



IFC STRATEGIC DIRECTIONS: IMPLEMENTATION UPDATE AND FY07-FY09 OUTLOOK

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INTERNATIONAL FINANCE CORPORATION

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Abbreviations and Acronyms

AML/CFT	Anti-money laundering/combating the financing of terrorism
BEE	Business enabling environment
CAPRI	Capital pricing and risk
CAS	Country assistance strategy
DFID	United Kingdom Department for International Development
DOTS	Development Outcome Tracking System
DRC	Democratic Republic of Congo
EE	Energy efficiency
EPFIs	Equator Principle Financial Institutions
FDI	Foreign direct investment
FIAS	Foreign Investment Advisory Services
FMS	Financial Markets Sustainability
FMTAAS	Funding mechanism for technical assistance and advisory services
FY	Fiscal year
GEM	Gender Entrepreneurship Markets
GPOBA	Global Partnership on Output-based Aid
HIV/AIDS	Human immunodeficiency virus/acquired immune deficiency syndrome
HR	Human resources
IEG	Independent Evaluation Group
ICT	Information and Communications Technologies
IFI	International financial institution
IPP	Independent power project
IT	Information technology
LAC	Latin America and Caribbean
MDB	Multilateral development bank
MENA	Middle East and North Africa
MSME	Micro, small and medium enterprise
NGO	Non-governmental organization
PACI	Partnering Against Corruption Initiative
PCG	Partial credit guarantee
PEP	Private Enterprise Partnership
PIDG	Private Infrastructure in Development Group
PPP	Public-private partnership
PRM	Project Risk Management
PSD	Private Sector Development Department
RE	Renewable energy
SEDF	South Asia Enterprise Development Facility
SME	Small and medium enterprise
SOx	Sarbanes Oxley Act
TA	Technical assistance
TAAS	Technical assistance and advisory services
U.N.	United Nations
WBG	World Bank Group
XPSR	Expanded project supervision report

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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.

SECTION I. THE EXTERNAL CONTEXT

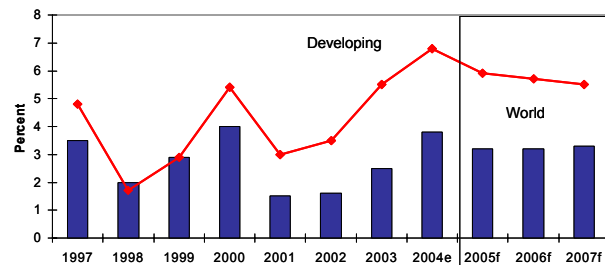
1.1 Overview. The external environment today for IFC can be characterized as one of great contrasts in an era of globalization. There have been unprecedented levels of overall growth in developing countries, but with great disparities in country progress and progress within countries. Substantial challenges 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 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 is 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. IFC is particularly well positioned to take a leadership role in the current environment. It has a solid track record of investments, 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 leading global development organization, the World Bank Group. Such a global, multi-faceted institution is what is required today.

1.2 Strong Economic Growth in Developing Countries, but Challenges Remain. Despite a modest slowdown since 2004, developing countries continued to enjoy strong economic growth in 2005, with average GDP increase estimated at 5.9%¹, outperforming high income countries growing at 3.2% (Chart 1.1). The growth was not only coming from the so called BRICs countries (Brazil, Russia, India, and China) which have received so much attention, but was broad-based, including Africa and MENA with growth rates around 4.5% over the last two years (Chart 1.2). Although the pace of growth is expected to slow down in 2006, developing countries are expected again to expand more rapidly than high income countries.

1.3 The trend of more developing countries participating in world markets and in many cases becoming drivers of world economic growth heralds a new globalization era. However, as some countries have enjoyed the benefits of the favorable conditions for developing countries, others have been left further behind, creating a bipolar situation both at a global level and at the country level.

Chart 1.1

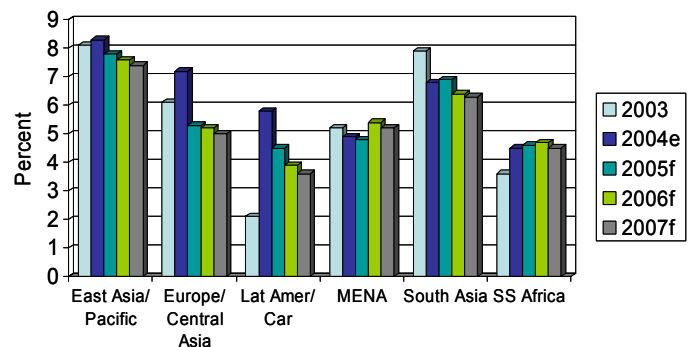
GDP Growth, 1995 Constant USD



Source: Global Economic Prospects 2006

Chart 1.2

Annual GDP Growth Rates, by Region



Source: Global Economic Prospects 2006

¹ Global Economic Prospects 2006.

1.4 Widening Gap: Africa as the Development Priority. While some countries have experienced real growth, the number of poor in Sub-Saharan Africa has doubled over the past two decades. Entrepreneurs face more regulatory obstacles on the continent than in any other region. According to the 2005 IFC/World Bank Doing Business Report, of the twenty countries with the most difficult business conditions, 80% are in Sub-Saharan Africa. In 2005 the G8 leaders pledged to support Africa's development and called for international coordination of increased assistance to Africa at the summit in Gleneagles, Scotland. The World Bank Group's response, the Africa Action Plan, recognizes the importance of a vibrant private sector as one of the key elements to strengthen the drivers of growth and development.

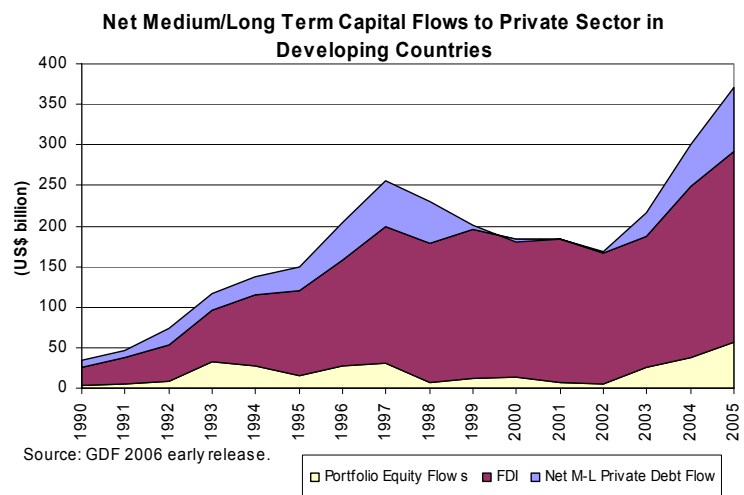
1.5 MENA . Countries in the Middle East and North Africa (MENA) region also have significant and widely varying needs. In this respect, the MENA countries can be grouped into three broad categories: i) countries with a lot of liquidity, but often with unsophisticated financial markets, which can benefit from TA and be a source of South-South transactions; ii) reforming countries with significant investment and TA needs; and iii) post-conflict countries which require substantial TA and foreign investment activity. Across the region there are large unemployment issues, particularly youth unemployment, and the region has low levels of foreign direct investment.

1.6 SMEs. Small and medium enterprises (SMEs) in developing countries continue to face particularly high constraints due to poor access to finance and other institutional obstacles. Yet thriving SMEs are important for development, they contribute significantly to local labor markets and they are a source of entrepreneurship and vibrant and competitive market activity. Investment climate and finance issues not only hinder SME growth but also affect the levels of informality in economies, which has impacts on country productivity and the social divide between formal and informal parts of the economy.

1.7 Poverty and Investment Needs in Middle Income Countries. Poverty and social challenges are still major issues in middle income countries. The total population living on less than \$1 a day in middle income countries is about 317 million, and 1,043 million on less than \$2 a day². Socio-economic problems such as high unemployment, wide-spread social exclusion, large income inequality and inadequate social infrastructure are also present. Middle income countries continue to have great investment needs, such as in infrastructure. World Bank estimates, however, indicate governments are vastly under-funding infrastructure, which has serious implications for growth and poverty reduction. Private sector investment in infrastructure in developing countries, which reached over \$100 billion per year in the late 1990's, is also not filling the gap, having dropped to about \$60 billion per year.

1.8 The private sector in middle income countries also faces growing issues related to meeting international standards in such areas

Chart 1.3



² Calculation based on the most recently available Poverty Data for each country using 2004 population

as corporate governance and environmental and social activities. These are important to accelerate the pace of growth, to minimize adverse effects on populations, promote social inclusion and provide access to product and financial markets.

1.9 Private Sector as Engine of Growth. For many countries today, private sector development has become a central theme in the development agenda. Sustained economic growth is critical for job creation and poverty reduction. In addition, a thriving, private-sector led economy is probably the best defense against corruption, as economies with broad private sector participation, active competition and clear rules have less scope for corruption. The private sector also has much to contribute to other government goals, via tax revenue, reaching out to local communities, setting international standards and working with government to extend infrastructure access.

1.10 International private sector financial flows play a major role in financing growth. Net private medium/long term capital flows to the private sector in developing countries reached a record high, estimated at \$375 billion, during 2005³ (see Chart 1.3), exceeding the level attained in 1997. Both bond flows and bank lending to the private sector continued to grow. These flows significantly exceed international government loans and aid. Indicative of the overall liquidity in financial markets, sovereign international bond spreads in developing countries declined to historically low levels at 183 basis points in early March⁴.

1.11 Domestic banking systems in developing countries have also continued showing improvements, with better asset quality, higher return on assets, and higher levels of domestic credit⁵ (Chart 1.4). Domestic bond markets have also expanded, with more sovereign and corporate bond issuance in local currencies contributing to a deepening of the financial markets (Chart 1.5). A stronger domestic financial services sector is strongly associated with improved growth and enhanced poverty reduction, and can also improve income distribution. Other important parts of the financial services sector from a development perspective include SME finance, microfinance, housing finance and securities market development.

Chart 1.4

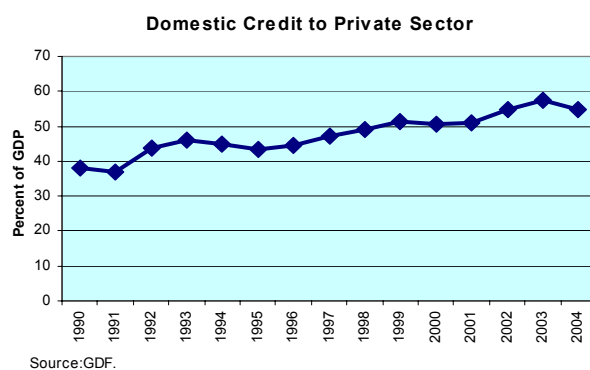
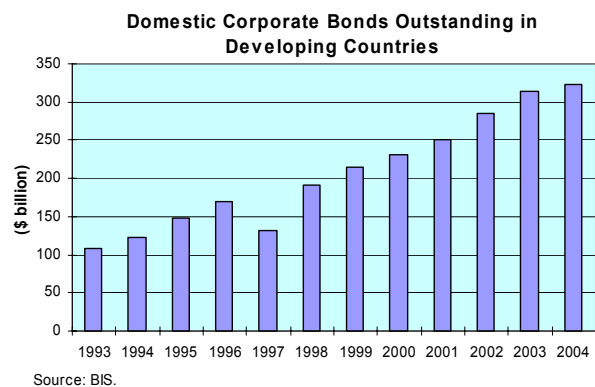


Chart 1.5



1.12 Long-term Capital Availability Still Limited for the Higher Risk Clients. Despite the strong growth in international and domestic finance, there remain significant limitations for companies with respect to access to finance. In the case of international finance, most loan syndications go to non-frontier countries (see Chart 1.6). In addition, the greatest portion of international bank lending to the private sector in all developing countries is primarily in short to

³ Global Development Finance 2006 early release.

⁴ JP Morgan Chase EMBI Global Index.

⁵ IMF Global Financial Stability Report.

medium term maturities (see Chart 1.7)⁶. Long-term international lending is still difficult to obtain for many companies unless there is support from an international financial institution like the IFC. For international syndicated lending with maturity of five years or longer, more than half of the deals in 2005 were supported by the participation of an official international financial institution. Access to long term finance is also generally far more limited for companies outside the top tier of corporate and financial institutions in developing countries. In the case of domestic finance, the capability to issue domestic bonds continues to be quite limited to certain countries and top tier companies, while long-term finance from domestic banking sectors remains underdeveloped in a great many of IFC's client countries.

Chart 1.6

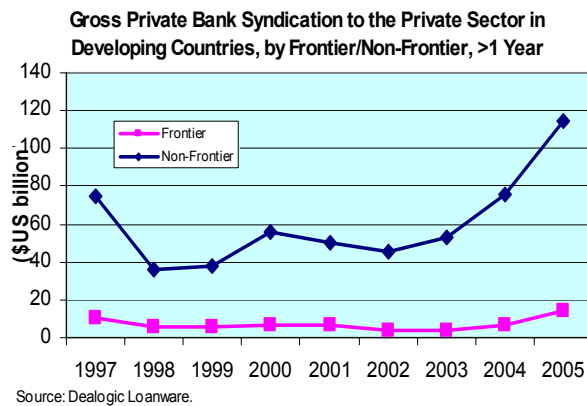
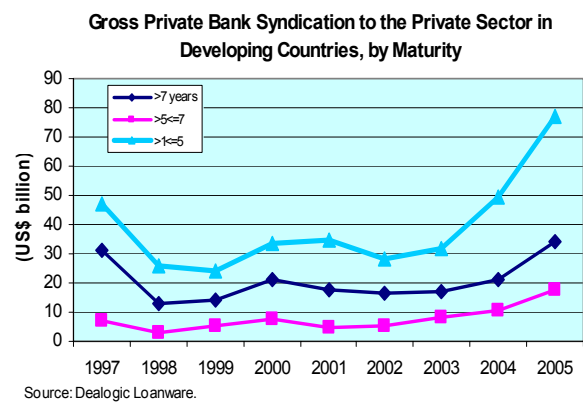
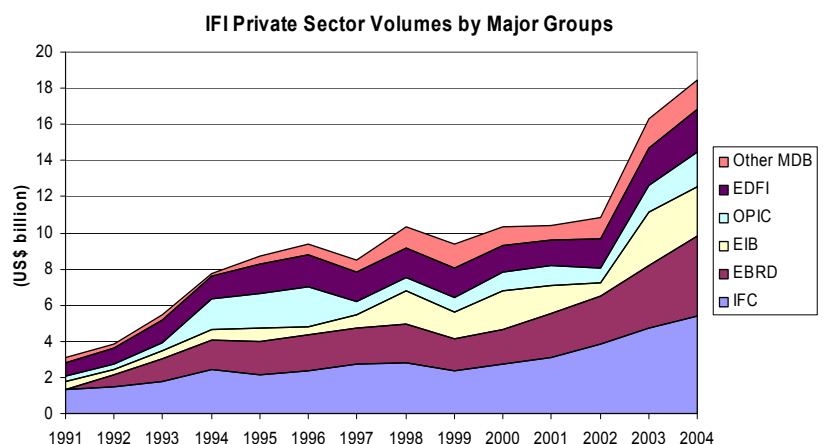


Chart 1.7



1.13 IFI Finance Growing, Enhancing Private Flows. International financial institutions (IFIs) have continued to increase support to the private sector in developing countries, to help extend the reach of private finance to higher risk and innovative projects. As shown in Chart 1.8, IFI flows to the private sector have reached significantly higher levels in the last few years, and preliminary data for 2005 indicate a continuing strong trend. Of particular note in the last year has been the increased use of alliances to improve performance, especially among the European institutions. In addition, there have been increased activities involving the IFIs and public sector agencies for TA and other funds, such as support for IFI private sector and infrastructure programs in Africa by the European Union and the Japan Bank for International Cooperation. IFIs are also providing a more varied set of product offerings, including new approaches in trade finance, equity and local currency financing.

Chart 1.8



1.14 Need for Effective Public-Private Cooperation. Investment climate issues remain a critical barrier to investment in many of the countries and sectors where finance remains scarce. This continues to be evident from the World Bank's and IFC's investment climate work such as in the

⁶ Calculation based on Dialogic Loanware.

Doing Business reports and Investment Climate Surveys, and in the IEG evaluations of IFC activities (see Box 3.5). Solutions to these issues require effective changes in government policies. In infrastructure, independent private provision has become difficult, especially in certain sectors such as water and power where there are great social sensitivities and limited potential to support foreign currency-denominated loans. Yet the investment requirements go beyond the capabilities of many governments. More innovative projects need to be developed that combine aspects of private discipline and private finance with public support to address the social issues.

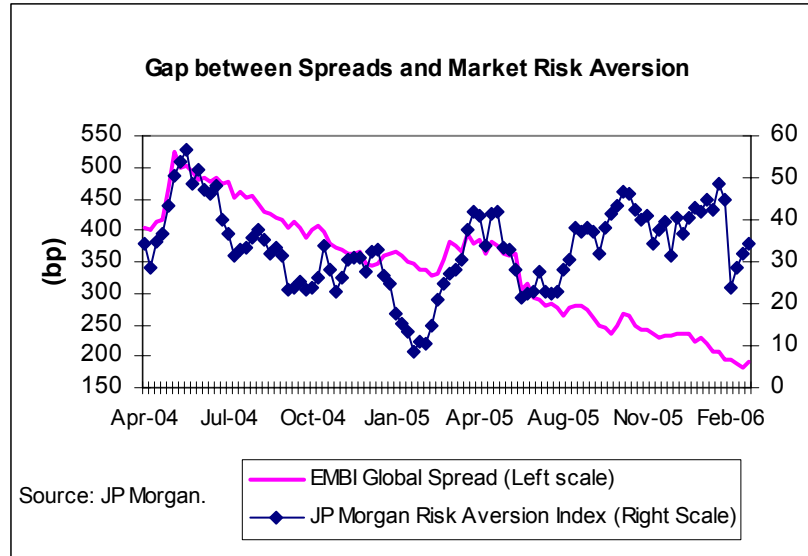
1.15 Need for Advice to Develop Projects and to Meet International Standards in Corporate Governance, Environmental and Social Activities and Anti-Fraud and Corruption. Companies in higher risk environments or sectors often need assistance to develop projects, work with governments or develop innovative project structures. They also often need assistance in corporate governance and environment and social dimensions. These issues have become critical for companies seeking local support and export opportunities, and seeking to enhance their ability to raise capital. In the most recent IFC Client Survey, environment, social and corporate governance factors showed the largest gain as reasons clients chose IFC. Clients also valued IFC's technical assistance and advisory services and those who received TAAS along with investments are far more satisfied, and show greater inclination to engage with IFC again, than those clients who did not receive TAAS.

1.16 An area of increasing importance for private sector companies is meeting evolving international standards in anti-fraud and corruption. The corrosive effects of corruption on growth are well documented and corruption is also among the major constraints hindering the private sector as reported in the World Bank's investment climate assessments. Leaders in the developing world, including senior management of private sector corporations, are increasingly taking this issue seriously. For instance, over ninety companies from both developed and developing countries have signed the recent World Economic Forum-sponsored principles under the *Partnering Against Corruption Initiative (PACI)*.

1.17 Market Risks Remain. The continued overall buoyant growth and access to international finance in developing countries is subject to a number of significant risks, as world inflation is slowly increasing and global interest rates are set to rise. There are already indications that current interest rate spreads for developing countries may not be sustainable (see Chart 1.9). High oil prices are harming low-income oil importers, while possible lower commodity prices may impede commodity-exporting countries. Global imbalances in current accounts and capital flows also pose risks to the stability of financial markets and global trade.

1.18 Other risk factors that could reverse the current global picture include unstable political situations in some areas of the world, potential threats from perceived increasing inequality, as well as the threat of global pandemics such as avian flu.

Chart 1.9



1.19 Implications for IFC. The ascendancy of the private sector in the development agenda, coupled with the complexities and challenges of the current environment, has broad implications for IFC. Development institutions with the means and experience to promote the private sector are becoming essential to help developing countries move forward. But these institutions also need to be prepared to address issues beyond traditional private sector finance:

- To provide expertise for clients on sustainability and corporate governance issues, and more broadly to provide leadership in global standard-setting, including private sector approaches to making advances in anti-corruption issues.
- To engage with both governments and the private sector on the critical improvements needed in the investment climate.
- To work with government and private participants to develop innovative public-private structures in infrastructure and the social sectors.
- To be pro-active in developing projects in difficult climates, providing needed technical assistance and expertise.

1.20 This is where IFC can play a leadership role. It has a long and successful track record in private sector investments and has a program for enhancing its strengths through greater client focus and decentralization, through expertise in corporate governance and sustainability and through development of extensive technical assistance capabilities. It is the largest development institution focused on the private sector, with extensive global presence. In addition, it is associated with the pre-eminent global development institution with unparalleled expertise and presence in developing countries, the World Bank Group. Such a global, multi-faceted institution, which plays the role of catalyst for progress through the private sector, is what is required today.

1.21 Given the immense development needs, leveraging partners will be critical, starting with closer work with the World Bank and MIGA to scale up impact, and also leveraging partners in the financial markets, such as the Equator Principle Financial Institutions, as well as donors and other IFIs. IFC must also continue to focus on better serving its private sector clients – its primary development partners – with continuous improvements in operational effectiveness.

SECTION II. SCALING UP DEVELOPMENT IMPACT, FY07-FY09

2.1 The rapidly evolving world in which IFC operates, with the benefits of growth and globalization accruing to some developing countries on the one hand, yet the issues of poverty and unemployment persisting in many countries and regions on the other, presents mounting development challenges, as discussed in Section I. There is now recognition that the private sector is key to development as the most important engine of growth and job creation. IFC, as a private sector-focused institution with a global mandate and at the nexus of public and private interests, has an important responsibility in helping to address these challenges and the role it can play is greater than ever. 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.

2.2 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 did so by first considering IFC from the ‘outside-in’ and 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 (WBG). They then moved on to an internal assessment of the Corporation to consider how it could build on the strengths it has established over the past several years to achieve greater development impact. The conclusion of this exercise was confirmation of the growth path and the five strategic priorities, and that the growth path should be extended into FY09. There was also agreement that certain areas demanded greater attention and the Management Group therefore set out several Goals (summarized below) to be achieved over the FY06-09 period.

2.3 The main Goal is to increase IFC’s development impact, with a continuing focus on frontier markets, particularly Sub-Saharan Africa. 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 WBG in order to enhance overall development impact. Furthermore, IFC can provide benefits to clients and developing member countries beyond finance through its value-added services and leadership on several fronts, particularly environment, social and corporate governance dimensions. An important measure of whether IFC is achieving its development goals is client satisfaction, and IFC is pursuing several avenues in order to address clients’ main concerns. All of these activities need to be underpinned by a strong financial position, and IFC must have in place a risk management framework appropriate for its increasing activities. Finally, the implementation of strategy must be driven by IFC’s most important asset, a good, diverse and motivated staff.

Greater Development Impact

2.4 As a development institution with a mission to reduce poverty and improve people’s lives, IFC has always considered that the developmental and financial success of its investments go hand in hand. IFC has played a catalytic role in mobilizing other sources of private development finance, and has targeted many projects for their demonstration effect. Over the past few years, IFC has grown substantially and its impact has therefore been even more significant. Now that it finds itself in a world where a strong private sector is recognized as key to sustainable growth in developing countries, and has the mandate and resources to expand its business further, IFC must continue to

scale up its development impact through increasing its activity in line with its strategic priorities. IFC's ability to deliver greater development impact will be considerably enhanced by the continued decentralization currently underway (see paragraph 2.10), allowing staff to develop closer contact with local sponsors, particularly in frontier markets, and by developing greater synergy with TA programs and staff, who are already in the field. Several areas will be of particular focus in the near term in increasing IFC's development impact:

2.5 Sub-Saharan Africa and other frontier markets. The focus of IFC's strategy will continue to be frontier markets, with particular emphasis on Sub-Saharan Africa and MENA. These markets require new approaches, in particular to address infrastructure needs and reach SMEs, and there are several innovative initiatives underway, as described in Section III.

2.6 Creating a dynamic and diversified private sector. IFC must strengthen the work it undertakes in many of its member countries, particularly in frontier markets, to help with some of the broader investment climate aspects of developing a strong and dynamic private sector. IFC will continue its privatization and other advisory services to governments, and will work more closely with the World Bank on sector reforms aimed at encouraging private sector development. The "Doing Business" report prepared by the joint World Bank/IFC Private Sector Development Department is an important tool to help governments to understand shortcomings in the investment climate in their countries and to prioritize steps to address them.

2.7 Measurement. In order to assess whether it is achieving its goals, IFC must be able to measure its development impact, and there are several initiatives underway to strengthen measurement. Increasing activity in the priority areas will be the key for *ex ante* measurement, using the Corporate Scorecard indicators (see paragraph 3.2 and Annex 2). IFC will use the Development Outcome Tracking System (DOTS), which was recently rolled out, for *ex post* measurement of how well it is achieving the development impact targets, in addition to existing *ex post* measurement and evaluation by IEG. Performance indicators have also been introduced for Technical Assistance and Advisory Services, and all TAAS projects will be subject to measurement and evaluation. (see paragraphs 3.7 to 3.9 on Measurement)

2.8 TAAS. It has become increasingly clear that an important part of IFC's impact is its TAAS work, especially in frontier markets, and IFC has now taken steps to align TAAS activities with its strategic priorities through formulation of five TAAS Business Lines and establishment of new processes for the approval, monitoring, supervision and resource allocation of TAAS. The move towards better focused TAAS will continue, alongside a scaling up of these activities. Paragraphs 3.4 and 3.5 provide more details.

Better World Bank Group Collaboration

2.9 IFC and other members of the World Bank Group already work together in many areas, but senior management of all the WBG institutions now recognizes that this collaboration needs to be further increased in order to enhance the WBG's effectiveness. With the World Bank focusing on policies and projects which prepare the ground for private sector solutions, IFC and MIGA are then better placed to support investments which will encourage other private investors. Through their experience in assessing the impacts of their projects, IFC and MIGA can then provide input into the design of future World Bank interventions. In addition, there is considerable scope for World Bank/IDA, MIGA and IFC to work together directly on focused areas, particularly in infrastructure, financial markets and investment climate. Several working models of extensive collaboration are evolving, for example the one in Sub-Saharan Africa (see Box 2.1, and also Boxes 3.1 and 3.2). Further, through the Country Assistance Strategy (CAS) process IFC continues to bring forward the private sector development perspective, and greater World Bank input will be sought in IFC strategy

discussions. As a first step, senior representatives from relevant World Bank regions attended and contributed to all of IFC's recent regional strategy meetings.

Box 2.1. World Bank/IFC Collaboration in Sub-Saharan Africa

IFC and the World Bank are approaching collaboration in a systematic way in the region to enhance the effectiveness of the whole WBG on the ground. The institutions are working together both at the strategic level and the sector and country levels. Below are some examples of how this collaboration is working on the ground. (See also Boxes 3.1 and 3.2.)

Strategy

-Africa Action Plan (AAP): IFC collaborated on the formulation of the private sector development component of the AAP. The three priority areas of IFC's Africa strategy complement the growth agenda of the AAP.

-Private Sector Development: IFC and the World Bank are developing a framework for collaboration aimed at scaling up at the country level. This will involve a mapping exercise the results of which will be used to refine the proposed framework of collaboration and develop an Implementation Action Plan which will then be tested in a few countries.

-Country Assistance Strategies: Recent and ongoing examples of collaboration include Uganda, Senegal, Mauritania, Madagascar and South Africa.

Investments

-Infrastructure: IFC and the World Bank's Africa Infrastructure Department jointly identify client countries, sectors and projects for collaboration and jointly engage governments and private sector players. In addition to the Kounoune power project in Senegal described in Box 3.2, recent and ongoing examples include Toamasina Container Terminal in Madagascar, AES Sonel in Cameroon and the Kenya/Uganda Railway Concession. In the Toamasina project, the process of institutional reform of the port sector and its implementation for the Port of Toamasina was initiated by the World Bank, and the structuring and implementation of the transaction were conducted by IFC. AES Sonel involves a potential IFC investment and World Bank assistance with sector reforms and other investments for a project where IFC advised on privatization. IFC was asked by the Government of Kenya to assist with the tender and bidding process for the Kenya/Uganda Railway Concession, and IFC and the World Bank are looking at financing of the new concession. IFC support also includes a linkages program. There are many other potential opportunities for collaboration in infrastructure which IFC and the World Bank are discussing.

-Oil, Gas and Mining: the joint IFC/World Bank Department works closely with other areas of the World Bank to address policy issues, transparency and governance as well as infrastructure issues. In particular, the World Bank is doing a lot of work in the areas of revenue management, capacity building and business environment which paves the way for private sector involvement in projects.

-Financial Sector Cooperation - IDA/IFC Africa MSME Pilot: In December, 2003 the Board approved a joint IDA-IFC micro, small and medium enterprise (MSME) program for Africa. World Bank and IFC teams prepare and process the IDA projects and separate IFC transaction teams process related IFC investments. Other examples include joint work on securities market development assistance and collaboration in leasing market development.

-Technical Assistance: PEP-Africa, IFC's TAAS facility in the region, currently has three programs in the pipeline and two at the implementation stage that are being designed/implemented with the World Bank. These are in Democratic Republic of Congo, Mozambique, Madagascar, Burkina Faso and Cape Verde.

-Africa Investment Climate Facility: Improving the business environment has become an important aspect of IFC's strategy in Sub-Saharan Africa. In order to scale up efforts and help improve donor coordination in this area, IFC, through the joint World Bank/IFC Private Sector Development Department, is considering a contribution from FMTAAS to the Africa Investment Climate Facility. The facility is being put together as a public-private partnership under the auspices of the New Partnership for Africa's Development (NEPAD) and was endorsed by the Gleneagles summit last year. It promises to promote investment climate reform using clear metrics and enhanced donor coordination. If IFC decides to proceed with this initiative it will revert to the Board for approval.

Improved Client Satisfaction

2.10 In the most recent (2004 and 2005) Client Surveys, the percentage of clients expressing satisfaction with IFC's overall services was at around 80%. This is a good score but could be further improved. The main areas for improvement concerned IFC's speed and flexibility. IFC is addressing this in two ways: i) further decentralization through a pilot in Asia; and ii) process review and improvements. The pilot will involve: i) increased deployment of staff to the field, including specialized sector expertise and support from Credit, Legal and Environmental and Social staff; and ii) clearly delineated delegation of management approval authority to the field, along with appropriate checks and balances. The pilot will test the decentralization of decision-making, and the resulting improvement in the efficiency of transaction processing for IFC's local client base. The Corporation is also making progress on the process review and improvements, with the review of a particular segment (commitment to disbursement) of the investment process as a starting point. The preliminary outcome of the review is encouraging with scope for significant efficiencies identified.

Leadership in Standard Setting

2.11 IFC has already assumed a leading role in several areas, in particular in environmental and social standards with the recent adoption of the new Performance Standards (see paragraph 3.34). Its work in promulgating the Equator Principles, which, as of March 31, 2006, had been adopted by 41 leading commercial financial institutions which collectively account for more than 85% of global project finance, is another important example. The 41 EPFIs are expected to adopt a new set of principles reflecting the new Performance Standards. IFC, together with the EPFIs, is now working to extend their use to other types of institutions. Other important areas of focus include corporate governance (see paragraph 3.27) and anti-corruption (see paragraphs 3.97 to 3.99).

Maintain Sound Finances

2.12 In implementing its growth strategy and pursuing its goal of greater development impact, IFC must not lose sight of the importance of remaining a financially sound institution. This involves not only careful selection and management of its investments but also adoption of an appropriate risk framework, this latter being particularly important in light of the planned growth and increasing decentralization. IFC has recently begun a review of its risk management practices, and a report will be made to IFC Management within a few months. See also paragraphs 3.88 to 3.91.

Good, Diverse, Motivated Staff

2.13 As highlighted in the last Strategic Directions Paper, employing the right people to implement the strategy is a challenge, and this remains the case today, especially for more senior staff. The recruitment drive to hire diverse and skilled staff is currently underway, and IFC is working on putting in place the training, incentives and performance measures which are necessary for these staff to become fully effective as soon as possible. Human Resources issues are more fully discussed in paragraphs 3.81 to 3.87 and Annex 3.

SECTION III. IMPLEMENTATION UPDATE

3.1 IFC has continued to make significant progress in pursuing its five strategic priorities, and has scaled up its activities in line with its ambitious growth plan approved last year. In order to deliver development results and fulfill its corporate goals, IFC must leverage its involvement by scaling up through partnerships with its clients, other members of the WBG, financial market partners, including ‘Equator’ banks, and developing and donor member countries. For private sector clients this means continuing the strategy of becoming a partner of choice, and placing greater emphasis on the range of value-added products and services it can provide to clients, as well as on staying close to clients to assist in delivering results throughout the life of a project. For other partners, this means closer working relationships, with efforts focused on improving the investment climate and setting standards in areas such as environment, social, corporate governance and anti-corruption. The scaling up also requires IFC to leverage its own strengths of being an institution with a culture of innovation, pragmatism and market discipline. IFC must continue to respond to development challenges through market-driven initiatives and innovations, many examples of which are presented throughout the rest of Section III. IFC will also need to address certain challenges if it is to maximize the development impact of its growth strategy, in particular in the areas of human resources, risk management and management of TAAS.

Highlights of Achievements, FY05-FY06 (to-date)

3.2 **Development Impact Targets.** Following discussions with the Board last year, IFC now has Board-endorsed development impact targets in its Corporate Scorecard which are based on the five strategic priorities. The Corporate Scorecard also reports on profitability and client service. Table 3.1 contains a summary of FY06 progress in the key development impact indicators. The full FY05 Scorecard can be found in Annex 2.

Table 3.1. Summary of FY06 Progress on Key Indicators

Scorecard Item	FY05	FY06 Estimate as of 3/24/06	Target FY08 (Board)
% Satisfactory or Better Ex-post Development Outcomes (XPSR)	60%	NA	65% on projects committed FY06-08 ¹
Africa Commitments	\$445m	\$500m-\$600m	\$735m – \$875m
SME Commitments (incl. Micro)	\$1,099m	\$0.8bn-\$1.1bn	\$1.1bn – \$1.3bn
IFC Frontier % vs. Frontier GDP %	28%:18%	31%:17%	Overweight in frontier
New Client %	56%	50%	Larger than 50% of projects
Renewable Energy/Energy Efficiency IFC Commitments ²	\$221m	NA	EIR target for the World Bank Group
Total RE/EE Component	\$832m	NA	
Infrastructure, ICT ³ , Health and Education Commitments	\$880m	\$1.2bn-\$1.4bn	\$1.5bn – \$1.8bn
Financial Sector Commitments ⁴	\$2,183m	\$2.0bn-\$2.2bn	\$2.1bn – \$2.5bn

1 There is generally 5-6 years’ lag for ex-post results.

2 Based on commitments as of end FY05. The total project cost of projects with RE/EE components was \$2.9 billion. IFC invested \$705m in these projects, of which \$221m was targeted to the RE/EE components. FY06 estimates are still under preparation.

3 Information and Communication Technologies.

4 Not including Funds.

3.3 World Bank Group Collaboration. As illustrated throughout this paper, IFC and other members of the WBG already work effectively together on a number of fronts. As acknowledged by WBG Management in recent announcements, however, there is considerable scope to enhance collaboration further, focusing on improving services on-the-ground by effective use of the institutions' respective business models. With IFC's and MIGA's focus being primarily on the private sector whilst IBRD and IDA work primarily with governments, their activities can reinforce each other, especially when responding to clients' needs and well coordinated. In addition to initiatives covered elsewhere in this paper, this paragraph outlines some further examples of the steps already taken to increase the effectiveness of collaboration.

-At the regional and country level:

- In Sub-Saharan Africa, IFC and the World Bank worked together on the private sector component of the Africa Action Plan (approved by the Board in September, 2005). IFC is now working with the World Bank Africa region's private sector group to develop a framework for scaling up collaboration.
- In Brazil, the two institutions have an extensive cooperation program, including work on infrastructure, the financial sector, agribusiness, environment and the business climate.
- Joint CASs are under preparation with significant engagement between the World Bank and IFC for China, Senegal, Mauritania, Madagascar and South Africa.

-At the transaction level: there are increasing opportunities for collaboration, particularly in infrastructure and other areas where it has been recognized that a combination of public and private involvement will be key to success. Several of such projects have already been closed and a number are in the pipeline. See Boxes 2.1, 3.1 and 3.2 for specific examples in Sub-Saharan Africa.

-At the thematic level: IFC and the World Bank are already cooperating on themes such as good governance, HIV/AIDs policy, sustainable development and business and clean and renewable energy, as these are areas where the WBG as a whole can provide value to both public and private sector interests.

3.4 Technical Assistance and Advisory Services. The ability to offer technical assistance and advisory services to clients, either together with or separately from an IFC investment, has become an increasingly important factor in IFC's development impact, as well as in its competitive advantage. Over recent years, TAAS have expanded rapidly in scope, geographic coverage and staffing: at the end of 2005, there were 457 active TAAS projects. In addition to helping IFC clients, IFC is increasingly offering TAAS targeted to help improve the investment environment to encourage a strong private sector to develop. Much of IFC's TAAS is carried out through IFC's facilities. There are now about 800 facilities' staff based in forty-five countries and in Washington, and in FY06 IFC rolled out training for these staff to help enhance their understanding of the investment side of IFC's operations and thereby their ability to recognize possible synergies with IFC's investments. IFC has now taken steps to align the facilities with the regional strategies and to clarify the TAAS principles and business lines. This has enabled IFC to prioritize funding allocations for TAAS in line with its strategic objectives.

3.5 Principles and Business Lines. With the growth in TAAS described above, IFC is moving quickly to improve TAAS selectivity, operational accountability and efficiency in resource allocation. IFC has therefore developed a set of Principles to be applied to all TAAS and has set out five TAAS Business Lines under which all operations will be aligned: business enabling environment, focused on frontier markets; value-addition to firms, focused on corporate governance; environmental and social sustainability; infrastructure, focused on public-private partnerships and privatization; and access to finance. Each Business Line has a leader and a committee process to bring objectivity to the review of funding proposals and allocation of resources. TAAS portfolio

supervision and monitoring systems have also been strengthened. The management principles involved include the separation of decision-making on funding from implementation (to handle conflicts of interest), more intellectual leadership and quality control from headquarters, implementation to the extent possible through TA facilities in the field and leverage of donor funds where possible. This structure is aimed at enhancing strategic focus, providing better governance and results measurement of TAAS and ensuring consistency in funding decisions across regions.

3.6 New Environmental and Social Performance Standards Adopted. In February, 2006 the Board adopted revised environmental and social standards, along with a new policy on disclosure. The new outcomes-based approach of these standards will help to make IFC's investments more sustainable and developmental (see paragraph 3.34). The Equator Principles are now expected to be updated in line with the new standards, which will also extend the development impact of IFC's approach to environmental and social issues.

3.7 Advances in Measurement. IFC is continuing to work on its evaluation and measurement systems, and is particularly focusing on how better to measure its development impact. IFC established the Development Effectiveness Unit in the Private Sector Development vice-presidency in July 2005 to spearhead and coordinate efforts to measure IFC's development impact. Until now, IFC's main measurement of *ex post* development impact was through the Expanded Project Supervision Report (XPSR) system, which is considered best practice among multi-lateral development banks (MDBs). However, the XPSR system only measures development results once in the lifetime of a project, and only for a random sample of projects (about 50% of projects are covered by XPSRs). To supplement the XPSR system, IFC has introduced a new Development Outcome Tracking System and briefed CODE about the new system in December, 2005.

3.8 Development Outcome Tracking System. This system will allow for systematic tracking of development results throughout the project cycle, from identification of clear, monitorable development objectives up front, to ongoing tracking during supervision, and will thereby provide for earlier learning and feedback into IFC's operations. With guidance from the Development Effectiveness Unit, investment departments have started to develop monitorable indicators specific for their types of operations and are starting to track them in DOTS. IFC plans to brief the Board on progress in July, 2006. IFC has also committed to report on its development results in a new Development Effectiveness Report, with the first report likely to come out in spring, 2007.

3.9 TAAS Measurement. Significant steps have been taken on the measurement of the impact of TAAS on several fronts. First, in FY06, IFC established a system for monitoring and evaluating the impacts of its technical assistance activities through deployment of TAAS supervision reports and standard performance indicators. All active TAAS projects have gone through the first corporate supervision cycle. Secondly, IFC has now launched the first TAAS project completion reports and results will be available by the end of the fiscal year. These reports include development effectiveness ratings akin to those used for investment operations. Thirdly, in order to gain insights into project performance and provide recommendations on the design and implementation of current and future projects, IFC has completed a number of operational reviews of TAAS programs, for example the Linkages Program and the SME Toolkit. In addition, several Facility-specific evaluations have been conducted during FY06 by both external evaluators and IEG. Finally, IFC is one of the leaders amongst providers of TA in implementing several experimental designs in order to have a more rigorous assessment of impacts as well as to inform design of TA interventions from lessons learned. This approach involves experimental and control groups for measurement of the impact of IFC's interventions. Key findings and lessons from these activities will be shared with staff, donors and external evaluation experts during the Monitoring and Evaluation Conference on TAAS which IFC will be hosting in May, 2006.

3.10 *Measuring Environmental and Social Sustainability.* IFC is developing a new system to track project compliance with IFC's new Performance Standards, as well as to monitor environmental and social performance throughout the project cycle. IFC is developing a matrix of environmental and social performance indicators, matching the Performance Standards, which aims to fulfill IFC's commitment to articulate expected development results systematically at project approval and track them during supervision.

3.11 **Investment Commitments.** IFC continued to experience strong growth in FY05 and FY06 to date, with new commitments increasing 13% to \$5.4 billion in FY05. At the end of March, FY06, commitments already stood at almost \$3 billion, compared to \$1.7 billion at the same time the previous year.

3.12 Looking forward, IFC has revised upwards its commitment targets for FY06-FY08 compared to those presented to the Board last year, and has extended its growth path into FY09. Table 3.2 shows the projection for FY06 and indicative figures for FY07-09, which are subject to developments in IFC's markets, in particular liquidity and demand for credit. Indicative figures for each region are shown in Annex 1.

Table 3.2. Total Commitments (US\$m)

	FY05	FY06 Proj.	FY07 Plan	FY08 Plan	FY09 Plan
Commitments	5,373	5,600-6,000	6,000-6,800	6,500-7,800	7,000-8,200
Projections in FY05	--	4,810-5,720	5,275-6,270	6,015-7,150	--
% Change from FY05	--	4%-12%	12%-27%	21%-45%	30%-53%

3.13 **Financial Performance: Third Year of Record Profitability.** IFC's operating income for FY05 was \$1.95 billion, representing a substantial increase over FY04. The growth reflected strong equity markets leading to significant realized gains on sales of equity, robust dividend income, greater loan portfolio income and the positive impact of a release of loss reserves. IFC's FY05 Return on Net Worth was 22.6%, up from 13.7% in FY04. IFC is anticipating continued strong profitability in FY06 due to the positive market environment.

Progress with the Five Strategic Priorities

1. Strengthen the Focus on Frontier Markets

3.14 IFC has continued to focus on increasing its activities in frontier markets. In FY05, commitments in these markets rose 24% to almost \$1.3 billion, and are forecast to increase to over \$1.7 billion in FY06. In terms of numbers of projects, frontier projects account for a somewhat higher percentage of IFC's total projects than the percentage of dollar volume commitments, representing about one third of IFC projects in number, due to the lower average project size in frontier markets. In addition, there are regions of several non-frontier countries which meet frontier criteria, for example north-east Brazil, where IFC is also focusing its activities. When commitments in these frontier regions are included in the total, the frontier market figures for FY05 account for 38% in terms of volume and for FY06 (first half) 37%. As noted in IFC's Independent Evaluation Group's *Annual Review of IFC's Evaluation Findings: FY2005* (see Box 3.4), the percentage of IFC's approvals in the frontier are now more than twice as concentrated as FDI, and also relatively more concentrated there than GDP.

Table 3.3. IFC Commitments in Frontier Countries

	FY03	FY04	FY05	Estimate FY06³
Frontier Country ¹ Investments (\$m)	\$874	\$1,032	\$1,278	\$1,738
IFC Frontier Commitments as a Percentage of Total IFC Commitments ²	28%	26%	28%	31%
<i>IFC Frontier Commitments excluding Argentina⁶ %</i>	26%	24%	25%	26%
<i>IFC Frontier Commitments including frontier regions⁴ %</i>	NA	NA	38%	37% ⁵
Frontier GDP as a Percent of Total Developing Country GDP	24%	22%	18%	17%

1 Frontier countries are countries which are either high risk (0-30 on a scale of 0-100) according to the Institutional Investor Country Risk Ratings, or low income according to the IBRD classification.

2 % Commitments excluding commitments to regional and global projects.

3 As of 3/10/06.

4 Based on a pilot analysis of frontier commitments in IFC's top ten non-frontier countries (in terms of recent commitments). Countries covered were Russia, China, Turkey, Mexico, Brazil, Indonesia, Philippines, Ukraine, Colombia and Romania. Frontier regions were identified based primarily on *per capita* income with adjustments by IFC staff to reflect prevailing business risk issues in the country.

5 Based on actual commitments for the first half of FY06.

6 Argentina entered into the frontier category in FY02 due to its high investor risk rating. It is expected to be back in the non-frontier category in FY07.

3.15 Some of the main obstacles to increasing frontier volume significantly remain the investment climate and the absorptive capacity of these markets. IFC is therefore stepping up its advice to governments in order to try to speed up establishment of an environment which is more hospitable to the private sector, both through greater collaboration with the World Bank and also through its TAAS and privatization work. The work with the Government of Senegal on the Kounoune power project, described in Box 3.2, is a recent good example of this.

3.16 **Progress in Sub-Saharan Africa.** Over the past two years IFC has significantly scaled up its capabilities on the ground. As a result, commitments grew to \$445 million in FY05, from \$140 million in FY03. Commitments in FY06 are again projected to increase substantially, to between \$500 and \$600 million. In FY06 and looking forward over the FY07-09 period, financial markets investments are projected to contribute significantly to new commitments in the region. Trade finance, MSMEs and housing finance will be the three main pillars of the financial markets strategy in Sub-Saharan Africa. Box 3.1 describes some of the financial markets initiatives in the region. Other activities in the region are discussed elsewhere in this paper, in particular in Box 2.1 and paragraphs 3.22 (Post-Conflict Countries Initiative) and 3.48 to 3.55 (Infrastructure).

3.17 The FY04-06 Strategic Initiative for Africa is ending, and will be reported on to the Board around mid-2006. While IFC considers that the three strategic pillars of this initiative remain valid (investment climate, SMEs and proactive development of large investments), some adjustments are necessary. In particular, IFC is proposing to add another pillar, trade and regional integration, and to extend its reach and strengthen partnerships. This is discussed further in Annex 1.

3.18 The last year saw the full launch of PEP-Africa as the primary vehicle for IFC TAAS in the region and the integration of PEP-Africa with IFC investment operations. PEP-Africa's structure is directly aligned with IFC's new TAAS business lines and there are Business Line Managers for each business line identified. PEP-Africa is ahead of targets in donor fund-raising, and in March, 2006 the Board of the African Development Bank approved \$7 million in funding to support PEP-Africa

programs. The programs concentrate on the three strategic pillars of IFC's Sub-Saharan Africa strategy. i) *Investment climate improvement programs*: the activities cover five main market needs (streamlining business start-up procedures, simplifying tax regimes, improving private sector property rights and addressing gender bias in property rights and access to finance) and the focus is on program implementation through on-the-ground teams complementing the work of the World Bank and Foreign Investment Advisory Services (FIAS). ii) *SMEs*: activities focus on improving SME access to finance and strengthening SME competitiveness through building financial institution capacity for SME lending, developing alternative sources of financing, such as leasing, providing business planning and capacity building for SMEs and implementing SME "cluster" competitiveness strategies. iii) *Proactive investment development*: PEP-Africa contributes to creating or supporting investments by providing TA services that add value to IFC's financial products. These services include SME linkages and supply chain development, business risk mitigation of HIV/AIDS, corporate governance, gender equity and the range of IFC's environmental and social programs.

3.19 The biggest challenge in the region remains implementation, especially attracting qualified staff, but here also IFC has made substantial progress, strengthening the eight regional offices throughout the continent and increasing staff from 140 in July, 2005 to 195 by the end of January, 2006. IFC's overall recruitment target for FY06 (75 new staff) is therefore well on track in the region, including achievement of diversity objectives.

Box 3.1. IFC Financial Sector Initiatives in Sub-Saharan Africa

Financial markets investments in Sub-Saharan Africa are expected to represent a significant proportion of new commitments over the next few years. As of December, 2005, the financial markets portfolio in the region stood at \$362 million, consisting of 47 projects across 24 countries. Despite this growth, IFC has recognized that it needs to leverage its involvement in this sector in order to increase its impact, and it is pursuing several initiatives in this regard. Below are some examples.

- **IDA/IFC Africa MSME Pilot**: this program, approved in June 2003, was aimed at providing an integrated approach to supporting micro, small and medium enterprises. This program has now grown to potentially in excess of \$400 million, considerably more than originally envisaged, but implementation remains an issue. As of January, 2006, IFC had committed \$49 million to 6 associated projects, with a pipeline of around another \$15 million, and \$7 million had been approved for linked investments, with a further \$90 million of such directly linked investments in the processing pipeline.

- **Africa SME Finance Program**: under the Performance-Based Grants Initiative described in paragraph 3.23, IFC is proposing to use \$30 million of the \$250 million designation of retained earnings to provide TA and performance-based grants to financial institutions, provided that they meet pre-defined targets in lending to SMEs. Due to its replicable and scaleable approach, the initiative is designed to deliver on the objectives of deepening and broadening the African financial sector and raising the standards of financial services provided to SMEs.

- **Greenfield microfinance initiative**: working with KfW, this program is intended to create seven new microfinance institutions in Sub-Saharan Africa. The total package is expected to be \$103 million over a five-year period, with IFC's share being around \$16 million in investments and TA.

- **Trade Finance**: IFC's \$500 million Global Trade Finance Program was approved by the Board in FY05. Africa has been a key focus of this business, projected to account for 50% of the program in FY06 with twenty African issuing banks participating. The program is an effective platform on which to build new relationships with banks, and IFC expects that some of the banks will become strategic partners with IFC in other types of projects, such as SME lending and housing finance. See paragraph 3.66 for more on Trade Finance.

3.20 Progress in Middle East and North Africa. Historically a region where IFC has not expanded rapidly, MENA was the region with the second highest growth rate of commitments in FY05, 33.5%, although the level was still relatively low at \$315 million. For FY06, IFC is predicting significant growth, which could be more than 40% over FY05. Growth in investment activity is accompanied by enhanced capacity to deliver TAAS through PEP-MENA, the region's TA facility. MENA regional staffing has increased over 50% since the beginning of FY06, driven by significant hiring in PEP-MENA.

3.21 Although the region has significant needs, there are several constraints facing IFC, of which the key ones are: i) relatively unsophisticated financial markets in many countries; ii) challenging governance environments; and iii) excess liquidity in some of the markets. IFC's strategy will focus on improving the investment climate, strengthening the financial sector, developing the infrastructure and energy sectors and supporting regional and South-South investments. This region is a significant source of South-South transactions, with seventeen committed between FY03 and FY05 for a total of over \$276 million. (See paragraph 3.25 for more on South-South transactions). In countries with more developed financial markets, IFC is focusing on underserved niches with significant development impact, such as microfinance. A recent example is the IFC partial credit guarantee program, combined with TA, provided to the Foundation for Local Development and Partnership, a microfinance institution in Morocco, offering services to about 45,000 beneficiaries.

3.22 Post-Conflict Countries Initiative. IFC has an important role to play, in full collaboration with the World Bank and other development partners, in fragile states and countries emerging from conflict in order to help them catalyze economic growth through establishment of a dynamic private sector. To this end, IFC is launching a pilot Post Conflict Countries Initiative in the Democratic Republic of the Congo (DRC). Phase 1, now underway, involves an intensive effort to define short, medium and longer term interventions in all key sectors of the fledgling DRC private sector. The objective is to be ready to launch several initiatives following the election in June, 2006. This work is being fully coordinated with the World Bank, MIGA, the U.N. and key donors. IFC will then be in a position to define the nature of a more proactive approach to a Post Conflict Countries Initiative including target countries, resources, as IFC will need to deploy additional resources in order to carry out the program of initiatives, types and amounts of funding and operating principles. This is expected to provide the basis for bringing a proposal to the Board.

3.23 Performance-Based Grants Initiative. The Board recently discussed⁷ IFC's innovative Performance-Based Grants Initiative, whose primary objective is to scale up IFC's impact in priority sectors in frontier markets. The pilot \$65 million is to be divided into two tranches, one of which, the Africa MSME Finance Program, is discussed in Box 3.1. For the other tranche of \$35 million IFC is proposing to partner with the Global Partnership for Output-Based Aid (GPOBA). Even prior to this collaboration with GPOBA, IFC has been working with GPOBA to identify private sector projects which might benefit from GPOBA's approach. IFC is now working with GPOBA on one such IFC project to try to put in place an incentive scheme to encourage expansion of gas connections in poor areas through connection subsidies.

3.24 Staff in Frontier Markets. IFC has significantly expanded the presence of senior staff in frontier countries, particularly in Sub-Saharan Africa, in order to be proactive through intense business development efforts. In addition, as indicated in last year's paper, business developers have now been placed in frontier regions of India and China. For example, in India, as part of a concerted effort to diversify its investments regionally, IFC first undertook an analysis of 16 states and subsequently categorized them into three groups, with a view to adopting a different business

⁷ "IFC Performance-Based Grants Initiative" IFC/R2006-0042.

development strategy for each. In order to facilitate business development in these states, IFC opened a new office in Chennai in Tamil Nadu, South-East India, and added business developers in Mumbai to cover Western states. IFC has also opened an office of the South Asia Enterprise Development Facility (SEDF) in Guwahati in Assam to manage TA activities in North-East India.

2. Build Long-term Partnerships with Emerging Global Players in Developing Countries

3.25 South-South Investments. IFC's global presence enables it to support developing country companies which want to invest in other developing countries and IFC has made this type of activity a priority. IFC's financing support is accompanied by the ability to help client companies raise their standards of business practices through its expertise on environmental, social and corporate governance standards. IFC's South-South investments have been growing steadily for the past three years, reaching \$484 million in FY05. Examples in FY05 include an infrastructure services company in Angola with Constructora Norberto Odebrecht of Brazil, a hotel investment in Burkina Faso with a Malian investor and a telecoms company in Ghana with a Lebanese sponsor.

3.26 Building Long-Term Relationships. Through the greater dedication of resources to the field IFC aims to move closer to, and increase activity with, both new and existing clients and IFC must be mindful to balance these two groups as both are important. In the 2005 client survey, the prospect of long-term partnership remained one of the top reasons clients came to IFC, and was one of the most highly scored features identified as important in IFC's services. IFC must continue to help its clients not only with innovative financial products but also value-added services, some of which are described below. The ability of IFC to continue to support them through positive and negative changes in their environments is also an important advantage often cited by clients.

3.27 Corporate Governance. Corporate governance assessment is now an essential part of IFC projects and IFC's assistance in this area has increasingly become important value-added for its clients, as evidenced by the scores in the Client Survey. Corporate governance is also important where IFC is proposing an equity investment, as good corporate governance is essential to protect the long-term interests of minority shareholders. IFC regards its involvement in assessing governance and working with companies on improvements to be an important value-added contribution to both portfolio quality and long-term investee performance. In addition to working directly with the private sector, the joint World Bank/IFC Corporate Governance Unit is looking at how to apply the lessons of modern corporate governance to the structuring of state-owned enterprises.

3.28 The web-based methodology developed by IFC is used not only by IFC staff, but is also seen as a standard for other development banks. It goes beyond diagnosis and helps companies come up with solutions to improve their governance, and is therefore increasingly valued by clients. IFC's corporate governance methodology is employed, for example, by Banco Real in Brazil for the new corporate governance tranche of the Sustainability Credit Line. IFC is also proposing a similar approach to encouraging good governance amongst credit line sub-borrowers in the Philippines and Indonesia. The methodology has recently been refined by the addition of a special financial institution governance tool-kit. Also in the realm of governance, IFC often nominates directors to the boards of its investee companies (136 of IFC's 625 equity investments, or 22%, had IFC nominees at the end of November, 2005), and through them IFC can play an important role in guiding the company to better governance. At the same time, this level of representation exposes IFC to reputation risks, and IFC has improved its policies and procedures for directorships and rolled out a revised training program for all nominees.

3.29 IFC also advises governments, regulators, stock markets, institutes of directors and other private sector players on corporate governance issues. IFC played an important role in the design and promotion of the Novo Mercado, the Sao Paulo stock exchange's (Bovespa) special listing

segment for well-governed companies. Since 2003, Novo Mercado has become the recognized gold standard, attracting the vast majority of the recent boom in IPOs in Brazil. It now accounts for 15% of the number of companies that trade, and 43% of the market capitalization, and has out-performed the general market index by more than 100% since June, 2001.

3.30 Linkages. IFC's Linkages program is designed to strengthen small and medium enterprises linked to IFC investment projects and thereby bring employment and other opportunities to local communities. A lot of this work is related to the supply chain to help increase local sourcing opportunities for IFC's clients, but it also involves facilitating access to finance for local entrepreneurs, improving SMEs' access to new markets and promoting local economic development in the communities around the projects through income-generating opportunities. In order to maximize the impact of this program, IFC hopes to replicate industry experience in one region in other regions. For example, IFC is in discussions to replicate a successful program carried out in Peru in an African project with the same sponsor, and is also pursuing discussions with clients in the mining sector. As at the end of March, 2006, the program had 27 projects being implemented or scoped related to total IFC investment commitments of over \$1.5 billion.

3.31 AIDS. IFC's AIDS program – IFC Against AIDS – was started in 2000 and aims to protect people and profitability by being a risk management partner, HIV/AIDS expert and catalyst for action where HIV/AIDS is threatening sustainable development. The program also aims to support IFC's business development by providing value-added services and contributing to IFC's brand. The program has been most active in Sub-Saharan Africa and this region will remain a priority for FY07. IFC will launch an innovative program to reach SMEs and will undertake capacity building efforts with clients and others, for example NGOs that work with IFC's clients. In India, IFC is aiming to show that private enterprises can be partners with governments, NGOs and international organizations to curb the epidemic, focusing on three areas: i) the workplace, by raising awareness; ii) in companies' clinical facilities; and iii) in the community, particularly in the trucking industry and migratory workforce. The program is also starting to become active in Russia and China. In all this work, and particularly in India, IFC has cooperated closely with the World Bank Institute and it is intending to build on this in a more systematic way in FY07.

3.32 Developing New Clients. IFC is further enhancing business origination capability and strengthening client service by being closer to local sponsors. IFC has continued to decentralize, not only to be more responsive to its clients but also to enhance its business development capacity through greater local knowledge and presence. Between June 30, 2005 and the end of February, 2006 the number of senior (Grade G+) staff in the field increased 13% and IFC is still actively recruiting for field positions, particularly in light of the decentralization pilot in Asia described in paragraph 2.10. In FY05, 66% of projects were with domestic sponsors, compared to 52% in FY04, and the expanded field presence should lead to an increase in the number of domestic sponsors going forward.

3. Differentiate Through Sustainability

3.33 IFC has continued its strong focus on promoting its sustainability agenda through improving policies and processes and developing sustainability strategies in sectors which have large environmental, social and governance impacts.

Improving Policies and Process

3.34 *New Performance Standards.* Following an extensive consultation process, in February, 2006 the Board approved IFC's new Policy and Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information, reinforcing IFC's role as a global standard

setter for private finance in emerging markets. The new framework marks a considerable strengthening of the safeguards, both due to their increased scope and the new outcomes-based approach. The policies will become effective on April 30, 2006 and around 40% of IFC investment staff had already been trained by the end of March, 2006. Experience from the in-house training will provide the platform for IFC to formulate a training approach for external stakeholders. In order to ensure that the changes in client requirements are well understood, IFC is implementing an intensive external communications strategy. IFC will also provide clients with reference, guidance and good practice materials to help them meet the new standards and, in certain circumstances, technical assistance to defray some of the up-front costs. The additional resources needed for these efforts will be considered in formulation of IFC's FY07-FY09 Business Plan and Budget. IFC will closely monitor implementation of the new policies, and will provide a progress report to the Board eighteen months after the effective date.

3.35 *Equator Principles.* The adoption of the Equator Principles by a significant number of financial institutions is a prime example of IFC's leadership in sustainability and standard setting. The 41 EPFIs are expected to adopt a new set of principles reflecting IFC's new Performance Standards. IFC is working to address the significant training and communication needs in order to facilitate this and is reviewing the associated resource implications. IFC, together with the EPFIs, is also promoting adoption of the Principles by other financial institutions, including bilateral, multilateral and export credit agencies.

3.36 *Mainstreaming.* In order to mainstream sustainability into IFC's investment work, mitigate environmental and social risks and ensure sustainability in clients' operations, 63% of IFC's environment and social specialists are now co-located in industry or regional departments. This will increase to 66% by the end of FY06 with enhanced field presence in Latin America, East Asia and Sub-Saharan Africa. The 'Building Better Business – Sustainability Learning Program' has now been offered nine times, including three times in the field, and over 500 staff have now been trained. Following this intensive up-front effort, training on sustainability will be mainstreamed via integration into other IFC programs, including the credit training courses, to encourage staff to approach the assessment of projects in an integrated way.

Developing Sector Strategies

3.37 *Renewable Energy and Energy Efficiency.* Renewable energy (RE) and energy efficiency (EE) investments are important components of IFC's strategy. IFC is committed to scaling up its activities in these areas in order to contribute to the overall World Bank Group target of increasing its RE/EE portfolio by an annual average of 20% over five years, FY05-09. IFC is also playing an important role in the World Bank Group's undertaking, together with other IFIs, following the July, 2005 Gleneagles Summit, to prepare an "Investment Framework" to accelerate investments in low carbon energy systems and to increase assistance to developing countries in order to help them adapt to climate change. IFC has now established a unit within its Infrastructure Department which focuses on investments in renewable energy projects, in coordination with the Environment and Social Development Department.

3.38 In FY05, IFC committed \$705 million in 21 projects that had an RE/EE component. The total value of these projects was \$2.9 billion, of which \$832 million were invested directly in RE/EE components, and IFC's investment in the RE/EE parts of these projects is estimated at \$221 million. In order to enhance identification of new opportunities, whilst also tracking the impact of IFC's existing RE/EE portfolio, IFC is building a tracking system. The resulting analysis will be updated annually.

3.39 IFC has now closed its first two direct investments in wind power projects, in the Dominican Republic and Brazil, and is actively pursuing wind investments in Mexico and China. It also recently closed a small hydro project in India. As in other areas of infrastructure, IFC is working closely with the World Bank in the RE/EE field, and for example the World Bank's efforts in China have helped to open up large concessions for wind projects of 100-200MW. There are similar joint World Bank-IFC initiatives involving RE under discussion for Russia and other countries. Generally, IFC's focus remains on directly investing in RE projects in those few countries where: i) the government is supportive and is putting in place the necessary regulations; ii) the private sector is responding to these initiatives; and iii) the projects are large enough to have a significant impact.

3.40 IFC currently manages \$100 million (soon to become \$150 million) in two carbon finance donor-funded facilities, of which 40-50% is expected to be committed by the end of FY06. The private sector is key to the development of carbon markets, as it is already the most significant seller of carbon credits and will soon be the most significant buyer. IFC's carbon finance strategy focuses on IFC moving beyond intermediation to take risk for its own account by leveraging its ability to manage and take long-term project and credit risk in emerging markets, working with financial institutions (see paragraph 3.44) and developing new risk mitigation and structured finance products.

3.41 *Extractive Industries.* IFC is facing strong demand for its services in the extractive industries sector, especially from local and smaller international companies, partly driven by persistent high oil and mineral prices. IFC's activities continue to be guided by the Management Response to the Extractive Industries Review and IFC will make its second report to the Board on implementation progress at the end of 2006. This remains a difficult sector, however, especially in some regions where governance issues are problematic, but IFC is keen to address the challenges by: i) ensuring more effective coordination of private sector investment support and policy work to help mitigate governance risks to expected benefits at the national level; ii) managing the increased complexity involved in ensuring sustained development impact at the community level; and iii) increasing the value-added which IFC can bring to the sector. In order to help address some of the governance issues, the World Bank Group is actively engaged in helping about twenty countries implement the Extractive Industries Transparency Initiative, which is aimed at increasing the level of transparency regarding tax and other payments to governments from the extractive industries sector.

3.42 *Agribusiness.* IFC continues to support two initiatives launched in FY04: "better management practices" for commodities and an "animal welfare" program that addresses humane treatment of livestock. Both programs have mobilized a wide range of stakeholders, including IFC clients, and have established roundtables to come up with a consensual view of better management practices in their respective industries. At the project level, IFC is active in raising its clients' awareness of issues critical to the sustainability of their operations and providing technical assistance as needed. IFC has also been helping its clients in the poultry industry facing the dangers of avian flu. It has provided technical advice and financial support to its clients in affected countries, and improved the preparedness of clients in other countries still spared by the disease. IFC has also joined forces with the World Bank to ensure that private and public initiatives in this area remain fully aligned and complement each other in an effective fashion.

3.43 The agribusiness sector continues to face challenges across several dimensions that need to be addressed in order to strike a balance between the need to secure increased food production and the need to safeguard finite resources. Based on the work with stakeholders following from the Better Management Practices work initiated in FY04, on a selective basis IFC will engage in countries and sectors where there is a perception that economic development and sustainability concerns may diverge. The objective is to help the private sector define sustainable solutions that will be of value due to their demonstration impact and ability to be replicated.

3.44 *Sustainability in Financial Markets.* IFC has been engaging with the financial sector on sustainable lending and investment issues beyond corporate governance and anti-money laundering. Many financial sector clients have come to appreciate the value of more sustainable approaches. IFC has been facilitating the growth of sustainability finance as a key business differentiator, and has established a Financial Markets Sustainability (FMS) unit to promote this effort. IFC has provided training and best practice guidance to financial institutions on sustainable banking through its Sustainable Financial Markets Facility, funded jointly by donors and IFC. For example, IFC's support to financial institutions in Central Europe to help them build sustainable energy lending businesses has yielded a substantial portfolio of small-scale renewable (wind, hydro, biomass cogeneration) and energy efficiency projects, totaling \$65 million to date. IFC will continue to expand its credit enhancement and finance facilities for local financial institutions across the globe, where market conditions support such business. In addition, IFC is focusing on the development of innovative environmental finance products in emerging markets which financial institutions can provide to sub-borrowers: carbon finance, sustainable energy finance, supply chain finance and corporate governance finance.

3.45 IFC's efforts in promoting sustainable investment also go beyond the project level. For example, in 2005, IFC helped the Sao Paulo stock exchange, Bovespa, to launch a corporate sustainability index, the second in emerging markets. The Index will track the environmental and social, economic, financial and corporate governance performance of leading companies listed on the Sao Paulo Stock Exchange. As another example, in November, 2005, IFC and the Financial Times launched the FT Sustainable Banking Awards, the first global awards program recognizing banks that have actively integrated social and environmental objectives into their operations, while maximizing financial gain for their shareholders. More than 80 entries were received.

3.46 *Gender Entrepreneurship Markets (GEM).* GEM was launched in December, 2004 to mainstream gender issues throughout IFC's operations, and at the same time better leverage the untapped potential of women in emerging markets. The three main goals of the program are: i) to provide advisory services to financial intermediaries on the delivery of financial services and business support to women; ii) to add value to IFC's investment projects; and iii) to address gender barriers in the business enabling environment. The initial focus has been on the financial markets and SME business lines, with a primary regional focus on Sub-Saharan Africa, where women run between 25% and 40% of registered businesses, yet face greater constraints than their male counterparts in accessing finance. One example of an integrated access to finance project is IFC's work with Access Bank in Nigeria, where IFC is extending a \$15 million line of credit to support the bank's lending activities to women entrepreneurs. This investment will be complemented by technical assistance to the bank, combined with enterprise-level capacity building activities. GEM will implement this program in partnership with PEP Africa and local business development support providers. The original funding of this program is due to expire in mid-FY07 and IFC will be proposing that the pilot be continued with an additional funding request.

3.47 *Sustainability Innovation.* With a view to encouraging innovation in environmental and social sustainability, IFC is managing a donor-funded portfolio to help develop new products, business models and instruments. Successfully tested products become new business lines for IFC. Practice areas include sustainable energy, carbon finance, cleaner technologies, biodiversity, social responsibility and sustainable finance. Some of these projects are co-financed with mainstream IFC investments, several are developed in coordination with the World Bank, and others are stand-alone.

4. Address Constraints to Private Sector Growth in Infrastructure, Health and Education

Infrastructure

3.48 Given the huge need for better infrastructure in many developing countries, infrastructure remains a priority area for IFC, but it has become clear that new approaches to infrastructure investments are needed. Large, traditional infrastructure sponsors from developed countries have retreated from emerging markets. At the same time, many countries are caught between wariness of what they perceive as the potential political costs associated with privatization and their own lack of capacity and fiscal resources to undertake projects effectively. As a result, many infrastructure projects have been cancelled, particularly in the sensitive water sector.

3.49 These developments reinforce the need for IFC to demonstrate that private involvement in infrastructure can be successful. With its decades of experience in infrastructure, and as a trusted partner for both investors and governments, the Corporation is uniquely capable of designing and helping implement investment projects that address the concerns of both sides. Although the level of commitments in FY05 decreased somewhat, to \$879 million from \$983 million in FY04, the pace has picked up and IFC is expecting to commit around \$1.1-\$1.3 billion in FY06. This year will see a large investment program in infrastructure in Sub-Saharan Africa, in particular, including expected new commitments in power projects in Cameroon and Ghana.

3.50 The investment growth reflects increased commitment of resources by IFC to upstream development and shaping of infrastructure projects. The needs remain great, however, and IFC is therefore seeking new ways to support infrastructure projects, particularly in Sub-Saharan Africa where the private sector is especially cautious, and in the less easily financed sectors such as power, roads and water, focusing on enhanced project development and shared public and private responsibility. Upstream project development can involve engaging earlier with infrastructure companies that may be exploring opportunities, advising governments on the introduction of private participation and the structuring of public-private partnerships (PPPs), or working with development companies that launch projects and then bring in longer-term partners. The Performance-Based Grants Initiative discussed in paragraph 3.23 will also provide an important element in IFC's ability to help member countries meet their infrastructure needs, particularly in those areas where user fees alone cannot provide a sufficient basis for covering service delivery costs.

3.51 **Project Development.** Lack of bankable project structures is increasingly seen as a significant obstacle in infrastructure, and a key aspect of IFC's strategy in these sectors is to become more proactive in project development, and to continue its close work with the World Bank in this regard. IFC has begun providing support to an innovative entity named InfraCo, a donor-sponsored infrastructure development company. InfraCo is expected to play a significant complementary role to IFC's in working with companies and governments in the development of bankable infrastructure transactions. Both InfraCo's and IFC's advisory work benefit from significant support from the Private Infrastructure in Development Group (PIDG), a group of donors including the UK, the Netherlands, Switzerland and Sweden. IFC is also considering innovative structures to support project development, for example employing a small pool of money specifically to cover development costs in projects, which would then be converted into IFC equity should the projects proceed. In order to accomplish its business development goals, IFC has located several infrastructure staff in the field and is planning to increase this presence.

3.52 **Public-Private Partnerships.** IFC has made development of PPPs a priority, and has a specialized unit within its Infrastructure Department to focus on them. This requires close collaboration between IFC, the World Bank and MIGA to ensure both that the sector frameworks are amenable to private involvement and that the public sector participation is appropriately structured,

be it through earmarked receipts, in-kind contributions, IDA and donor funding or other mechanism. In addition to financing and the demonstration effect of these projects, as the only IFI with substantial capacity in this area, IFC's role in PPPs includes balancing the needs of investors with the public policy considerations, and ensuring that the projects have financially, economically and politically sustainable structures. Box 3.2 describes a recent PPP project, Kounoune Power in Senegal, in which IFC was involved from project concept through to financing, and which was a joint undertaking on the part of IFC and IDA.

3.53 Advisory Services to Governments. IFC provides transactional and advisory services to governments, both in designing and executing privatizations and to help them structure private participation in infrastructure. IFC's Advisory Services often acts as a nexus between World Bank and IFC work. Through cross-support, this group makes regular use of World Bank staff as specialists, and staff from this group is increasingly working alongside investment staff in order to help structure projects with a public component. Its work, which often follows sector reform work carried out by the World Bank, lays the groundwork for subsequent private investments, and has led to projects both for the World Bank and IFC. Demand for advisory support is growing rapidly. The number of advisory mandates underway has gone from 12 at the end of FY04 to 28 at present. Advisory activity is most concentrated in Africa and the Middle East. Recent high profile structuring work includes the cross-border Kenya/Uganda railway concession, for which IFC advised on the tender and bidding process and World Bank lending is supporting resettlement and labor restructuring elements, the concessioning of Madagascar's largest port, off-grid power supply in the Philippines and the Moatize project in Mozambique.

3.54 Sub-national Finance. The recent trend towards decentralization of government services has provided new opportunities for the WBG to finance these services, by providing support to various clients in the sub-national sphere. The IFC Municipal Fund, established in 2003, represents the first phase of the WBG's response to the demand for sub-sovereign products without sovereign guarantee. During FY06, approval was obtained for transactions in South Africa, Mexico, Guatemala and China and IFC's Board has so far approved six operations which will help to mobilize around \$500 million in investments. The transaction in Guatemala comprised an IFC local currency partial credit enhancement to a local bank (which had previously never taken municipal risk) through a risk-sharing facility of up to the equivalent of \$6.7 million, which will help to mobilize the equivalent of \$46.2 million for the Municipality of Guatemala City. The Municipality will invest the proceeds to finance part of the first phase of the TransMetro mass transport system and other infrastructure-related projects.

3.55 Having determined that the sub-national business could be profitable as well as having significant development impact, IFC is scaling up its support and is pursuing opportunities in many other markets. The future shape of this business for the WBG, including still greater collaboration between the World Bank and IFC, was recently considered by the Board at an informal meeting.⁸ Further discussions are anticipated at a Board Meeting in May, and one of the possibilities under consideration is a joint Department. In the meantime the IFC Municipal Fund will continue to build further on the strong partnership with the World Bank and thereby scale up and broaden its involvement in the sub-national sector.

⁸ "Sub-National Development Program", IFC/SecM2006-0001

Box 3.2. Kounoune Power, Senegal

The recently approved 67.5 MW Kounoune I independent power project (IPP) in Senegal illustrates the importance of developing a creative public-private partnership to ensure a successful transaction. The assistance IFC provided to the Government of Senegal proved invaluable in reaching the final financial commitment for the project. The Government of Senegal had taken bold steps to reform the power sector in the late 1990s, with a view to privatizing Senelec, the national electricity company. The first privatization was completed in 1999, but it was cancelled after 18 months as the privatization failed to improve electricity services in the country substantially. In 2002, a second attempt also failed as a result of a lack of agreement between the Government and the preferred bidder on the financial terms. The main problems were that: i) private investors were unwilling to commit to the massive investment needs necessary to meet the Government's stated objectives; ii) tariff levels were not high enough to cover investment and operating costs without substantial concessional financing; and iii) the universe of investors interested in the Senegalese power sector dwindled substantially along with the overall retreat of investors from emerging markets at that time.

Nevertheless, some appetite remained for smaller and well structured private sector projects despite Senelec's failed privatizations. IFC took an active role in assessing the market potential. Along with the World Bank, IFC worked closely with the Government and Senelec to develop the Kounoune I IPP. With their input, the Government hired a reputable firm to advise on the IPP development process. Throughout the bidding process, IFC and the World Bank remained involved, providing the Government and the advisor with valuable feedback to make the IPP project bankable. From those that expressed interest, three companies participated in the bidding process, with the Mitsubishi/Matelec consortium selected as preferred bidder. IFC helped the winning bidder raise financing from a syndicate of financial institutions comprising African Development Bank, Banque Ouest Africaine de Developpement, Compagnie Bancaire de l'Afrique Occidentale (CBAO), Proparco and IFC. The commercial tranche provided by CBAO will benefit from a partial risk guarantee from IDA which will back-stop certain Government obligations in the project. Loan Agreements were signed in November, 2005 and commercial operations are expected to start in the second half of 2006.

The success of the Kounoune I IPP is expected to have a strong demonstration effect. Future IPPs structured along the same basis are expected. IFC's role in bringing the project to fruition demonstrates the importance of developing strong partnerships with the Government and close coordination of the different arms of the World Bank Group.

Health and Education

3.56 In the health and education sectors, IFC continues to build on its experience financing healthcare and education through traditional project financing for capital expenditures on hospitals, clinics, schools, universities, colleges, curriculum and information and communication technology-assisted education services. In addition, IFC has begun to implement, and continues to develop, new tools for more innovative financing of social sector projects, for example developing 'wholesaling' structures such as the Ghana school finance facility and the student loan program described in Box 3.3 below. In all cases, IFC seeks out and supports institutions that introduce innovations to the market, demonstrate best practices or are directly aligned with public sector objectives. Regionally, IFC's efforts in East Asia (particularly in China) and Sub-Saharan Africa have begun to bear fruit, with two projects signed in China in FY06 and two in Africa. IFC has also established a strong pipeline with much greater geographical diversity than was historically the case. IFC is projecting FY06 commitments of over \$120 million, a more than 50% increase from FY05.

3.57 Technical assistance remains a critical component of IFC's work, both in exploring markets, which are predominantly local in orientation, and in assisting clients. During FY06, at the request of

and in conjunction with China's Ministry of Finance, IFC organized a conference on public-private partnerships in education, as well as a workshop on technical and vocational education and training. In partnership with a large foundation, IFC is also launching a major work program on the private health sector in Africa. The aim is to develop an action plan to prioritize and guide future IFC activities, as well as develop an advocacy framework to raise awareness of the pivotal role of the private sector in Africa. IFC also seeks to use its experience in private health care and education—unique among bilateral and multilateral development institutions—to establish itself as a center for networking and information dissemination among private institutions and investors worldwide.

Box 3.3. New Approaches in Health and Education

In light of the traditionally small size of IFC's investments in these sectors, IFC recognized that it needed to develop a different approach to projects in order to increase its impact in health and education. IFC is therefore introducing innovative financing schemes to meet the increasing demand for finance among smaller institutions and consumers and is considering the potential of PPPs.

- **School finance facility.** IFC piloted the early implementation of a project to provide financing to small private schools in Ghana by extending a partial credit guarantee to a local bank covering its school loan portfolio. This project also has a TA component, providing both business development and educational services to private primary and secondary schools. IFC is seeking to replicate this model elsewhere in Africa, and is currently establishing the groundwork in Kenya and Senegal. The lessons learned from this pilot will be incorporated as IFC seeks to replicate this project structure elsewhere.

- **Student loans.** IFC is exploring innovative ways to promote student loan initiatives, for example by using foundation money to cover first losses and to leverage commercial financing in the sector.

- **Private/public.** Finally, IFC is supporting private companies that work directly with public institutions to provide much needed services. Ongoing projects include the private provision of information technology services to public universities in Nigeria, which currently do not have access to such services, and the use of distance education technology to provide medical training to nurses in public hospitals throughout China. IFC will continue to pursue such opportunities in the future.

5. Local Financial Markets Development

3.58 IFC plays an important role in enabling greater access to finance in its developing member countries, through a combination of loans, equity and TA. Financial sector investments have recently accounted for 30-40% of IFC's commitments, and this level is expected to continue. IFC has adopted a three-pronged approach to developing financial markets: i) it invests in, and provides TA to, financial institutions; ii) it helps to build the necessary financial infrastructure for such institutions to operate effectively, for example rating agencies and credit bureaus; and iii) it works alongside the World Bank to create supportive policy, legal and regulatory frameworks. On a selective basis, IFC will also participate in financial institution privatizations. The key strategic areas for IFC are SME finance, microfinance, housing finance, trade finance, local currency finance, structured finance and sustainability finance. These are discussed below, other than sustainability finance which is discussed in paragraphs 3.44 and 3.45.

3.59 **MSME Finance.** Micro-enterprises and small and medium enterprises are critical to the development of the private sector in IFC's client countries, yet rarely have access to the financial services they need. Recognizing the importance of reaching a large number of these firms, IFC has moved away from direct investments to a more focused and effective approach, relying on financial institutions to reach them. This allows IFC to scale up significantly the amount of support it gives to MSMEs. MSME commitments in FY05 were \$1.1 billion, more than triple the figure in FY00. As

an indication of the reach of this approach, in calendar year 2004, IFC's clients disbursed an estimated 4.4 million MSME sub-loans for \$27.8 billion. The outstanding MSME portfolio stood at \$1.9 billion for IFC's account at the end of FY05 and represented around 15% of IFC's disbursed portfolio. IFC targets MSMEs both through encouraging financial institutions to downscale into SME lending and by investing in microfinance institutions, as described more fully below. See also Box 3.1 which describes two innovative programs in Sub-Saharan Africa which target MSMEs.

3.60 *SME Finance.* In FY05, just over \$1 billion was targeted to SMEs. IFC's work in strengthening credit infrastructure, for example through support of rating agencies and credit bureaus, and TA to improve credit assessment and monitoring capabilities, is also important in laying the groundwork to encourage banks to lend more to SMEs. (See paragraph 3.71)

3.61 *Microfinance.* IFC promotes microfinance globally by: i) creating new "greenfield" microfinance institutions; ii) helping micro-credit non-governmental organizations transform into financial intermediaries; iii) encouraging commercial banks to enter the microfinance segment; and iv) setting up commercially managed microfinance investment vehicles to attract and channel private sources of capital. Investments typically combine financing with well-targeted TA to microfinance institutions, banks and strategic partners. Microfinance commitments in FY05 were \$55 million in 12 projects, and this is expected to increase significantly in FY06.

3.62 **Housing Finance.** Housing finance is a growing focus of IFC's activities. IFC sees access to house ownership and housing finance as a contributor to economic prosperity at the individual and sector level, and it contributes to social stability. Housing finance also plays an important role in the World Bank's overall financial sector strategy, and IFC works closely with the World Bank to develop an integrated approach to this sector. There is close coordination on many TA activities and the two institutions have recently been collaborating on joint sector assessments for Saudi Arabia and the Government of Nigeria. In both cases the focus was on making policy recommendations to create an institutional structure that can more efficiently deliver housing finance while reducing risk in the financial system.

3.63 IFC has invested in more than 80 housing finance-specific deals in over 40 countries. This represents a marked growth in its investment portfolio: in FY00, commitments in this sector were approximately \$30 million, but in FY05 this had grown to \$565 million in housing finance-related projects, with a similar level expected in FY06. IFC's approach is to address strategically each country's needs in concert with its financial sector development, providing long-term lines of credit and partial guarantees of local currency credit issues to foster local currency mortgage lending, and warehouse lines to support securitization activities.

3.64 While IFC continues to see significant growth potential in its activities, there are still several challenges which are creating new areas of focus for IFC's housing finance work, for example, expanding the availability of mortgages to the lower income segments of the population and frontier markets. IFC is exploring ways to address this, including working with lease arrangements and microfinance for housing. Another important challenge is to find innovative ways to address housing needs. Given the lack of bankable housing stock in many countries, IFC is looking to bolster the supply of quality housing stock through support to construction companies and property development. A recent example is the Filinvest transaction in the Philippines, where IFC agreed to provide a 2.25 billion peso loan (approximately \$41 million) to one of the leading local housing development companies. IFC is also exploring wholesale vehicles to provide funding for construction finance, including a Real Estate Investment Trust (REIT), an investment vehicle in Africa to support property development, property management and a portfolio of rental stock. IFC is also exploring work in other niche products, such as housing products consistent with Islamic finance

principles, sustainable housing constructions and energy efficiency/home renovation products that are key for meeting housing needs in selected markets.

3.65 In order to promote an environment hospitable to private home ownership, IFC's housing finance technical assistance work is also growing, and IFC provides support both for institution-building amongst selected financial institutions and for sector reform through advisory services. In the case of the former, IFC will focus on institution-specific TA to improve the mortgage operations of client companies, underwriting guidelines and standardization and servicing techniques. In the case of sector-related TA, the focus is on legal and regulatory frameworks, for example land titling and registration, which has been carried out in conjunction with the World Bank.

3.66 **Trade Finance.** IFC's Global Trade Finance program of \$500 million, approved in FY05, is already starting to show significant results. Total commitments for FY06 are estimated at \$200 million, with over 50% of this being in Sub-Saharan Africa. The objective is for IFC to be in a position to provide guarantees on a variety of trade instruments quickly where and when they are needed and to assist local banks in developing credit relationships with international commercial banks. The program also provides banks with appropriate funding for capital goods imports, assists in pre-export financing and arranges training and TA where most needed to improve their trade finance capabilities. The program plays an important role in IFC's efforts to stimulate South-South trade with a third of the transactions having been between emerging market countries, and to assist SMEs, which are estimated to have benefited from three-quarters of the program's guarantees.

3.67 **Promoting Local Currency Financing.** IFC promotes local currency financing through both structured finance and derivatives-based local currency products. Total local currency financing commitments increased in FY05 to \$820 million. To date, IFC has provided local currency products in 18 emerging market currencies. Box 3.4 provides more details on structured finance and local currency products.

Box 3.4 Structured Finance and Local Currency Products

Structured Finance. IFC has developed three primary structured finance products: partial credit guarantees (PCG), securitization credit enhancements and risk sharing facilities. The focus of all three products is to promote and support local currency financing. Cross-border transactions are also pursued, but the focus remains on domestic markets. Mobilizing local currency through the bank or bond market helps domestic borrowers to match assets and liabilities, and eliminates the foreign exchange risk associated with borrowing in foreign currency. Local currency financing through IFC's structured products provides benefits not only to local clients but also to domestic institutional investors who are generally in need of high quality assets for portfolio diversification.

Derivatives based Local Currency Products. IFC uses long-term derivatives markets to provide local currency loans and hedges to its clients, and can offer these products in any currency where it can hedge the local currency loan cash flows back into US dollars using the derivatives markets. The number of emerging markets where long-term swaps are available continues to increase, with over 20 such countries as of the end of February, 2006. There is significant interest and demand from IFC's clients for these products, especially in China, Colombia, India, Indonesia, Mexico, Romania, Russia, South Africa and Turkey. In FY05, IFC committed over \$700 million equivalent in derivatives-based local currency products in 8 currencies to 23 clients. In frontier markets especially, IFC works closely with market counterparts and government regulators to structure swap instruments that enable the Corporation to provide local currency loans. This effort requires modifying or introducing international swap legal documentation in many of these markets. A priority over the next year is to develop derivatives-based local currency products in Sub-Saharan Africa where possible, and to obtain regulatory approval to provide such products in China, Pakistan and Ukraine.

3.68 Developing Local Securities Markets. There is growing demand by IFC's client countries for long-term, local currency financing for projects as diverse as housing, infrastructure, privatization, health and education, agribusiness and SME growth. Nonetheless, the local financial markets continue to be dominated by the banking sector in many developing countries, and the lack of alternative financial intermediaries still presents constraints to private sector development. In order to help develop domestic securities markets and improve access to longer-term local currency funding, IFC participates in domestic and cross-border securitizations, generally by taking on the mezzanine portion of risk. This investment takes the form of either a PCG on the senior tranche or a PCG on the investment vehicle. Moreover, investors also benefit from IFC's direct involvement in structuring the transaction. This includes a thorough initial due diligence process, modeling the transaction, contributing to the documentation, negotiating with rating agencies when applicable, as well as ongoing monitoring of the borrower throughout the life of the guarantee instrument. To date, the majority of IFC's clients have returned to the market after their first successful issuance without further need for IFC's support. Some examples of IFC's innovative securitizations include the first securitization of non-performing loans in Latin America, the first cross-border securitization of residential mortgages in Central and Eastern Europe, the first future flow securitization of student tuition payments in Peru and the first mortgage bond issuance in South Africa. Another example of a new initiative aimed at developing local securities markets is the work IFC and the World Bank are doing together to establish the Efficient Securities Market Institutional Development Program. The program was initially funded with \$5 million provided by the Swedish International Development Cooperation Agency. Its main priority will be to provide TA to develop domestic securities markets, initially focusing its work on Africa.

3.69 IFC also helps to build the financial infrastructure necessary for expanding access to finance, both through direct investments and TA. For example, IFC is currently involved in developing credit bureaus in 38 countries around the world under its multi-donor Global Credit Bureau Program, and several transactions with securities firms are under consideration in three regions.

3.70 Introducing Innovative Products. IFC is continuing to develop new products customized to meet client needs. Through the use of partial credit guarantees, securitizations and other structured finance products, IFC raised \$574 million in FY04 for clients, increasing to just under \$1.3 billion in FY05, of which IFC's exposure in FY05 was around \$215 million. An example of the use of derivatives to customize products for clients is IFC's ruble-indexed loan product in Russia, totaling over \$250 million equivalent in disbursements to date, through which IFC provides synthetic ruble financing to clients using non-deliverable swaps. As another example of innovation, IFC and the World Bank are working together on a new concept, the Global Index Reinsurance Facility, a special purpose vehicle which would be a commercial risk-taking entity to promote and underwrite indexable weather and disaster risk insurance in developing countries. Whilst this is still at an early stage, the intention is that this facility will promote the development of a global commercial market for index-based insurance instruments for risks in developing countries.

3.71 Financial Sector Technical Assistance and Advisory Services. IFC's financial sector TA activities are focused on expanding access to finance to the poor and underserved by increasing the availability of financial services. IFC is approaching this on two fronts: giving help to financial intermediaries and improving the financial infrastructure in a country, for example by supporting new credit bureaus, as described above, and working on bond market and securities market development. In the last three years, IFC's financial markets TA activities have grown significantly, from 86 projects worth \$27 million in funding commitments in FY03 to 135 projects worth more than \$91 million in FY05. As of March 15, 2006, there were 125 active projects worth \$137 million, of which 79% were funds committed to frontier countries. Key sectors include microfinance, banking (including retail and SME finance), housing finance and environment finance.

Box 3.5 IEG-IFC Evaluation Findings: Informing IFC's Strategic Directions

Last year's IEG-IFC evaluation reports included Pakistan and Turkey Country Impact Reviews, Malawi and Senegal Country Evaluation Notes and the two IEG-IFC annual flagship reports, the Annual Review of Evaluation Findings and the Annual Report on Operations Evaluation. Some of the findings of these reports with strategic relevance include:

Achievement of Strategic Priorities: IFC has significantly increased its commitments to frontier countries since it first articulated the frontier strategy in 1998. IFC's frontier strategy has resulted in a bigger proportion of projects in high risk countries at approval. To help offset this risk, IFC undertook a number of steps, including engaging in higher work quality at entry through greater IFC review intensity. Development results in frontier country groups have been similar to non-frontier country groups. IFC also actively pursued its strategic sectors (for example financial markets, infrastructure, and social sectors) and overall, outcomes have been better than in other sectors.

Importance of Developing Local Currency Financing: Many MSMEs and other end users of IFC financing, such as clients in housing finance and health and education, are unable to bear the foreign exchange risks associated with foreign currency loans. In a number of cases, this has been a key constraint in expanding IFC financing in these sectors. IEG-IFC recommended in at least three evaluation reports last year that IFC help develop the long-term local currency debt markets and mobilize long-term local currency loans, for example via developing guarantee and structured finance markets or supporting development of local financial markets pension and insurance industries.

Need for Emphasis on Business Enabling Environment: As in earlier evaluations, IEG-IFC found that development and investment outcomes are better when the business enabling environment is improving. Poor investment climates also limit IFC's opportunities to expand operations in many countries. All four recent country evaluations and this year's Annual Review feature this finding. IEG-IFC has recommended that IFC leverage with the work of the World Bank in addressing investment climate issues.

Improved Measurement: The overall quality of XPSRs has improved and IFC's newly-developed Development Outcome Tracking System should increase the timeliness and coverage of development results measurement. The TAAS evaluation system, which has been piloted and is ready to be launched in the coming fiscal year should provide a systematic measure of TAAS' development results. IEG-IFC expects to play a role in both investment and TAAS operations evaluation and measurement systems.

A number of new initiatives in IFC are consistent with recommendations in recent IEG-IFC's evaluation reports. Given the higher risks and more challenging investment climates in frontier countries, IFC has undertaken several steps to enhance its capability to manage risks and help improve business enabling environments. In this regard, IFC has been moving staff closer to clients through increased decentralization and enhancing field-based project facilities. In Africa, for example, staffing in IFC's eight regional offices has been significantly strengthened and the recruitment of 75 additional staff is on track. IFC also recently launched PEP-Africa as the primary vehicle for technical assistance and advisory services. PEP-Africa has developed a strategy aimed at improving investment climates.

Working with Other Financial Institutions

3.72 IFC nurtures relationships with other financial institutions, both private and public, in order to enhance its ability to deliver on its development mandate. Through its B Loan program, in addition to catalyzing funding, IFC gives emerging market companies access to international banks which they would not otherwise have, and helps the banks get comfortable in markets which they might otherwise not have approached. Through promoting adoption of the Equator Principles, IFC has extended its environmental and social standards beyond its own projects. By working with

emerging markets financial institutions on corporate governance and sustainability finance, IFC helps them become leaders in their markets and improve the business environment for investors and companies. Lastly, by working with other IFIs, IFC can address some of the more pressing needs in the most difficult markets.

3.73 International Banks. IFC's B Loan program is a critical part of its catalytic role, and IFC continues to "crowd in" private sector financing through this mechanism. There has been significant recent growth in the program, with over \$1 billion in B Loans signed in the first half of FY06, only just under the amount for the whole of FY05. Despite the liquidity in the bank market, tenors available to most emerging market borrowers are still limited, and an important part of IFC's role with B lenders is enabling them to stretch maturities, helping clients to achieve better balanced debt profiles. Furthermore, in many countries, international lending is only available for trade-related activities, and through the B Loan structure IFC can mobilize bank lending for capital expenditure, acquisition finance and project finance.

3.74 The current global economic environment, strong liquidity and compression of spreads present IFC with a unique opportunity to lead international banks towards more frontier countries and second tier borrowers. Consistent with IFC's strategy to scale up its impact on the ground, the nature of IFC's relationships with international banks is changing to one of partnership to mobilize funding for emerging and frontier markets, and several banks now approach IFC to help them address their clients' needs in terms of both funding and sustainability initiatives.

3.75 IFIs. In addition to work with other members of the World Bank Group described throughout this paper, IFC is increasingly working alongside other IFIs. Examples include infrastructure development work with PIDG (see paragraph 3.51) and initiatives in Sub-Saharan Africa with the United Kingdom Department for International Development (DFID) and the African Development Bank. IFC is seeking to enhance these relationships in all its regions.

3.76 Mobilization. In furtherance of its catalytic role, IFC seeks to mobilize funding for developing countries in a number of ways. In FY05, in addition to the \$1.1 billion raised through the B Loan program discussed above, IFC mobilized around another \$1 billion through structured finance transactions and a further \$2 billion in project financing using derivative-based products. The total size of all projects which IFC's investments supported in FY05 was \$25.2 billion.

Strategic Communications

3.77 Several factors point to the importance for IFC of a broader and more intensive approach to communications: i) the Corporation's growth strategy, and especially the focus on new markets and clients, necessitating more focused communications efforts; ii) IFC's leadership role in several areas, particularly in environmental and social standards, which leads to increased attention being paid to IFC's projects, especially in politically contentious environments; iii) the commitments which the Corporation has made to improve its public disclosure, local community outreach and handling of community relations; iv) the need to educate and assimilate large numbers of new staff in an ever more decentralized structure; and v) the key role that TA is set to play in IFC's activities.

3.78 In light of the above challenges, IFC is putting in place an enhanced communications function in order to support IFC's role and growth strategy more effectively. This will be approached on several fronts: i) sustaining and extending IFC's leadership role as an agenda-setter on environmental, social and corporate governance issues; ii) improving IFC's ability to engage in productive dialogue with civil society at the corporate level and with communities at the project level; iii) improving familiarity with IFC's products and services amongst smaller, rising companies in developing countries, as well as Part I multinationals that are still unfamiliar with IFC; iv)

improving awareness and understanding of IFC's role, especially among agencies, foundations and civil society organizations that are donors, partners in delivery of services, or both; v) increasing awareness of IFC's development impact among all stakeholders; and vi) improving internal communications across the Corporation so that staff can be better aligned with IFC strategy.

3.79 The year 2006 marks IFC's 50th Anniversary, and IFC has a program of internal and external events to mark the occasion, aimed primarily at supporting its business. These include, for the first time, a full day of private sector programming during the Program of Seminars, which takes place in advance of the WBG-IMF Annual Meetings in Singapore.

Implementation Challenges

3.80 We believe IFC has made good progress in implementing its five strategic priorities and its multi-year growth plan, particularly in frontier markets, including Sub-Saharan Africa. The share of new clients, although within the target range of 50%, should be increased. The enhanced decentralization should help to address this. There are some areas where the pace of implementation needs to accelerate, such as field recruitment and completion of the development impact tracking system to enable full reporting of IFC's institutional impact. IFC is focusing on these activities. IFC is also facing some significant challenges. As highlighted in discussions last year, the ability to grow is largely dependent on scaling up resources, particularly in the field, and recruitment in the field is lagging behind targets, as noted above. This problem will be heightened as IFC moves towards greater decentralization. There are also information technology implications of growth and decentralization which need to be addressed. In terms of its financial capacity, although IFC is currently in a relatively strong position, it needs to be prudent in order to maximize its development impact whilst also remaining able to accommodate market downturns, crises in its member countries and potential increased volatility in its net income reporting as it moves to adopt International Financial Reporting Standards.

Human Resources

3.81 Over the last few years, IFC has strengthened its operations capacity and core expertise by implementing a human resources (HR) strategy based on the principles of performance-based differentiation and results measurement. The objective of this strategy is to support IFC's business goals and priorities. Going forward, IFC's HR strategy will focus on the three pillars of: i) building and developing diverse talent; ii) enhancing corporate and staff incentives; and iii) accelerating decentralization. Please also see Annex 3, which is a recruitment update as of March 15th, 2006.

3.82 **Building and Developing Diverse Talent.** In order to be equipped to implement its growth strategy and to meet changing market needs, over the last eight months IFC has embarked on the most significant recruitment drive in its history. To date in FY06, IFC has hired over 240 new staff from its administrative budget, including around 137 at Grades F and above; IFC projects to hire a total of around 350 new staff from its administrative budget for FY06, including around 200 at Grades F and above (an additional 300 staff are being hired for IFC's donor-funded operations). In parallel with recruitment, IFC's HR strategy includes a significant training and development program to accelerate the productivity and effectiveness of new staff, and IFC will probably have to increase its investment in staff learning and development in FY07-08.

3.83 *Hiring senior field staff.* IFC's staffing strategy has traditionally been to hire at junior levels and develop staff in-house through an apprenticeship model. IFC's FY06 staffing strategy called for more senior, mid-career staff, particularly in the field, in order to build local expertise in key markets and enhance IFC's leadership capacity to develop new business. Whilst recruitment for Washington-based positions is ahead of target, recruitment in the regions lags behind, with a particular challenge

in recruiting senior local staff. IFC will therefore need to find ways to hire locally more effectively and to continue to move experienced resources from Washington to the field (see Decentralization, below). One of the main challenges facing IFC's recruitment drive in the field is the ever more competitive labor markets in some of the key business hubs, such as China, Russia, South Africa, Brazil and, increasingly, India, where experienced, mid-career local professionals are difficult to attract with local compensation packages. Operational directors are increasingly calling for the possibility to adopt a global, functional pay line for senior investment/finance staff to address this issue.

3.84 *Compensation challenges.* IFC Management is currently working with the World Bank on the comprehensive review of the WBG compensation framework, as requested by the Board. The current WBG compensation framework aggregates and averages pay lines in a structure which is designed to maintain equity and eliminate differences between occupations. A significant constraint of this system is that some occupations are under-paid vis-à-vis the market (investment, risk management and treasury staff) while others may be over-paid. For IFC, this impact is especially pronounced in some of the regional hubs, as noted above. IFC Management believes that this review is an opportunity to develop and implement a modern compensation system with a framework founded on both market and performance. This would ensure a more disciplined and cost-efficient approach to human resources management, while allowing for sufficient flexibility to hire and retain top talent. A results-driven system would also strengthen staff accountability for results. A new compensation framework ought to be based on actual market data for relevant occupational groups. As pressure mounts to contain costs, a more rationalized approach to compensation would ensure that IFC has the appropriate talent, at the right cost, to deliver what clients want.

3.85 *Diversity.* Strengthening diversity and inclusion continues to be a top corporate priority. IFC's FY06 recruitment has been successful in exceeding current WBG diversity indicators and targets for Sub-Saharan African staff, women and recruits from Part 2 countries. An important change from past trends is that IFC's current career management framework provides the same opportunities for advancement and rotation to both international and local recruits and the standards for recruitment are the same worldwide. Over the next year, IFC will continue to strengthen opportunities for local staff as part of the implementation of global career systems. For more on diversity, please see Annex 3.

3.86 **Incentives.** IFC has implemented a number of incentive programs focused on driving results, where staff are differentiated based on performance, skills and behaviors. IFC currently has in place four major programs to measure and reward performance: i) an annual performance, evaluation and planning process (PEP system) which is linked to annual salary increases; ii) a competency-based career framework to provide staff with clear guidelines on what it takes to progress; iii) the Performance Awards program to reward and recognize annual results at the corporate, departmental and staff levels; and iv) the Long Term Performance Awards (LTPA) program for long-term results, introduced in FY05 for new business investment staff and rolled out for portfolio staff in FY06. The Corporation is also aligning its performance measurement and incentive framework throughout the organization. The key elements of the corporate Goals (described in Section II) and the Board-endorsed development impact targets are tracked through corporate, department and director scorecards. The Corporation is also working on refining the performance indicators for TAAS and on enhancing the incentive framework to align the different parts of the organization.

3.87 **Decentralization.** Over the last five years, IFC has moved from a Washington-centric organization to a global organization. IFC staffing in the field has almost doubled from 669 staff (35% of staff) in FY00 to 1,249 (46% of staff) today. The largest portion of this growth has been a five-fold increase in staffing associated with donor-funded TA operations. In parallel, the number of

investment staff in the field has also increased, primarily through the transfers of over 130 staff mostly in the last three years following the 2002 reorganization. Going forward, IFC will accelerate the presence of core operations staff in the field and will decentralize management decision-making authority for the first time with an East Asia/South Asia pilot. Under the pilot, some transaction processing and decision-making authority for smaller projects which have no complex structuring, environmental or policy issues will be decentralized, and to support this a critical mass of senior staff from the Legal, Credit and CES departments will be located in the field.

Risk Management and Financial Capacity

3.88 IFC is by its nature a risk-taking institution and by mandate makes investments under higher risk conditions than commercial financiers, such as in frontier markets and liquidity crunch situations, while relying on the business fundamentals of the projects. Economic theory postulates that there is a trade-off between risk and reward and IFC's experience bears out this relationship: it has traditionally made some of its largest returns in investments considered amongst the most risky at the time. Examples include investments in the financial sector in Korea immediately following the Asian financial crisis and investments in frontier markets where the investment climate subsequently improves. IFC makes this risk transformation of investing in riskier assets while maintaining its AAA credit rating by: i) diversification in its investments, giving it exposure to a range of risk profiles; ii) maintaining a strong financial structure and capital base; iii) being a long-term investor particularly for its equity investments; and iv) rigorous due diligence, accumulated knowledge and experience in developing countries and sophisticated risk management practices. As IFC scales up its activities under its growth strategy, management of risk, including maintenance of a sound financial structure and appropriate risk management practices, will become an even more critical issue.

3.89 IFC has implemented a review of its risk management practices, as noted in paragraph 2.12, and will be reporting to the Board once this is complete. IFC already has in place the Business Risk Group, to address operational and strategic risks, and the Project Risk Management (PRM) Group. PRM's function is to address operational risk associated with significant portfolio growth, increasing decentralization and ever-increasing dispersion of information sources. PRM has adopted a two-pronged approach: i) Portfolio Inventory Analysis, which is the review of active portfolio projects to identify and quantify existing operational risk; and ii) PRM Operations, which will work with the Industry Departments to help manage operational risk in IFC's pipeline and portfolio projects.

3.90 As indicated in last year's Paper, IFC is piloting and using the new Capital Pricing and Risk (CAPRI) approach for internal risk management purposes such as pricing, risk and concentration measurement, return on economic capital and new product development. The information systems needed for full use of this approach are currently being developed and implemented.

3.91 IFC plans to resume presentation of its financial statements using International Financial Reporting Standards (IFRS) by the year ending June, 2007, subject to resolution of balance sheet presentation issues applicable to IFC and IBRD. Amongst other changes this will require the Corporation to make expanded use of fair value accounting, principally in equity, and derivatives associated with the loan and equity portfolios. This will imply significantly greater volatility in net income reporting, including the possibility of sizeable net losses due to market downturns. IFC estimates that its current capital position would allow it to accommodate a shock in two of its high exposure countries and continue to meet its countercyclical role. However, given the uncertainties in many of its markets, including some high exposure countries, and the future volatility of its net income, IFC is proposing a conservative approach to income allocation. These issues will be discussed further in the Annual Report on Financial Risk Management, which will be discussed with the Board before the end of the fiscal year.

3.92 During FY05, IFC Management decided to adopt new best practice standards on internal controls over external financial reporting, including those promulgated under Section 404 of the U.S. Sarbanes-Oxley Act of 2002 (SOx Section 404), whilst at the same time reviewing and enhancing its core business processes to facilitate accomplishment of its growth strategy.

3.93 IFC is implementing an Action Plan on Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) approved by the Audit Committee and Board early last year. This includes strengthening the due diligence on sponsors to account for potential AML/CFT risks, while also making necessary changes to policies based on the Financial Action Task Force recommendations.

Equity

3.94 IFC's ability to invest in equity has been an important element in its development impact. Partnering with project sponsors as a minority equity investor, IFC brings its global industry knowledge and expertise in corporate governance and environmental and social dimensions, and adds value to investee companies in management and organizational practices. Private equity funds also look for IFC to transfer its knowledge and expertise in the management of governance, environmental and social issues in investee companies and application of institutional best practices. Given its significant development contributions in equity investments, and the persistent absence of risk capital in many developing countries, IFC needs to develop a more proactive and systematic approach to equity investment. In terms of profitability, returns on equity investments have increased substantially due to IFC's risk taking in equity in the past and the recent market trends, but will remain volatile by nature. The last few years have seen a fundamental shift in the sentiment towards some emerging equity markets, and this also calls for IFC to reassess its approach to equity investment. In order to address these issues, over the past year a team has been working on formulation of an IFC Equity Strategy and associated recommendations for how IFC should organize and process its equity investments. Effective implementation of the equity strategy will be a key challenge for the Corporation over the coming years. The working group is also reviewing the resource implications of a new approach to equity investments.

Information Technology Implications

3.95 The alignment of the information technology (IT) functions with the strategic directions for growth has become an important part of IFC's strategy implementation. Last year, the Board approved a new IT work program aligned with these directions and anchored in four main areas: i) improved and expanded client relationship management; ii) more efficient processing and knowledge management; iii) protecting the integrity of the Corporation's balance sheet and financial statements; and iv) measurement and evaluation, including development impact tracking. The aim is to enable IFC staff to enhance their effectiveness in serving clients and to deliver the results efficiently on the ground. Additional mandates, for example IFRS, SOx and new IT infrastructure demands to support accelerated decentralization, have increased the complexity of the overall IT work program. Collectively, they have introduced new challenges linked to work program prioritization and sequencing, IT delivery and business absorptive capacity, upstream business-IT engagement and business process definition and streamlining. Increased collaboration with the World Bank on shared IT challenges, for example document management, telecommunications and out-sourcing, is also underway to leverage synergies in existing investments, new technology platforms and skills across the organizations. To ensure that these challenges are addressed in full, with knowledge of all constraints, the strategy and work program formulation exercise is underway with close coordination with all parts of IFC to

be certain that the right priorities and trade-offs are made. The IT budget, based on this exercise, will be included in the Business Plan and Budget Board Paper.

Technical Assistance Funding

3.96 Much of IFC's TA is funded via donor contributions and the Funding Mechanism for Technical Assistance and Advisory Services (FMTAAS). FMTAAS was established in 2004 to centralize financial support for TA, and is funded by annual designations from IFC's retained earnings on a sliding scale based on IFC's net income for the year. As already discussed, IFC has now taken steps to align its TAAS with its strategic priorities and has introduced a structure and TA business lines to ensure more effective use of TA funds. As part of this rationalization of its management of TAAS, IFC will be proposing some reallocation of previously approved funds to each of the business lines, and once this proposal has been finalized internally, IFC will discuss it with the Board. In any event, IFC would continue to seek Board approval for any proposal over \$2.5 million.

Anti-Corruption

3.97 Corruption is a serious problem in many developing countries, and takes on greater significance for IFC's business the more IFC works in frontier markets and in sectors where the public sector plays an important role, such as infrastructure. Addressing corruption issues effectively is therefore essential for IFC to fulfill its development mandate, and fighting corruption is a priority for the whole World Bank Group. This must be tackled on several fronts: by improving the investment climate through clear and low-cost rules for doing business, the incentives for corruption are reduced; by making activities that can best be performed by the private sector the responsibility of the private sector, there is less scope for corruption; through appropriate use of output-based aid, services that require public subsidies can also be held accountable; by improving corporate governance for commercial activities remaining in the public sector the corruption risks associated with state-owned enterprises can be mitigated; and by checking their choice of partners with appropriate procedures, the members of the WBG can serve as models for tackling corruption.

3.98 IFC has already implemented some measures to address the corruption issue, and the work of the Corporate Governance and the AML/CFT units and some of the TA initiatives discussed earlier in this paper form part of this effort. IFC has strengthened the focus on sponsor due diligence in its projects at an early stage, including the use of investigative firms when appropriate, and this process continues during appraisal of any project. In addition, IFC requires anti-fraud and anti-corruption representations, warranties and covenants in its documentation. It is also encouraging its clients in the infrastructure sector to disclose certain public-interest components of concession-type agreements and is actively engaged in the Extractive Industries Transparency Initiative.

3.99 IFC acknowledges that it needs to do more and therefore, together with other members of the WBG, intends to pursue a leadership role to foster anti-corruption initiatives. IFC Management recently assigned a working group to focus attention further on anti-corruption issues and potential areas of leadership. In pursuit of these efforts, IFC will engage with parties such as the *Partnering Against Corruption Initiative*, which is sponsored by the World Economic Forum, with a view to complementing and strengthening existing initiatives such as the UN Global Compact.

Resource Implications

3.100 In June, 2005, the Board approved a three-year business plan and budget for the first time, covering FY06-08. Commitment targets and budget figures were approved on a definite basis for FY06 and an indicative basis for FY07-08. As noted earlier, the current estimate is that the

implementation of the business plan is ahead of schedule. IFC currently expects that FY06 commitments may even exceed the target range presented in the June, 2005 business plan. IFC anticipates increased investment opportunities over the next several years and this will be reflected in the business plan for FY07-09 to be presented to the Board in June, 2006. Commitment targets are expected to be higher than those in the current plan.

3.101 In order to achieve higher growth with the same resources, intensive efforts will be made to increase cost-effectiveness and productivity, and IFC hopes to benefit from a long-term business process review to facilitate streamlining.

Management Structure

3.102 In light of IFC's growth and decentralization, IFC has recently announced the strengthening of its management structure to enhance its capability to deliver on its strategic objectives. By increasing the number of operational vice presidents to three, with two being regionally focused and one industry focused, and enhancing the risk and control Vice President's function in accordance with modern governance standards, IFC will be better able to serve its clients and focus on high priority areas. These changes will be effective from July 1, 2006.

ANNEX 1. REGIONAL STRATEGIES

Sub-Saharan Africa**Table 1. Sub-Saharan Africa**

	FY04 Actual	FY05 Actual	FY06 Plan	FY09 Indicative
Commitments (\$m)	405	445	500-600	825-900
TA Spending (\$m)	--	--	35	NA
Development Impact Score (%) ¹	37.5%	38.5%	NA	NA

¹ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

A quantum increase in IFC’s business and impact in Sub-Saharan Africa remains at the heart of IFC’s path to growth approved by the Board last year. IFC’s overall investment commitments were projected to grow by about 35% while IFC’s commitments in Africa were projected to grow by about 100% to over \$800 million by FY08. IFC is on track to achieve this quantum increase. Investment commitments in FY06 are likely to approach \$600million, a 30% increase over FY05.

These growing investment volumes are one (but certainly not the only) important outcome of the increasingly successful implementation of IFC’s Strategic Initiative for Sub-Saharan Africa which was approved by the Board in FY03 and covers the three years FY04 – FY06. The strategy for this period has focused on three goals: active IFC engagement in improving the investment climate; enhanced support for MSMEs; and a more pro-active IFC role in developing large investment projects. Progress in implementing this strategy, particularly in FY06, has centered on building the right organization, introducing appropriate new IFC products and services, and strengthening key partnerships.

Concerning organization and people, IFC’s eight regional offices have been substantially strengthened and the FY06 recruitment target is on track. Key developments over the past year have included the full launch of PEP-Africa as the primary vehicle for IFC TAAS in the region and the integration of PEP-Africa with IFC investment operations. Paragraph 3.18 gives more details of PEP-Africa’s programs.

Concerning products and services appropriate for IFC’s clients in Africa, the FY06 emphasis has been on launching of the trade finance program, development of a new performance-based MSME initiative, consolidation of the IDA-IFC MSME program and development of a substantial new micro-finance program. Each of these complimentary programs incorporates a combination of TAAS and IFC investments, and all are directly aimed at the MSME component of the strategy. In addition to these financial sector initiatives, IFC is focusing on building the pipeline of advisory and investment opportunities in the critically important infrastructure sector, with emphasis on public-private partnerships. IFC now has active mandates in prospective PPP’s across most infrastructure sub-sectors (rail, airlines, airports, ports, water, power). This work bears directly on the pro-active project development component of the strategy.

Concerning partnerships, on-the-ground collaboration with the World Bank has been the top priority in FY06 and is now the norm in infrastructure (including telecom), extractive industries, and the financial sector. Good progress is being made on investment climate work (the third pillar of IFC’s strategy) where PEP-Africa and FIAS now have integrated management and a joint strategy. A pilot has now been established with PSD and MIGA to map and offer mutual clients a fully coordinated

set of WBG products and services. Beyond the WBG, IFC's focus is on building stronger operational partnerships with the African Development Bank (now a core PEP-Africa partner) and the European Commission.

Looking forward, IFC is undertaking a review of the FY04 – FY06 Strategic Initiative for Africa (which ends in June of this year), and definition of the appropriate strategy for FY07 – FY09, in the context of the present overall Strategic Directions report. IFC will engage with Executive Directors and all key stakeholders over the coming months, and bring recommendations to the Board around mid-2006.

The present view of IFC management and staff is that IFC's strategic direction in Sub-Saharan Africa over the coming three years should embrace the following three priorities:

- Continuation of the present “three pillars” strategic focus as outlined above, with strong emphasis on innovation and partnerships.
- Addition of trade and regional integration as a fourth strategic pillar. This reflects the emphasis in the World Bank Africa Action Plan on where the private sector must perform a key role in Africa's growth. IFC is already engaging in these areas with the World Bank, especially in development of regional financial and physical infrastructure, trade finance, SME competitiveness, and South-South investment.
- Significantly increasing IFC's reach and sustained impact in more Sub-Saharan Africa frontier countries, through combined technical assistance and investment operations. In FY06, IFC expects to have substantive operations in 18 countries and plans to increase this to 26 countries in FY07.

A key challenge for IFC in expanding its reach is how to engage effectively in higher-risk post-conflict countries and fragile states, in full collaboration with the World Bank and other development partners. The private sector can perform a crucial role in job creation, restoration of infrastructure, stabilization and economic growth. Historically, this role has been slow to emerge. IFC is well-placed to be the catalyst for accelerating private sector involvement in the critical early years following conflict, by introducing innovative ways to mitigate risk, helping improve the investment climate, building MSME capacity and mobilizing local and foreign investors. To this end, IFC is launching a pilot Post Conflict Countries Initiative in the Democratic Republic of the Congo, and this was described more fully in paragraph 3.22.

Cutting across all elements of IFC's strategy for sustained growth of the Sub-Saharan Africa private sector is continuous improvement in the tracking and measurement of development outcomes. A consistent theme of all IFC's work in the coming three years is implementation of appropriate metrics for both investment and technical assistance.

Latin America and the Caribbean

The Latin American and Caribbean (LAC) region is experiencing its fourth consecutive year of growth in 2006. Gross domestic product in LAC is projected to grow by 4% in 2006, repeating the performance of 2005. Favorable external conditions, including buoyant commodity prices and ample global liquidity, have combined with domestic economic policy improvements. That has led to low inflation and strengthening fiscal positions, particularly in Brazil, Chile and Mexico. This combination of global and local factors created a very positive environment for the region's economies. As a result, LAC is currently in a stronger position to withstand external shocks than in the past. Most countries are using the windfalls in the right ways to strengthen public finances and

reduce external vulnerabilities. LAC countries have made major strides, especially in pursuing prudent macroeconomic policies and coupled with a more flexible exchange rate.

Nevertheless, LAC has been falling behind other emerging markets. LAC's relative growth in GDP per capita measured against the world average of the past 25 years is below average and lower than any other emerging market region except for Sub-Saharan Africa. This is further evidenced by LAC's persistent poverty and inequality resulting in rising social and political tensions. Today there are demands for change in LAC and public impatience is growing. Elections in the past few years, including political crises in Ecuador, Bolivia and Argentina, have led to important changes in the political leadership in several countries. This year is one of elections for a number of LAC countries and progress in structural reform may slow down.

While Latin American countries have reduced direct risks to their economies, there is still the possibility that any downturn in the global economy could have an indirect impact. For instance, continued oil prices may slow down growth in key markets such as the U.S. and Europe, which could mean less demand for Latin American exports. Likewise, the rise in US interest rates may divert capital away from LAC and other emerging markets. LAC is not yet on a sustainable growth path and structural impediments to private sector growth remain. Progress in structural reform is still needed in pension, labor, fiscal, infrastructure, and financial sector areas to achieve sustainable growth. Inequality persists while the investment gap remains. Significant progress is needed in four key areas: (i) the enabling business environment; (ii) infrastructure; (iii) access to finance; and (iv) sustainability. These are areas where LAC is lagging behind many other emerging markets.

IFC's activities in the region have been evolving and adapting to this dynamic environment. Commitments in FY05 reached \$1.4 billion, marking the fourth year in a row they exceeded the billion dollar mark. As countries are making headway in accessing capital markets, as liquidity is increasing and spreads getting tighter, IFC places its emphasis in providing long-tenor financing, which remains difficult to access in most countries in the region. Nurturing long-term partnerships with its clients, as well as market accessibility for MSMEs, second-tier companies, leading companies aiming to become global players, the Corporation is also using more of its equity, TA and advisory products. Looking forward, IFC continues to focus on assisting the region in addressing the social and economic pressures that are limiting its growth and stability.

Table 2. Latin America and the Caribbean

	FY04 Actual	FY05 Actual	FY06 Plan	FY09 Indicative
Commitments (\$m)	1,218	1,398	1,350-1,450	1,800-2,100
TA Spending (\$m) ²	1.2	2.7	5.6	NA
Development Impact Score % ¹	70%	66%	NA	NA

1 Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

2 Spending managed by Region.

Strategic Priorities

Making Markets Work for Equitable Growth IFC's priority in the region puts the clients first, i.e. meeting both the country and the company needs, while striving for strong growth with developmental impact. At the country level this means focusing the Corporation's efforts on 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, efficient delivery, and global knowledge and innovation.

The region is focusing in these areas seeking to have a greater impact on alleviating poverty, and reducing inequality and social pressure. This strategy seeks to maximize the World Bank Group synergies, so as to address effectively the structural impediments to private sector growth and achieve a greater developmental impact. The region has an integrated approach including both investment and technical assistance. Furthermore, emphasis is put on upstream work so as to enhance development impact. Drawing lessons from the past, upstream work involves: i) a sector approach; ii) an intensive use of TA and advisory; iii) up-front involvement of the World Bank; and iv) early engagement with key stakeholders.

One key area in improving the **business enabling environment** is the program of municipal simplification implemented by the LAC facility. Initially started with the municipality of El Alto in Bolivia, the program is being scaled up at the national level in Peru and Brazil, and being implemented in other countries (Nicaragua, Honduras). It is benefiting from the launch of the Doing Business studies in those countries, and complementing World Bank Analytic and Advisory Activity and Development Policy Lending operations.

Improving **access to finance** implies not only trade finance lines and long-term financing for corporations, but also reaching out to those excluded from the market: the micro-enterprises, the small and medium size companies and the second tier companies. Most of them cannot access medium-term financing, while they are a key component of the private sector growth engine and the main source of employment. IFC is working with the World Bank to improve the regulatory framework, which has recently resulted in innovative transactions favoring local currency financing in the housing sector (Brazil, Mexico). IFC is also active in developing local capital markets in countries like Peru and Colombia, notably working with non-bank financial institutions (housing, microfinance and SMEs, credit bureaus). TA and linkages work is helping MSMEs access financing by assisting both local banks and borrowing companies. Furthermore, IFC has started to work with second tier banks who are closer to mid-sized companies. In small island economies, the focus is to work with regional players which are developing the Caribbean financial market, including for MSMEs.

In the **infrastructure** sector, governments continue to face fiscal constraints and are aware that private sector participation in infrastructure is needed if they are to meet the enormous needs of the region—estimated at over \$70 billion per year. The design and implementation of infrastructure sector reform is complex and cumbersome, both for political and technical reasons. In spite of this, headway is being made, notably when IFC and the World Bank are working together using the full array of their respective products – including, on IFC’s side, advisory services, investment operations (especially in logistics and transport, some in power), being the voice/messenger of the private sector through its dialogue with the government and inputs to World Bank operations. Illustrative examples include the PPP law in Brazil and the regulatory framework in Mexico. One area with great potential and requiring creative solutions is local currency financing. Other focus areas in infrastructure are public-private partnerships targeted toward logistics, utilities, and renewable energy industries. In some countries there are further opportunities in municipal and sub-national finance.

Sustainability for the region is another priority which involves corporate governance, environmental and social standards. IFC is leading a number of corporate governance initiatives (Brazil – Sustainability Index, Novo Mercado) as well as providing TA 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 controversial projects (Mining in Peru, Guatemala and Guyana, Labor rights in Haiti/DR, Agribusiness in the Amazon, etc) where IFC is maximizing the use of its products (loan, equity, TA with the LAC facility, CES and the linkages team) in addition to increasing its field presence. 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. In the 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. IFC also continues to invest in the health and education sectors (for example, Brazil and Mexico, establishing new models for public-private partnerships).

To have a larger developmental impact across its four areas of focus, IFC is working with first tier companies in some of the region's larger countries when it has a specific role to play in helping these local and regional companies become more competitive in the global economy. IFC's support is extended through assistance in technology transfer, better corporate governance and global environmental and social standards as well as by helping companies make investments in other emerging economies.

South Asia

Table 3. South Asia

	FY04 Actual	FY05 Actual	FY06 Plan	FY09 Indicative
Commitments (\$m)	405	443	440-525	600-700
TA Spending (\$m)	4.5	6.1	10	NA
Development Impact Score % ¹	66.7%	57.1%	NA	NA

¹ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

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, reducing poverty levels, while the expectation of continued strong growth offers the best prospect for further poverty reduction. At the same time, this growth must be matched by attention to social infrastructure and 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. 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 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, while adding value from mobilization, sustainability and IFC's 'seal of approval'.

Infrastructure continues to be the main bottleneck to economic growth in South Asia, and seriously affects the quality of life, especially for the poor. The main constraint to greater private financing is the lack of bankable projects and, outside India, availability of equity and long tenor funding. IFC aims to increase private investment in infrastructure through a multi-pronged approach, in close collaboration with the World Bank, including: project investments; corporate investments in local infrastructure development companies; municipal finance transactions; and advisory work to structure concessions, privatizations and PPPs. To counter the lack of bankable projects, IFC is leveraging its investments in infrastructure financial intermediaries to support project development activities to improve deal flow. IFC is also proposing a donor-funded project development facility to

develop and structure projects in difficult sectors where there are few or no precedents of private sector involvement.

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.

IFC sees good prospects for promoting energy efficiency and renewable energy in infrastructure and industry and services projects in South Asia. To encourage companies to make energy efficiency and renewable energy investments, IFC will provide incentives by mobilizing and monetizing carbon credits. IFC will promote energy efficiency in all new projects. IFC is focusing business development efforts on bagasse-based co-generation, wind energy and small hydro projects.

In the financial sector, IFC's strategy is to make investments and provide technical assistance 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 second tier private sector banks through equity investments as the sector opens up to increased competition and as banks strive to meet Basel II capital adequacy standards. IFC also intends to undertake pioneering financial transactions, such as securitizations, to develop capital markets. IFC is precluded from a larger role in the Indian financial sector by government regulations which largely prohibit IFC lending to financial institutions. In Bangladesh, IFC is working with partner banks through SEDF to increase SME financing, and also to provide trade finance.

IFC will increase the amount of investment-related TA activities, focusing on capacity building for banks, HIV/AIDS prevention, renewable energy/energy efficiency and linkage programs.

The proportion of equity in the portfolio has fallen as IFC has taken advantage of the strong equity market in India. IFC plans to increase the proportion of equity in new commitments to 20% over FY07-09, with increased sector concentration in infrastructure. Within the South Asia region, India offers the best opportunities for equity investments, due to the size and growth of the market, and large number of listed or pre-IPO companies issuing equity. Other equity markets are small and illiquid, with few deals large enough for IFC direct investments. In view of the increased flows of equity capital to India, and consequent increases in valuations, IFC's focus will be on overlooked market segments, including second tier, medium sized companies; investments of less than \$10m, where private equity is generally not available; and investments in frontier regions. In addition, IFC will pursue equity transactions where IFC's ability to offer debt-equity packages, value added services, reputation enhancement and mobilization of additional debt and equity provide value to clients which cannot be obtained from private equity or public offerings. IFC will also invest selectively in funds to reach segments (e.g. smaller companies, specialist areas) which IFC cannot effectively invest in directly. In doing so, IFC will contribute to institution building of the fund management industry in the region; encourage global best practices; and seed companies for future IFC direct investments.

Currently, 78% of IFC's investment portfolio in South Asia is in India, and within India, the majority of investments are in a small number of states. IFC is making increasing efforts to engage in frontier countries in the region and frontier regions within India. However, conflicts in Nepal and Sri Lanka limit investment opportunities in these countries, while IFC is constrained by exposure limits in Bhutan and the Maldives, which are small countries with limited debt service capacity. In Bangladesh, a difficult investment climate has also limited investment opportunities in recent years, although prospects for new investments are improving. IFC has strengthened its business development team in Dhaka to generate more investments in Bangladesh, Bhutan and Nepal, and is

focusing business development efforts in India on underserved regions and frontier states. As discussed in Paragraph 3.24, IFC has opened offices in Guwahati in Assam and Chennai in Tamil Nadu, and is expanding its business development team in Mumbai, to improve its coverage of India.

TA for SME development is the main contribution to private sector development in the parts of the region where investment opportunities are limited (Bangladesh, Bhutan, Maldives, Nepal, Sri Lanka and North-East India). The SEDF program in these areas is laying the foundations for later investment opportunities, by engaging with local banks, improving the business enabling environment and encouraging the growth of SMEs in key sectors. SEDF works closely with the World Bank, leveraging World Bank analytical work such as Investment Climate Assessments. In Bangladesh, SEDF and FIAS are jointly leading preparation for a World Bank-led multi-donor Private Sector Development Project, which consolidates most donor activity to improve the business enabling environment in Bangladesh. This project may include substantial donor funding for a SEDF/FIAS-managed TA component. SEDF recently underwent an independent mid-term review, after which donors confirmed the overall direction of the program, and agreed that it should continue to operate at existing spending levels through FY08, using existing funding. Major donors have indicated an interest in funding a Phase II beyond that. Exploration will begin during FY07 on the need for such a program, and the appropriate shape and size. IFC has already developed a proposal to expand SEDF into West Bengal, which is pending funding decisions from donors.

Central and Eastern Europe

Table 4. Central and Eastern Europe

	FY04 Actual	FY05 Actual	FY06 Plan	FY09 Indicative
Commitments (\$m)	825	1,128	870-1,030	965-1,145
TA Spending (\$m)	--	--	14	NA
Development Impact Score (%) ¹	77.3%	70%	NA	NA

¹ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

The strategy in this region has not changed substantially over the last year. In the new EU member countries, IFC is not promoting new business, and has closed all field offices there. IFC responds to opportunities only where the Corporation has a clear role in projects that contribute to support complex privatizations, environmental improvements (such as energy efficiency financing), contribute to the introduction of new financial products, or promote inter-regional investment (i.e. from Central Europe to the South or East). In the rest of the region, IFC’s strategic priorities continue to include: i) supporting local companies while improving transparency and corporate governance; ii) catalyzing foreign investment, as foreign direct investment is still relatively low; iii) introducing and developing new financial products; iv) focusing on frontier markets with an emphasis on SMEs through both advisory work and the development of financial institutions; v) building long-term partnerships with strong regional players; and vi) promoting private sector investment in infrastructure.

In Russia, a new area of engagement is municipal infrastructure and sub-national finance. Financial markets will continue to be a key area, with a focus on the introduction of new financial products and strengthening institutions in the less developed regions of the Federation. Technical assistance will remain an important part of engaging in Russia, in particular in housing finance, energy efficiency and community and supply chain development linked to large investments.

Ukraine is likely to present significant opportunities for growth over the next 4-5 years. In Ukraine IFC will increase its resources and investment activity to respond to the positive signs generated by the government's reform agenda. IFC will need to allocate adequate resources through further decentralization and local hiring to meet the rapidly growing demand for IFC financing across a wide variety of sectors, including agribusiness, financial markets, manufacturing and services, infrastructure and chemicals. The Corporation will also maintain its advisory activities in Ukraine in order to enhance the attractiveness of IFC's value-added package to clients, improve the business enabling environment and the competitiveness of producers in key industries, and strengthen financial institutions.

The frontier countries of Belarus, Armenia and Georgia remain difficult markets in which to find many viable investments because of the small size of their overall economies (in the case of Georgia and Armenia) or the constraints on private sector activity (in the case of Belarus). Therefore, IFC's overall investments are likely to remain limited to small projects that will require extensive technical assistance.

East Asia and the Pacific

East Asia and Pacific is one of the most dynamic economic regions in the world. In 2005, economic growth remained strong with a growth rate of a little over 6%, and it is expected to remain at about the same rate in 2006. This dynamism is underpinned by some of the highest levels of savings and investments in the world. Partly due to the high domestic savings rates, banks in the region are generally liquid. The region is characterized by rapid integration driven by the emergence of China as its economic center. 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.

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. Other "transition" (moving from central control to more of a free market) economies in the region, including Vietnam, Mongolia, Laos and Cambodia, are reforming and looking for ways to improve the business environment for their small and medium sized enterprises, while the market economies of Indonesia, Thailand, Malaysia, Korea and the Philippines have made significant progress since the 1997 Asian crisis. Despite these positive developments, addressing the institution-building issues of financial sector development and corporate governance is still a long-term challenge. The banking sector is dominated by state banks, many countries suffer from weak legal institutions and transition countries still present difficult investment environments for private sector growth. There is also a huge demand for physical and social infrastructure investment. Although poverty continues to fall in most parts of the region, there is still wide-spread poverty in the region with more than 600 million people living on under \$2 a day.

IFC's commitments in the region have remained steady, growing from \$730 million in FY04 to \$740 million in FY05. In the financial sector, IFC has engaged in highly visible (with strong demonstration effect) banking transactions with a strong TA component, resolution of NPLs through asset management companies and undertaken institution-building. IFC also supported companies in general manufacturing where local firms are 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 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: 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.

Table 5. East Asia and the Pacific

	FY04 Actual	FY05 Actual	FY06 Plan	FY09 Indicative
Commitments (\$m)	730	740	835-990	1,025-1,200
TA Spending (\$m)	14.8	18.2	24	NA
Development Impact Score (%) ¹	48.3%	61.5%	NA	NA

¹ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

IFC’s strategy in the region has not changed substantially over the last year and has focused on: i) maintaining business in the large markets of China and Indonesia with more focus on frontier areas; ii) developing strong financial institutions with a focus on deepening the capital markets in the region and expanding access to finance (rural, SME and microfinance); iii) addressing the major infrastructure needs facing the region; iv) helping domestic companies grow into global players, including support for South-South investments in the region and beyond; and v) expanding IFC’s coverage in frontier markets by deepening integration between the TA facilities and investment business and supporting improvements in the business environment, renewable energy and energy efficiency.

IFC’s strategy in China is to support domestic companies seeking to adopt international standards in governance, environmental and social practices while at the same time investing in companies located outside China’s major industrial cities. IFC is strengthening business development capacity and broadening geographical coverage to increase its business development efforts in the country. Another challenge for China is to strengthen and deepen its financial markets so that savings are intermediated efficiently to productive investments. Supporting this process is a major part of IFC’s strategy and IFC aims to support the development of non-bank financial institutions and capital markets and access to finance for the underserved markets.

In Indonesia, IFC’s primary focus will be to develop financial markets, and create model infrastructure projects in collaboration with the World Bank. Indonesia’s infrastructure needs are enormous as rapid growth and years of low investment in the sector are straining the regional infrastructure. At the same time, the government and investors are looking for ways to develop new models of infrastructure financing, some of them involving both public and private participation. IFC is uniquely positioned to respond to these needs in Indonesia given its previous experience around the world. The challenge will be to maximize the synergies between IFC and the World Bank to advance the infrastructure agenda through policy advice and demonstration transactions involving public-private partnerships. In the financial sector, IFC aims to strengthen banks and non-bank financial institutions and support SME finance through local currency financing and technical assistance. Based on this strategy, and additional investments in agribusiness, infrastructure, oil, gas and mining and general manufacturing, there is the potential to grow the program in Indonesia significantly.

In the frontier countries in the region⁹, IFC's strategy will address development of financial markets and investment in infrastructure, but will put more focus on expanding its reach to SMEs and providing technical assistance on investment climate issues. Technical assistance in these countries will be aligned with potential investments where possible and encompass linkages programs, access to finance and corporate governance TA. Technical assistance will be done in close coordination with the World Bank through a partnership which leverages World Bank expertise in policy advice and IFC's transaction experience.

Middle East and North Africa Department

Overall GDP growth for the MENA region in 2005 was 5%, with oil exporting countries registering better numbers. Iraq, Lebanon, Syria, West Bank & Gaza and Yemen ended the year with weaker growth. The region tends to be more public sector-dominated than other regions, and governments are struggling to address the most pressing economic problems, which are unemployment and the growing youth population. These can only be addressed in a sustainable way by an increased contribution by the private sector, and many governments are recognizing that this implies changes. Some governments such as Egypt and Pakistan have embarked on reform agendas, and increased IFC investment and TA activity is taking place as a result.

The MENA region is undergoing a period of increased economic integration. Private companies throughout MENA are investing increasingly in other countries in the region in banking, services sectors and telecoms. Other positive developments include improvements in the financial sectors of these countries with the introduction of new types of institutions and products.

In terms of sectors, oil and gas dominate many of the economies of the region, particularly the wealthy Gulf countries, but also in Algeria, Iran, Iraq, Syria and Yemen. While oil revenues have surged to unprecedented levels and fiscal balances have markedly improved, many oil producing countries have also kept pace with their plans to liberalize their economies.

IFC's portfolio of investments in the region totals about \$1.2 billion. Over the past two years, annual commitments have increased from \$236 million to \$315 million. Investments are held in fifteen out of the total nineteen countries/territories in the MENA region. IFC's investment portfolio is in the financial sector, power, textiles and other manufacturing and recently in oil, gas and related sectors. Stemming from increased business development in frontier countries, IFC expects a solid program of investments in FY06 in Afghanistan, Pakistan and Yemen. The opening of the economy to the private sector has also facilitated IFC investments in Egypt. IFC has also invested with a number of companies from the MENA region as they go beyond their own borders.

The key staff in the PEP-MENA TA facility are on board, and the facility has provided technical assistance to companies and government entities to address broader private sector development issues. IFC's engagement in Public Private Partnerships in the MENA region included the recently completed mandate with the Hajj Terminal in Saudi Arabia, and a mandate on Queen Alia International Airport in Jordan was started.

⁹ Includes Vietnam, Cambodia, Laos, Papua New Guinea, Mongolia, Timor Leste, and Pacific Islands

Table 6. Middle East and North Africa

	FY 04 Actual	FY 05 Actual	FY06 Plan	FY09 Indicative
Commitments (\$m)	236	315	360-400	800-900
TA Spending (\$m)	--	--	13.5	NA
Development Impact Score (%) ¹	30.8%	35%	NA	NA

1 Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

IFC will focus on supporting the countries that are shifting their economies to more open markets, through private sector participation. While IFC’s traditional role in the region has been a provider of long-term capital, IFC’s technical assistance is increasingly helping companies and government entities in the region introduce best global practices.

On the investment side, IFC has taken steps to strengthen its business development efforts in order to expand its program and has placed senior business development officers in Algiers, Cairo, Dubai and Islamabad. IFC’s investment program will focus on the financial sector (including housing finance, SME and microfinance), infrastructure, oil, gas and petrochemicals, the services sectors and health and education. An IFC priority will be the region’s post-conflict and frontier countries. In infrastructure, stemming from introduction of private investment, IFC investment opportunities are foreseen in power, gas, telecommunications and port sub sectors. In health and education, a pipeline of promising projects is being developed in the region.

Another key area of opportunity for IFC is the promotion of intra and inter-regional investments. The Dubai office focuses on leveraging the private resource flows from the capital-rich Gulf countries to the North African and Middle Eastern economies and to nearby regions. IFC expects to play an important role fostering such investments that would accelerate the integration of the region.

The donor funded PEP-MENA TA facility, has its hub in Cairo and has 13 field offices in the region. It is focusing on the financial sector, SMEs, and the business enabling environment (BEE). It also includes Advisory Services, focusing on public-private partnerships and privatization or restructuring of state-owned enterprises. PEP-MENA takes advantage of synergies between IFC investments and technical assistance which will enhance development impact of IFC’s interventions. For example, IFC provides TA in the housing finance sector while making investments in the sector in Egypt, Oman and Pakistan. It also provides stand-alone TA such as institution building in frontier and post-conflict countries.

The MENA region is particularly challenged by political events and conflicts. IFC has remained active despite these events and maintains a diversified approach to keep business going during challenging times in Iran, Iraq, Syria and West Bank and Gaza.

Southern Europe and Central Asia

The region grew 6.3% in 2004 and 5.3% in 2005. In Southern Europe and Turkey economic and political reforms are guided to a large extent by the EU accession agenda, and the business environment is improving. In Central Asia the pace of reforms is uneven. Private sector share of GDP is growing, ranging from 80% in Bulgaria and Albania to 45% in Uzbekistan. New and

dynamic local businesses are emerging in all sectors of the economy, including in infrastructure. Access to finance is improving and loans to the private sector increased significantly in many countries. In addition, loan spreads are dropping while tenors are rising in a number of countries. There is an increasing interest from foreign investors in the Southern Europe region, with FDI and privatization activity gaining significant momentum in Turkey and Romania.

As of January 2006, IFC held a portfolio of \$2.9 billion in the SECA region, of which \$1.04 billion is in Turkey. Three other countries – Romania, Bulgaria and Croatia – have portfolios ranging from \$540-\$210 million. Other countries in the region are small economies where IFC’s portfolio is smaller. Nevertheless, IFC has been actively seeking opportunities resulting in a relatively high level of investments on a *per capita* basis even in small economies. During the last three years, IFC has doubled its investments in the region. About 47% of IFC’s portfolio in SECA is in the financial sector, given its key role in private sector development. IFC has been actively involved in the restructuring and privatization process of the financial sector in almost all the countries in the region. IFC has also been fostering the development of non-bank financial institutions, especially in housing finance and leasing. The general manufacturing and services sector is important for Southern Europe countries of the region in many ways and has been a priority for IFC operations. This sector is becoming more important within the context of globalization given the increasing shift of manufacturing activities from OECD countries to developing countries.

Table 7. Southern Europe and Central Asia

	FY 04 Actual	FY 05 Actual	FY06 Plan	FY09 Indicative
Commitments (\$m)	842	809	930-1,030	1,250-1,500
TA Spending (\$m)	--	--	15.3	NA
Development Impact Score (%) ¹	73.7%	71%	NA	NA

¹ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

SECA region, where all countries except Turkey are transition economies, is changing rapidly. By 2007-08, Romania and Bulgaria will join the European Union (EU) and Croatia, Turkey and FYR Macedonia are candidate countries. Consequently, companies have urgent needs to meet EU requirements and the countries have large infrastructure requirements. To continue to expand its role in EU accession countries, IFC will be selective and will continue to introduce creative new solutions, approaches and products, especially in the financial markets. In Bulgaria, Romania and Turkey the focus will include infrastructure, housing finance, and the social sector, whereas in Croatia the focus will include agribusiness and construction materials sectors. In the frontier markets, IFC will increase efforts to grow its portfolio by working more with local investors, being more proactive with investments in infrastructure, and using technical assistance to generate investment opportunities.

IFC is implementing a strategic shift from the restructuring and privatization of the financial sector to a greater focus on regional and country-specific infrastructure investments (power, gas distribution, transport) and telecom. Most countries in the region have limited resources and fiscal space to fund infrastructure projects; however, there have been growing challenges for private sector involvement in the sector. IFC has been seeking to address some of these problems by facilitating PPPs, especially in the Balkans, and providing a number of innovative financing, advisory and project development activities. IFC will also explore opportunities in renewable energy and environmental services in the Balkans and in Turkey. IFC, in close cooperation with the World Bank, will continue

to find ways to help attract private sector investments in infrastructure through joint work, for example in Romania and Tajikistan in the power sector, and create projects together in the energy sector in Kosovo and in the water sector in Bulgaria, for instance.

General manufacturing will also be important and IFC will respond to market demand. This, for example, would include support for Turkish outward investments in the region as well as other interregional investments. IFC will also help companies from other developing countries, such as Mahindra, a leading car and tractor manufacturer from India, invest in the region. IFC intends to make more equity investments, mostly in financial markets in Serbia and Montenegro, and Bosnia and Herzegovina, and bring its experience in corporate governance and environmental and social sustainability to its clients. IFC will introduce more innovative structured finance, local currency finance, trade finance and other products to the market.

Technical assistance will be an important instrument to implement IFC's strategy in the region, enhancing the development impact of its activities, especially in frontier countries. IFC's TA and advisory services will continue to be multidimensional, including programs to improve the business environment in client countries, assist SME sector development through banking and microfinance institutions and facilitate the privatization of key industries. IFC's technical assistance facilities in the region will play an important role in providing advice for the development and operation of projects in an environmentally and socially sustainable manner, implementing SME linkages and community development programs, and establishing a framework for constructive engagement with local and international NGOs.

ANNEX 2: CORPORATE SCORECARD FY05

Mission: To promote sustainable private sector investments in developing countries, as a way to reduce poverty and improve people's lives.

CLIENT SATISFACTION MEASURES	FY05 RESULTS	FY06 ESTIMATES	FY08 TARGET OR BENCHMARK
External: % of satisfied respondents in the Annual Client Survey	79%	NA	Benchmark: FY05
DEVELOPMENT IMPACT MEASURES	FY05 RESULTS	FY06 ESTIMATES	FY08 TARGET OR BENCHMARK
A. Ex-post Development Impact Measures			
% satisfactory or better ex-post development outcomes (XPSRs) – IEG ratings	59%	NA	65% on projects committed FY06-08 ¹
B. Ex-ante Development Impact Measures			
<u>Pillar 1. Strengthen the Focus in Frontier Markets</u>			
Commitments in Sub-Saharan Africa	\$445m	\$500-600m	\$735 – 875 million
Commitments in MSME ²	\$1,099	\$0.8-1.1b	\$1.1 – 1.3 billion
% of IFC total commitments in frontier countries, compared with the frontier share of developing member country GDP ³	28%:18%	31%:17%	Overweight in Frontier
<u>Pillar 2. Build Long-term Partnerships with Emerging Global Players</u>			
Number of projects with new clients as % of total project count	56%	50%	Larger than 50%
Domestic sponsors as % of total number of commitments	66%	66%	Benchmark: FY05
South-south commitments	\$484m	\$338m (as of March 06)	Benchmark: FY05
<u>Pillar 3. Differentiate through Sustainability Competencies</u>			
Renewable Energy and Energy Efficiency projects IFC Commitments ⁴ Total RE/EE Component	\$221m \$832m	NA NA	EIR target for the World Bank Group
% of Clients who received significant E&S input in Annual Client Survey	69%	NA	Benchmark: FY05
% of Clients who said E&S input had impact on their business	64%	NA	Benchmark: FY05
<u>Pillar 4. Address Constraints to Private Sector Growth in Infrastructure, Health and Education</u>			
Commitments in infrastructure, ICT, health and education	\$880m	\$1.2-1.4bn	\$1.5 – 1.8 billion
of which, ICT ⁵	\$200m	\$330m	Benchmark: FY05
of which, Infrastructure other than ICT	\$599m	\$900m	Benchmark: FY05
of which, Health and Education	\$81m	\$120m	Benchmark: FY05
Commitments in Sub-nationals	\$0m	\$13m	Benchmark: FY05
Number of mandates in Advisory Services to Private-Sector Participation in Public Infrastructure Services	Closed – 4 Ongoing - 21	Closed – 3* Ongoing – 28*	Benchmark: FY05
<u>Pillar 5. Continue to Emphasize Local Financial Market Development</u>			
Commitments in Financial Sector ⁶	\$2,183m	\$2.0-2.2bn	\$2.1 – 2.5 billion
of which, Housing Finance ⁷	\$565m	\$600m	Benchmark: FY05
Commitments in Local Currency Financing	\$820m	\$297m*	Benchmark: FY05
Number of Technical Assistance and Advisory Services in Financial Sector ⁸	135	125*	Benchmark: FY05

FINANCIAL AND ORGANIZATIONAL PERFORMANCE MEASURES	FY05 RESULTS	FY06 ESTIMATES	FY08 TARGET OR BENCHMARK
IFC net commitments	\$5,373m	\$5,600 - 6000m	\$6,015 – 7,150million
IFC committed syndications	\$1,076m	\$1,660m	Benchmark: FY05
Operating income ⁹	\$1,953m	\$1.5-2.1bn	FY06 Plan: \$517 million
Return on Net Worth	20.6%	NA	Benchmark: FY05
Return on Net Worth, adjusted for TAAS ¹⁰	21.0%	NA	6.0%
Technical Assistance and Advisory Services, DFO Expenditures ¹¹	\$122m	NA	Benchmark: FY05
Loan portfolio: Non-performing loans	6.4%	6.0%*	Benchmark: FY05
Maintenance of AAA Rating	Yes	Yes	Yes
Productivity: # Commitments / Investment staff ¹²	0.55	0.56*	Benchmark: FY05
Productivity: \$ Commitments / Investment staff	\$12.4m	\$12.5m*	Benchmark: FY05
HR Dimension			
Diversity: % of Sub-Saharan African and Caribbean Nationals	7%	8%*	WBG target 10%
Diversity: % of Female Workers	38% GF-GG 23% GH+	41% GF-GG* 24% GH+*	45% GF-GG 30% GH+
Staff morale: % of satisfied respondents in the Biannual Staff Survey ¹³	NA	81%	Benchmark: FY06

* Actuals to date (March 2006).

¹ There is generally 5-6 years lag for ex-post results.

² MSME commitments include: direct MSME borrowers; financial institutions with more than 50% of their business clients being MSMEs; and any other investments that explicitly target MSMEs as primary beneficiaries.

³ Frontier countries are low income (World Bank income category) or highest risk (Institutional Investor rating of 30 or less) countries. The comparator is the size of frontier economies as a % of all IFC's developing member countries, measured by GDP in current US dollars.

⁴ Based on commitments only as of end FY05. Projects with RE/EE components totaled \$2.9billion, in which IFC invested \$705million. The \$221m figure above represents the % of the IFC investments corresponding to the % of total project cost estimated to be represented by RE/EE components. FY06 numbers will be reported after the end of FY06.

⁵ Information and Communication Technologies.

⁶ Not including funds.

⁷ Does not include direct commercial bank lending that targets housing finance sector.

⁸ Active TA projects.

⁹ Excluding unrealized gains of \$163 million from IFC's investments in Limited Liability Partnerships and certain investments in Limited Liability Corporations (FY05). If these gains are included, the return on net worth would be 22.6%.

¹⁰ IFC Return on Net Worth based on operating income adjusted for FMTAAS expenses: IFC expenses contributions to the Trust Fund program, FIAS, PEP, Project Development Facilities, SME Capacity Building Fund, special Environmental Facilities, and other programs. The target ROE of 6 percent is based on 1) a potential range of 6-8 percent for a commercial benchmark, based on returns of commercial banks and other IFIs adjusted for leverage (Board technical briefing on "Benchmarking IFC's Profitability," November 2003), and 2) adjusted for IFC non-commercial activities (Board Technical briefing on "Unbundling Non-Commercial Activities," January 2003).

¹¹ Donor-funded Operations (DFO) expenditures include overhead costs and cost of delivering projects in the following 27 DFO programs: Trust Fund program, FIAS, DEVCo, six Environmental Facilities, SME Capacity Building Fund, SME Initiatives, Grassroots Business Initiatives, Project Development Facilities, and PEPs.

¹² Total number of projects divided by the total number of investment officers from grade F to H, excluding managers, industry specialists, economists/strategists, and budget officers.

¹³ Biannual Staff Survey 2005, percentage of favorable respondents on "overall satisfaction" section.

ANNEX 3. RECRUITMENT UPDATE

IFC Administrative Budget: Recruitment Update (As of March 15, 2006)

Recruitment is a critical factor in the implementation of IFC's growth strategy, as endorsed by the Board in June 2005. IFC is in the midst of its largest recruitment drive in its history. Current departmental staffing plans project that IFC will hire around 350 new staff for all grades from its administrative budget in FY06. The exact numbers have varied slightly over time due to adjustments of hiring plans to meet unexpected business needs. As of March 15, 2006, 69% of the total recruitment plan has been completed.

Recruitment Progress: As of March 15, 2006, 241 new staff have been hired out of IFC's administrative budget, including 137 new staff at Grades F and above and 104 new staff at Grades A-E. As of this date, 110 positions remain open, including 61 positions at Grades F and above (see Table 1 for more details on recruitment progress).

Table 1. Recruitment Progress Report by Grade Group FY06 YTD 03/15/2006

Grade Group	Total External Recruitment Positions	Filled External	Open Positions	% Filled Ext
GF+	198	137	61	69%
GA-GE	153	104	49	68%
Grand Total	351	241	110	69%

International and Local Recruitment: Out of the 137 new recruits at Grades F and above, 91 were international hires and 46 were local hires. IFC has achieved 74% of its international mid-career staffing plans. However, there are still 32 international positions and 29 local positions open for recruitment. In particular, recruitment of local mid-career professionals has proven to be more challenging, partly due to highly competitive market conditions in some markets, including Asia, Africa and Latin America (see Table 2).

Table 2. Recruitment Progress Report International vs. Local Hires (GF+) FY06 YTD 03/15/2006

Contract Type	Total External Recruitment Positions	Filled External	Open Positions	% Filled Ext
International	123	91	32	74%
Local	75	46	29	61%
Grand Total	198	137	61	69%

Decentralization: Projections indicate that IFC will hire 87 new staff at Grades F and above in country offices during FY06. As of March 15, 2006, 52 out of the 87 field-based positions have been filled, a 60% completion. To date, there are still 35 positions projected for recruitment in the field, primarily at mid-career level. To date, out of the 137 new recruits at Grades F and above, 85 were for Washington based positions (see Table 3).

Table 3. Recruitment Progress Report by Location (GF+) FY06 YTD 03/15/2006

Location	Total External Recruitment Positions	Filled External	Open Positions	% Filled Ext
Field	87	52	35	60%
Washington	111	85	26	77%
Grand Total	198	137	61	69%

Progress by Department Type: Given the slower pace of locally-based recruitment, Regional Departments show slower progress than Industry and Service departments in recruiting staff at Grades F and above. Out of 48 positions planned in the Regional Departments, only 25 new staff have been recruited, a 52% completion (Table 4).

Table 4. Recruitment Progress Report by Department Type (GF+) FY06 YTD 03/15/2006

Department Type	Total External Recruitment Positions	Filled External	Open Positions	% Filled Ext
Regional Departments	48	25	23	52%
Industry Department	86	64	22	74%
Service Departments	64	48	16	75%
Grand Total	198	137	61	69%

Recruitment Diversity Progress

In recruiting new staff, diversity continues to be a key priority for IFC. Recruitment diversity progress information for FY06 is displayed in Table 5 below:

Table 5. Recruitment Diversity Progress: FY06 YTD 03/15/2006

Diversity Indicator	New Recruits	Total GF+ Recruits	% Over Total GF+ Recruits	Board Diversity Target
Part 2 (HQ+CO)	79	137	58%	48%
Women (HQ+CO)	66	137	48%	45% GF-GG, 30% GH+
SSA/CR (HQ) ¹	18	91	20%	10%

¹ Recruitment indicator excludes 3 SSA/CR new recruits with dual American nationality

- Part 2: About 58% of IFC's new hires are Part II, exceeding the WBG target for this group for FY06.
- Gender: While IFC continues to make progress hiring female staff at Grades F and G, senior level recruitment at Grade H is weak. IFC has hired 63 female staff at Grades F and G, exceeding the WBG target for gender at these grades, but only 3 female out of 12 new staff had been hired at Grade H.
- Recruitment of Sub-Saharan African and Caribbean nationals (SSA/CR) accounts for 20% of the total number of international new recruits. This pace is substantially above past IFC recruitment trends and is in line with IFC's deliberate strategy to reach the 10% WBG target for this group as an outcome of IFC's three-year growth strategy.

- Nationalities of Concern: IFC is making progress recruiting nationals of some nationalities of concern. However, IFC is also facing some difficulty in attracting new staff from certain countries, partly due to compensation differences in the private sector between the WBG scale and certain European countries in particular, where we continue to see an increase in the number of declined offers.
- Education Backgrounds: To improve diversity further, IFC overhauled its recruitment strategy in FY06 and now recruits staff globally, including through universities typically not targeted by the WBG. As a result of this approach, around 54% of IFC FY06 recruits come from non-traditional universities, including around 23% from Part 2 schools: 15% of all international hires and 39% of all local hires come from Part 2 universities at the post-graduate level, compared to 8% and 31%, respectively, for the FY01-05 period. Furthermore, IFC has made a concerted effort to focus on the development of high performing local staff. For example, in the last 24 months, over 50% of the participants selected into IFC's development programs for high performers were from local offices and, in the last 12 months, nine locally-recruited staff relocated internationally, compared to only one per year before 2004.

IFC User
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