

EXECUTIVE SUMMARY

1. The external environment today for IFC can be characterized as one of great contrasts in an era of globalization. There have been unprecedented levels of overall growth in developing countries, but with great disparities in country progress and progress within countries. Substantial challenges remain in Africa, the Middle East and frontier countries, while middle income countries also have extensive poverty, investment shortages particularly in infrastructure, and challenges of environmentally and socially sustainable growth. International financial flows are at record levels, but the finance is primarily available for low risk countries and companies. It is now widely recognized that a vibrant and strong private sector is key to reducing poverty and improving people's lives in developing countries, but the development needs are immense and the efforts in private sector development must be accelerated. Critical for increasing the success of the private sector are improvement in the investment climate, including measures to reduce impediments for the private sector posed by corruption, implementation of public-private structures and greater efforts to meet international standards in corporate governance, environmental and social activities.

2. IFC is particularly well positioned to take a leadership role in the current environment. It has a solid track record of investments and leadership in sustainability, and an extensive and growing capability in technical assistance and advisory work. It is the largest development institution focused on the private sector and part of the largest global development organization, the World Bank Group. Such a global, multi-faceted institution, which plays the role of catalyst through the private sector, is what is required today.

3. It was with the aim of scaling up its development impact that IFC embarked on its growth plan, approved last year, which is being implemented in pursuit of its five strategic priorities: i) strengthening the focus in frontier markets; ii) building long-term partnerships with emerging global players in developing countries; iii) differentiating through sustainability competencies; iv) addressing constraints to private sector growth in infrastructure, health and education; and v) continuing to emphasize local financial markets' development through institution building and by the use of innovative financial products.

4. Following the arrival of a new Executive Vice President in January, IFC Management took the opportunity to review, through discussions at the Senior Management Strategy Meeting and the Regional Strategy Meetings, the direction IFC should be taking over the next three years. They considered IFC in light of the external environment in which it operates, the needs of its clients and its role as a member of the World Bank Group. As a result, they identified areas which should be strengthened and challenges IFC was facing, and assessed how the Corporation could build on the strengths it has established over the past several years to address these challenges and achieve greater development impact.

5. The conclusion of this exercise was confirmation of the growth path and the five strategic priorities, and of the extension of the growth path into FY09. There was also agreement that certain areas demanded greater attention and the Management Group therefore set out several Goals to be achieved over the FY06-09 period:

- *Greater Development Impact.* Focus on development impact will include growth in activity in high priority areas including frontier markets and Sub-Saharan Africa, improved measurement of development impacts for both investment and technical assistance operations, more focus on building a dynamic private sector in developing member countries by improving the investment climate, and strengthening technical assistance operations.
- *Improved World Bank Group Cooperation.* With the growing realization that many of the development challenges can best be met by a combination of public and private solutions,

IFC must leverage the resources of the whole World Bank Group in order to enhance overall development impact.

- *Leadership in Standard Setting.* Building on its on-going global standard-setting work, such as with the *Equator Principles*, IFC will continue to extend its leadership role in the environmental, social and corporate governance dimensions, and will provide benefits to clients and developing member countries beyond finance through its value-added services. IFC will also focus on anti-corruption issues and, in addition to its existing work, is developing an approach to pursue a leadership role in this area.
- *Improved Client Satisfaction.* An important measure of IFC's impact is client satisfaction. IFC is pursuing several avenues in order to improve client service, including a pilot for further decentralization, and a process review and improvement program.
- *Sound Finances.* A sound financial capacity remains essential to pursue all these activities. In particular, IFC must have in place a risk management framework appropriate for its increasing activities, and has recently begun a review of its risk management practices.
- *Strong Staff.* Finally, the implementation of strategy must be driven by IFC's most important asset, a good, diverse and motivated staff. Focus will continue on recruitment, training, incentives and performance measures.

6. IFC has scaled up its activities in line with its ambitious growth plan approved last year. IFC is predicting strong commitment growth in FY06, already reaching about \$3 billion by the end of March, compared to \$1.7 billion at the same time in FY05. The Corporation is also making good progress on the development impact targets it agreed with the Board last spring.

7. Significant progress has been made in management of technical assistance and advisory services (TAAS) with the development of operating principles and strategic business lines. This should focus TAAS activities strategically for greater development impact, and enhance effectiveness through scale and knowledge sharing. There have also been advances in measurement, through the roll out of the *Development Outcome Tracking System* for investment operations, a monitoring and evaluation system for technical assistance, and a new system to track compliance with environmental and social standards.

8. Collaboration within the World Bank Group has increased on many fronts. A number of extensive cooperation programs at the country and regional levels are being developed, for example in Sub-Saharan Africa and in Brazil, and programs for greater joint efforts on Country Assistance Strategies are under way. At the transaction level, joint work is leading to significant progress on projects, particularly in the infrastructure sector in Africa. Other areas of cooperation include investment climate technical assistance, governance, sustainable development, public-private partnerships in infrastructure, sub-national finance and clean and renewable energy.

9. IFC has also made significant progress in pursuing its five strategic priorities. Some highlights:

- *Frontier Markets.* Frontier commitment levels are increasing, with significant growth in Sub-Saharan Africa. PEP-Africa has been fully launched and is ahead of targets in donor fund-raising. Staffing at the eight African regional offices has been strengthened and IFC's overall recruitment target for Africa in FY06 is on track. IFC is launching a Post Conflict Countries Initiative in the Democratic Republic of the Congo (DRC) and is also launching the Performance-Based Grants Initiative, which will provide innovative grants to support finance for micro, small and medium (MSME) enterprises in Africa and Output-Based Aid projects primarily in frontier markets. In the Middle East and North Africa (MENA) the investment pipeline has been building up and regional staffing has increased over 50% since the beginning of FY06, driven by significant hiring in PEP-MENA, the region's technical assistance (TA) facility.

- *Building Long Term Partnerships and South-South Investments.* IFC is further enhancing business origination capability and strengthening client service by being closer to local sponsors. IFC has continued to decentralize, and in FY06 through the end of February the grade G+ field staff increased 13%. IFC's South-South investments have been growing steadily for the past three years, reaching \$484 million in FY05. In Corporate Governance, IFC has continued to refine its assessment methodology, which is becoming a standard for other development banks. IFC has also been active in its linkage and IFC Against AIDS programs.
- *Differentiating through Sustainability.* In February 2006 the Board approved IFC's new Policy and Performance Standards on Social and Environmental Sustainability, reinforcing IFC's role as a global standard setter. The 41 Equator Principle Financial Institutions (EPFIs) are expected to adopt a new set of principles reflecting these new standards. In order to mainstream sustainability into IFC's investment work, 63% of IFC's environmental and social specialists are now co-located in industry or regional departments. Progress has also been made in IFC's programs on renewable energy and energy efficiency, implementation of the Extractive Industries Transparency Initiative, sustainability programs in agribusiness, technical assistance and investments related to sustainability issues, and launching of the Gender Entrepreneurship Markets program. IFC also helped the Sao Paulo stock exchange launch a corporate sustainability index, the second in the emerging markets.
- *Addressing Constraints to Private Sector Growth in Infrastructure, Health and Education.* IFC commitments in these sectors are expected to reach \$1.2-\$1.4 billion in FY06, with a large investment program including public-private partnerships in Sub-Saharan Africa. IFC's Advisory Services have significantly increased the number of mandates underway, concentrated in Africa and the Middle East. IFC's Municipal Fund was also active, with approvals for several transactions. In Health and Education, IFC has begun to implement innovative financing techniques, such as a Ghana school wholesale facility.
- *Local Financial Markets Development.* IFC's financial market activities have been growing substantially. Use of innovative financial products is expanding: for example, local currency and structured finance products grew from \$574 million in FY04 to almost \$1.3 billion in FY05, and IFC is considering several pioneering initiatives such as a vehicle to underwrite weather and disaster risks. MSME commitments in FY05 were \$1.1 billion, more than triple the figure in FY00 and as an indication of the reach of these investments, during 2004 IFC's MSME financial institution clients disbursed an estimated 4.4 million sub-loans for \$27.8 billion. Housing finance is also a growing focus of IFC's activities and IFC works closely with the World Bank in this sector. IFC's housing finance portfolio grew to \$565 million in FY05 from \$30 million in FY00. IFC's Global Trade Finance program is starting to show significant results, with total commitments for FY06 estimated at \$200 million, over 50% in Sub-Saharan Africa. IFC's financial sector TA activities are also growing significantly, focused on expanding access to the poor and underserved.

10. IFC is making good progress in implementing its five strategic priorities and its growth plan, although there are some areas where the pace of implementation needs to accelerate, such as field recruitment and implementation of the development impact tracking system to enable full reporting of IFC's institutional impact, and IFC is focusing on making progress in these areas. Looking forward, in order to deliver development results and fulfill its corporate goals, IFC must leverage its involvement through partnerships with its clients, other members of the World Bank Group, financial market partners including 'Equator' banks, and developing and donor member countries. For private sector clients – IFC's primary development partners – this means continuing the strategy of becoming a partner of choice, placing greater emphasis on value-added products and services and staying close to clients throughout the life of a project. For other partners, this means closer working relationships, focused on improving the investment climate and setting standards in the environment,

social and corporate governance areas. IFC needs to leverage its own strengths as an institution with a culture of responding to development challenges through market-driven initiatives and innovation, and with pragmatism and market discipline.

11. Going forward, IFC will need to address certain challenges in its pursuit of higher development impact through its growth strategy, in particular in the areas of decentralization, human resources, risk management and management of technical assistance and advisory services. As IFC reviews its risk management framework and practices it must factor in the high risk of many of its investments as well as the volatility in emerging markets and the consequent unpredictability in net income reporting as it moves to adopt International Financial Reporting Standards.

12. IFC has recently taken some important steps to enhance further its capability to deliver on its strategic objectives. Of particular note are the moves towards greater decentralization through the pilot proposed for Asia, the improved management and governance put in place for TAAS and the recently announced changes in the senior management structure which increase management depth, especially in the emerging high priority areas for the Corporation. These management changes will be effective from July 1, 2006.