based AS programs, including pre-project, project, program management and overhead costs for regional DFOs, global facility allocation, business line envelope and stand-alone advisory services.
[2]Expanded Project Supervision Report (XPSR) – percentage of XPSRs which scored "mostly successful and above" on the development outcome measure based on a 3-year rolling average. The FY07 score is an estimate. The development impact scores in recent years reflect the adverse effects of the Brazilian and Argentinean crises on IFC's operations.
[3]FY05 result of 66% shown in last year's paper was on the basis of one XPSR rating that had yet to be validated by IEG. Subsequently, the XPSR was re-issued, giving a result of 64% for FY05.

Strategic Context

4.1. Latin America is enjoying a sustained period of solid growth and low inflation. In 2006 real GDP growth is expected to be more than 4%, and is projected to be at the same level for 2007. The regional economy has been boosted by high prices for the commodities it exports, good global financial market conditions, and strong growth in its trading partners. Its success also owes much to sound fiscal policies. Average inflation has come down in the last two years, fiscal and external positions are much stronger, more countries have flexible exchange regimes and most central banks have established credibility in combating inflation. This credibility enables them to set lower real interest rates, which support growth. In many countries, domestic demand has played a crucial role, with real incomes boosted by lower inflation and both investment and private credit benefiting from the expansion of bank credit. This combination of global and local factors has created a positive environment for the region's economies.

4.2. Whilst governments seem determined to maintain macroeconomic stability, concerns about persistent poverty and inequality remain and have given rise to political and social tensions. Elections in the past few years, including in Ecuador, Bolivia and Argentina, have led to important changes in the political leadership in several countries. After a year of unusually high electoral activity, the relative populist shift in the region mirrors a certain degree of public dissatisfaction about the distribution of economic power and wealth. Economic growth in LAC has also been falling behind other emerging markets. LAC's relative growth in GDP per capita measured against the world average of the past twenty-five years is below average and lower than any other emerging market region except for Sub-Saharan Africa. The region remains vulnerable to a possible slowdown in the global economy and to potential decreases in commodity prices. An investment gap remains, particularly in upgrading manufacturing competitiveness, infrastructure development, and in social sectors such as health and education. Progress in structural reform is still needed in pension, labor, fiscal, infrastructure, and financial sector areas to achieve sustainable growth. In a nutshell, the region is not yet on a sustainable growth path.

4.3. **IFC Activities in FY06**. IFC's activities in the region have been evolving and adapting to this dynamic environment. Commitments in FY06 reached $1.7 billion. As countries are making headway in accessing capital markets, as liquidity is increasing, IFC places its emphasis in providing long-tenor financing, which remains difficult to access in most countries in the region, and supporting MSMEs, second-tier companies and leading companies aiming to become global players. The Corporation is also using more of its equity and advisory services.

4.4. **Global Trends: Implications for LAC**. IFC sees four global trends which have significant implications for LAC, in terms of both opportunities and challenges for IFC: (i) Shifts in global economic activity, although primarily towards Asia, are also occurring in LAC and IFC is finding opportunities in agribusiness, steel, and forestry. However manufacturing companies in several countries are experiencing declining competitiveness, exacerbated by gaps in workforce skills, access to infrastructure and bureaucracy. (ii) Climate changes and a concern for sustainable development are prompting IFC to encourage sustainable practices in the Amazon, to develop partnerships with NGOs, and to support new markets in renewable energy such as ethanol. (iii) The changing consumer landscape creates new opportunities for IFC to provide support in housing and retail finance. And finally, (iv) the aging population in both the US and Canada, including aging populations from Latin America and the Caribbean living in those countries, is opening new markets for healthcare, tourism and health-related education in Mexico, Central America and the Caribbean.

IFC Priorities

4.5. IFC's effort to support the development of the private sector in order to make markets work for all of its citizens remains the focus of its activities in the region. Specifically, against a backdrop of persistent inequality in the region and economic growth rates that lag most other emerging economies, IFC will focus on helping improve the business environment, broadening and deepening the access to finance for large and small entrepreneurs, and encouraging the sustainable development of physical and social infrastructure.

4.6. **Systemic Approach.** Whilst considerable progress has been made to encourage the private sector to invest and develop certain sectors, bottlenecks remain. A case in point is infrastructure, where public and private sector investment remains significantly below what is needed to upgrade the regions' crumbling infrastructure. In many instances, the know-how, ability and expertise of regulators to organize, prioritize and structure Public Private Partnerships is inadequate. IFC sees a critical need to work "upstream" through some combination of technical assistance and advisory services in order to encourage these PPPs to be successful. A "downstream" investment opportunity may materialize several years later but the early project development work needs to be undertaken. In both Mexico (Irapuato-Piedad Toll Road) and Brazil (BR116), IFC has seen its early stage efforts bear fruit but it took time (2-5 years) and resources to get to this stage. This systemic approach has also worked in Mexico (Housing finance) and Peru (Land Titling/Microfinance) where IFC, by complementing and building on the efforts by the World Bank and the Government, is able to catalyze private sector investment in a sector. In the Peru example IFC has leveraged the World Bank's work in helping slum dwellers get title to their properties by providing microfinance for water connections. This systemic approach seeks to maximize the World Bank Group synergies, to address effectively the structural impediments to private sector growth and achieve a greater developmental impact.

4.7. IFC plans to do more of this type of work in coming years. There are currently six to eight such initiatives underway in the LAC region. Currently, around 25% of IFC's annual commitment volume in LAC comes from such long-term initiatives. IFC's goal is to increase substantially this share during the next three years. Focus sectors include financial markets, health & education, agribusiness, infrastructure and general manufacturing.

4.8. **Putting Clients First.** IFC relies on its clients in the delivery of development impact. It is critical that IFC continually identify, develop and nurture the appropriate set of strategic clients with whom to work so that development impact can be maximized over time. At the country level this means focusing the Corporation's efforts on the key sectors that correspond to the core country needs: improving the business climate, strengthening infrastructure, improving access to finance and promoting sustainability. At the company level, the LAC region focuses on understanding client needs, ensuring efficient delivery, sharing global knowledge/best practices and innovation. This combination of assessing country needs, and selecting appropriate clients to help meet those needs will allow IFC to be more effective in frontier countries (e.g. Haiti), and smaller economies such as the small island economies of the Caribbean, whilst also making a difference on poverty in the bigger economies where 90% of the poor in LAC are struggling to make a decent living.

4.9. **Sustainability**. In Latin America, sustainability is an overarching theme which includes corporate governance, environmental and social standards. IFC is leading a number of corporate governance initiatives (Brazil – Sustainability Index, Novo Mercado) as well as providing advisory services to its clients in order to improve their access to markets. Setting benchmarks in environmental and social standards across LAC has become an everyday challenge for the Corporation. This involves the will to tackle difficult and high profile projects (Mining in Peru, Guatemala and Guyana, Labor rights in Haiti/DR, Agribusiness and forestry in the Amazon, etc) where IFC provides its full range of products and services to address stakeholder needs. The implementation is strengthened further by close collaboration with the World Bank. On the one hand, IFC is setting benchmarks in the private sector, on the other the World Bank is working more at a macro level on developing the regulatory framework and its enforcement to provide the right signals to the private sector. Similarly, in extractive industry projects, emphasis is placed on tying IFC's financial investments with advisory work in consultation with the World Bank when synergies exist, on revenue management, local capacity building for efficient use of fiscal revenues and community engagement, in addition to IFC's established assistance in environmental management.

MIDDLE EAST AND NORTH AFRICA

Annex II - Table 5: Middle East and North Africa

	FY05 Actual	FY06 Actual	FY07 Plan	FY10 Indicative
Commitments ($m)	315	668	900-960	1,000-1,250
Advisory Services Spending ($m)[1]	8	15	23	27
Development Impact Score (%)[2]	35%	44%	50%	-

[1]*Incurred by field-based or HQ-based AS programs, including pre-project, project, program management and overhead costs for regional DFOs, global facility allocation, business line envelope and stand-alone advisory services.*
[2]*Expanded Project Supervision Report (XPSR) – percentage of XPSRs which scored "mostly successful and above" on the development outcome measure based on a 3-year rolling average. The FY07 score is an estimate.*

Strategic Context

5.1. **Overview of the Region**. Middle East and North Africa region (MENA) has shown strong economic growth over the last three years, averaging about 6.2% per annum. Whilst many countries in the region benefit from high oil revenues, oil-importing countries such as Egypt, Jordan and Pakistan have also experienced GDP growth in the past four years of 5% to 7% p.a. Some governments such as in Egypt and Pakistan, are privatizing state owned enterprises which have dominated the economy and are trying to diversify the basis of economies opening opportunities for private sector participations.

5.2. The region is undergoing a period of increased economic integration. In the region high oil prices have led to growing inter and intra regional FDI flows. Private companies throughout MENA are investing increasingly in other counties, not only in banking, oil, gas and petrochemicals, and telecoms, but also in manufacturing, health and education and agribusinesses sectors. Financial markets have been improving with the introduction of new types of institutions and products such as housing finance, microfinance and bond markets.

5.3. The challenge of employment creation nevertheless remains high since the economic growth rate is not high enough to absorb a fast growing young population (67% of the population is below the age of twenty-four). The region as a whole still tends to be more public sector-dominated than other regions.

5.4. The private sector has an important role to play in generating more jobs and income opportunities, but many factors still hamper the development of the private sector. They include weak and costly business environments, inadequate infrastructure, under-developed capital markets, low contribution of SMEs in most economies and weak corporate governance.

5.5. **IFC's current investment portfolio, commitments and advisory services activities**. IFC's portfolio of investments in the region totals about $1.6 billion. Over the past three years, annual commitments have increased from $236 million (FY04), $315 million (FY05) to $670 million (FY06). Investments are held in fifteen out of the total nineteen countries/territories in the MENA region and span all the sectors, while the investments in the financial sector represent about 30% of commitments. IFC expects to commit 30% to 40% of its investments in frontier countries in FY07, particularly in Pakistan and Yemen.

5.6. The PEP-MENA advisory services facility is currently engaged in about one hundred active advisory services projects across fifteen countries. IFC's engagement in Public Private Partnerships in the MENA region now includes five recently signed mandates in Egypt in such areas as private sector concessions of waste water management and construction and maintenance of public schools.

IFC's Priorities

5.7. IFC's strategic priorities in the MENA region are: (i) catalyze South-South investments; (ii) promote investments in the frontier countries and sectors; and (iii) post-conflict response.

5.8. MENA is a very diverse region in terms of countries' endowment of natural resources and political and economic situations. These countries can be grouped into four categories, and IFC aims to address the particular challenges facing these countries:

- Egypt, Pakistan, Jordan, Lebanon, Morocco, and Tunisia, which are poor in natural resources but have abundant labor. IFC is seeking investment opportunities in several sectors including agribusiness, petrochemicals, and infrastructure in addition to supporting housing and SME finance. The advisory services activities focus on business regulatory reforms, corporate governance, PPP and privatization. The post-conflict initiative in Lebanon is discussed in Annex I, paragraph 3.13;

- Algeria, Iran and Syria are countries which have both natural resources and abundant labor. IFC seeks to engage in developing financial markets and privatization/post-privatization support in the oil and gas and telecom sectors. Advisory services activity primarily addresses business regulatory reform and financial markets;

- Frontier and post-conflict countries of Afghanistan, Iraq, West Bank and Gaza, and Yemen. IFC has a strong program of investments and advisory services in Yemen acting as a catalyst for investment, and providing technical assistance to build local capacity of SMEs; and

- GCC countries are rich in resources and are importing labor. GCC is the source of South-South investments with strong regional players with whom IFC continues to develop strong partnership within and beyond the region. In addition, IFC will assist these countries to deepen financial markets on a selective basis and use Islamic products with a view to replicating in countries outside of GCC. Advisory services to enhance corporate governance are well accepted by the GCC business community.

5.9. The MENA region is particularly challenged by political events and conflicts. IFC has remained active despite these events and will continue to be engaged in conflict countries. Investment and advisory services continue to work in a coordinated manner. Nearly half of the expenditures of PEP-MENA are spent on investment-related AS and/or privatization and PPP advisory work. The remaining activity is either directly complementary to World Bank activity or in other priority areas such as Business Edge and Corporate Governance.

SOUTHERN EUROPE AND CENTRAL ASIA

Annex II - Table 6: Southern Europe and Central Asia

	FY05 Actual	FY06 Actual	FY07 Plan	FY10 Indicative
Commitments ($m)	811[1]	991	1,000-1,200	1,200-1,600
Advisory Services Spending ($m)[2]	11	9	23	16
Development Impact Score (%)[3]	71%	63%	69%	-

[1]This is slightly higher than the $809 million shown in last year's paper due to allocation of World Region projects.
[2]Incurred by field-based or HQ-based AS programs, including pre-project, project, program management and overhead costs for regional DFOs, global facility allocation, business line envelope and stand-alone advisory services.
[3]Expanded Project Supervision Report (XPSR) – percentage of XPSRs which scored "mostly successful and above" on the development outcome measure based on a 3-year rolling average. The FY07 score is an estimate.

Strategic Context

6.1. Southern Europe and Central Asia (SECA) countries have continued to grow fast. In 2006, the region continued to experience strong economic growth (6.2%) driven by recovery in industrial growth influenced by a strong inflow of FDI, strong domestic demand fuelled by credit growth, revival of export markets, and increase in oil prices (in Central Asia). Turkey has been one of the fastest growing economies in the world over the last four years with 7.8% average annual growth during 2002-2005. Overall, the growth has been driven by competitive markets rather than by governments. South Eastern Europe countries made the most headway in reforms while in Central Asia the reforms have been slower.

6.2. **Private sector is faced with constraints and challenges to grow.** The main barriers to private sector growth remain weak local institutions, degraded economic and social infrastructure, difficult business environment, corporate governance, and corruption. External shocks are a threat and capital may be withdrawn from vulnerable economies. The financial sector is developing fast and long-term funding is becoming increasingly available in more developed markets such as Bulgaria, Croatia, Romania, Turkey and Kazakhstan. However, financial intermediation and the quality of the financial institutions remain low in most of the countries in the region.

6.3. **IFC has achieved very good results in the SECA region**. Results from DOTS show that IFC has achieved high development impact in the SECA region. IFC's activities have been growing fast and its strategy/approach has been changing to adapt to a fast changing business environment. As a result, the outstanding portfolio has grown, from $1.65 billion in FY04 to $2.5 billion as of January 2007, and is healthy (non-performing loans of less than 2%). The number of projects with new clients is forecast to double in FY07 as compared to FY06. SME financing grew significantly in Kazakhstan, Macedonia, Albania, Croatia, and Azerbaijan. In FY06, about 40% of the projects and 60% of advisory services expenditures were in frontier markets (compared to 7% of their share of GDP). IFC continued to support South-South projects, investing in ten projects in FY07 to end-February as compared to five projects in FY06.

6.4. To respond better to the country needs and to a fast changing business environment, IFC has been implementing innovative approaches such as: (i) wholesale products in smaller countries or difficult sectors (e.g. student loan facility in Turkey and credit facility to

Hamkobank Uzbekistan); (ii) small equity investments in the financial sector in frontier markets; direct investments in the SME sector (twelve projects); (iii) groundbreaking advisory services products (alternative dispute resolution, European standards, recycling, advisory services for privatizations in infrastructure); (iv) transformation of NGOs to commercial microfinance in frontier countries (e.g., the transformation of Ekonomic Kredit Institution from its not-for-profit status to a regulated, commercially oriented, non-deposit taking financial organization); and (v) multi-country projects in retail and oil and gas in the Balkans and Turkey.

IFC's Priorities

6.5. **Countries' needs drive IFC's Strategy in the SECA region**. Financial markets and general manufacturing remain the main sectors of focus. The level of financial intermediation is low in most of the countries in SECA (domestic credit to GDP ratio of 8-30% in most markets). Housing finance is still at an early stage of development and the lack of it is the main constraint for people to have access to affordable housing (mortgage penetration ranges as low as 3% in Turkey compared to 70% in developed countries). In general manufacturing IFC's activities are largely driven by services/industries such as retail, real estate, construction materials and export oriented manufacturing. Food processing is an important component of industry given its staple nature and the fact that agriculture represents 16% of GDP of SECA region countries and significantly more in terms of employment. In addition, infrastructure and energy services have a lot of potential to develop in the region. Access to efficient utility services is lower in most SECA countries than in developed markets. Resource development continues to be a priority in Kazakhstan, Azerbaijan, Turkmenistan and Uzbekistan. Turkey and Southeast Europe will remain important players for regional energy transport projects.

6.6. **IFC is expanding its reach to smaller/frontier markets**. IFC will increase its presence and provide better services through adjusting its approach, being more active and taking higher risk, working with other IFIs to share risk, and benefiting from the synergies with advisory services and the World Bank. In three years, IFC expects to double the number of projects in frontiers. IFC will also expand beyond capital cities in more developed countries in the region. To reach out to frontiers, smaller markets and difficult sectors IFC will continue to use its strong advisory services.

6.7. **In more developed markets, IFC will be more innovative**. IFC will continue to develop new products, support South-South projects and provide a range of products and services. In the financial sector, IFC will increase its activities in structured finance, mortgage and housing finance and local currency finance. In Turkey, IFC will further diversify its client base, reach out to more sectors, and offer its products (including equity) to a wider group of clients. IFC has made significant progress in reaching out to good second tier companies in Turkey as a result of a comprehensive mapping for a number of sectors. IFC expects to develop more projects with a diverse set of second tier clients, including reaching out to the less privileged parts of the country. IFC will offer new products to larger clients, supporting South-South investments and smaller companies in their supply chains.

6.8. **IFC will continue to grow in the SECA region**. In three years, IFC aims to increase its outstanding portfolio from $2.5 billion at end-February 2007 to around $4 billion. South-South investments will remain a priority. To enhance its development impact, IFC will also expand advisory services significantly. The focus of advisory services will be on frontier markets allocated on a limited number of business lines. In three years, IFC expects to increase its equity portfolio in SECA investing primarily in Turkey, Balkans and Kazakhstan in financial markets, infrastructure and regional funds. IFC will continue to work with its regional private equity fund clients as an effective way of increasing equity investments in the region.

6.9. **To achieve results, IFC will foster its cooperation with the World Bank**. The region has a promising start through its joint work in regulatory reforms in Central Asia and close cooperation on joint CASs for Serbia, Bosnia, Montenegro and Albania. IFC is in the process of further exploiting IFC/Bank synergy: promoting public-private partnerships in infrastructure in the Balkans through PEP-Southern Europe Infrastructure to create future projects; in Kosovo, to develop a lignite-fired power generation project with significant importance to the economic development of the country; IFC and FIAS are implementing a joint program in the Western Balkans; in Central Asia, co-locating offices and sharing of support staff such as IT, accounting, reception, public relations, etc.

SUB-SAHARAN AFRICA

Annex II - Table 7: Sub-Saharan Africa

	FY05 Actual	FY06 Actual	FY07 Plan	FY10 Indicative
Commitments ($m)	445	700	770-850	900-1,000
Advisory Services Spending ($m)[1]	19	20	51	67
Development Impact Score (%)[2]	39%	41%	48%	-

[1]Incurred by field-based or HQ-based AS programs, including pre-project, project, program management and overhead costs for regional DFOs, global facility allocation, business line envelope and stand-alone advisory services.
[2]Expanded Project Supervision Report (XPSR) – percentage of XPSRs which scored "mostly successful and above" on the development outcome measure based on a 3-year rolling average. The FY07 score is an estimate.

7.1. IFC's Strategic Initiative (SI) for Africa – Progress Report (FY04-FY06) and FY07-FY09 Priorities (IFC/R2006-0297) was discussed by the Board in December 2006. The following is a summary of this report.

Strategic Context

7.2. The economic and political environment in Africa is changing. Macroeconomic improvements in Africa have been substantial over the previous three-to-five years. There are fewer conflicts, spurred by The African Union's proactive approach to resolution of issues. Importantly for IFC, there is increased confidence among African investors.

7.3. There were three pillars in the FY04-06 strategy (which will remain the pillars for the next three years): (i) improving the investment climate; (ii) enhanced support to SMEs; and (iii) proactive project development to support IFC investments, especially in infrastructure projects. Implementation of the SI focused on: (i) developing new products and services for clients; and (ii) leveraging partnerships in implementation. IFC's results in Africa over the FY04-FY06 period are indicators that its approach is working: during FY04-FY06, IFC's commitments in Africa grew by 400% (and in FY07 IFC expects to commit around $770-

$850 million); the Private Enterprise Partnership for Africa (PEP-Africa) has made good progress; and partnerships, external and internal, have been enhanced throughout the region.

7.4. Resources from the SI together with enhanced administrative budget allocated to Africa have enabled IFC to develop new services and products, notably, the SME solution centers, local currency lending, trade finance and the Post-conflict and IFC Against AIDS Initiatives. Progress has been made in implementing the three pillars of the African strategy.

7.5. During FY06-FY07 IFC has leveraged internal and external partnerships. On-the-ground collaboration with the World Bank and MIGA has been a top priority. Progress is good on investment climate work, where PEP Africa and FIAS integrated their management and strategies. A pilot with the World Bank and MIGA to map and offer to mutual clients a fully coordinated set of World Bank Group products and services is being established.

7.6. Improving corporate governance is an important focus for IFC in the region. There are two major aspects to IFC's corporate governance work: (i) implementation of proper corporate governance procedures in IFC projects; and (ii) funding of the Pan-African Consultative Forum on Corporate Governance meetings. The Forum is a major initiative aimed at improving corporate governance in Africa and involves a number of regional and international institutions including the World Bank, IFC, African Development Bank, African Capital Markets Association, East Central and Southern Africa Association of Accountants, Centre for Corporate Governance, NEPAD, African Association of Central Banks, African Capacity Building Foundation, UN Economic Commission for Africa, and others.

IFC's Priorities

7.7. IFC will be retaining the same strategic focus under the Strategic Initiative for Africa:

- **Pillar 1: Improving the Investment Climate**. IFC will develop business based on: (i) maximizing the synergies from joint World Bank Group programs; (ii) concentrating efforts in post-conflict countries; and (iii) expanding into new advisory services product areas. The priorities are aligned with other initiatives previously approved by the Board and reflect the priorities of the Africa Action Plan (AAP) of the World Bank;

- **Pillar 2: Enhanced Support to SMEs**. This involves concentrating efforts on two areas: (i) expanding the MSME finance portfolio; and (ii) leveraging Linkages programs for SMEs.

- **Pillar 3: Proactive Project Development to Support IFC Investments, especially in infrastructure projects**. The three priority areas are: (i) advisory services-led business development; (ii) leveraging IFC's corporate advisory mandates; and (iii) improving market reach.

7.8. An additional priority area for IFC is stronger involvement in cross border projects in line with the regional integration work of the World Bank.

7.9. IFC plans to explore South-South investment opportunities, especially with investors from China, India, Brazil, and South Africa. IFC hopes to play a bigger role in assisting

South African companies that are interested in investing in the rest of Africa. Early indications suggest opportunities exist in energy, oil gas and mining, infrastructure, and telecommunications.

7.10. IFC plans to accelerate the growth of investments into FY10. Over this period, commitments in Africa are expected to grow substantially, reaching up to $1 billion. The three key sectors behind the projected growth are: (i) Financial Markets; (ii) Infrastructure; and (iii) Oil, Gas, Mining and Chemicals. In addition, IFC intends to increase its activities in the agribusiness sector.

7.11. Given the limited market-oriented mortgage system in most of sub-Saharan Africa, IFC is supporting a program to facilitate the general market development through the standardization of mortgage provision and improvements in the quality of housing construction. IFC's focus in housing finance are on: (i) advisory services that targets capacity building at the sector level and mortgage origination capability at the financial institutions level, such as the Mortgage Toolkit for Africa; (ii) financing the supply side (construction finance and residential property development to provide bankable and affordable homes; and (iii) financing the demand side (primary mortgage products).

7.12. Opportunities in the infrastructure sector are strong and are likely to remain so in the next three years. IFC will seek to make early stage equity investments in parallel with the TA interventions. IFC is currently considering a proposal, discussed in the paper "IFC: Creating Opportunity and Update on Capital Position" for a project development facility which will enable IFC to capture the value of early stage project development interventions in the infrastructure sector.

7.13. **Post-Conflict Countries**. A key challenge for IFC in expanding its reach is how to engage effectively in post-conflict countries and fragile states, in full collaboration with the World Bank and other development partners. In June 2006, the Board approved funding for the post-conflict initiative for Africa, to enhance IFC presence in Democratic Republic of Congo, Liberia, Sierra Leone and Central African Republic. IFC plans to play a more proactive and catalytic role to accelerate private sector involvement by: (i) introducing innovative ways to mitigate risk; (ii) helping improve the investment climate; (iii) building MSME capacity; and (iv) mobilizing local and foreign investors. IFC will request the approval for setting up new SME facilities in these countries. This should complement the reconstruction efforts currently underway that put greater emphasis on access to finance and other support for local businesses in post-conflict countries. Subject to lessons learned from this pilot, consideration will be given to extending the initiative to other post-conflict countries.