

III. PROGRESS UPDATE

3.1 This section consists of two parts. The first part provides an update on: (i) progress on development outcome of IFC's investments; (ii) progress on World Bank Group cooperation; (iii) progress on advisory services; (iv) advances in measurement – Development Outcome Tracking System (DOTS) for investments and advisory services; (v) the Corporation's equity strategy; and (vi) risk management. The second part provides a detailed discussion on IFC's progress under the five priorities: (i) strengthening the focus on frontier markets; (ii) building long-term partnerships with emerging players in developing countries; (iii) addressing climate change, and environment and social sustainability; (iv) addressing the constraints to private sector growth in infrastructure, health and education; and (v) developing local financial markets through institution building, the use of innovative financial products and mobilization.

PROGRESS ON DEVELOPMENT OUTCOME OF IFC'S INVESTMENTS

3.2 **Development Impact.** Two years ago, IFC made greater development impact its principal corporate Goal. Results from DOTS and those of the Independent Evaluation Group (IEG) feed into strategy formulation (see Box III-1) and inform IFC's incentive system. Taking into account past results, current market conditions and expected future performance, IFC continuously refines its scorecards to ensure emphasis on areas where it expects to have strong additionality and development results, setting clear *ex ante* expectations for new business.

3.3 As discussed in IFC Road Map, FY09-11, IFC has already met or even exceeded the Board-endorsed targets for FY08, and is therefore in a strong position to embark on the next phase of its growth and evolution. An example of findings from DOTS, which is supported by the Independent Evaluation Group (IEG) findings, is that in IFC's projects development impact and financial success are closely interrelated (see Chart III-1 and Chart III-2).

Chart III-1: Correlation Between Financial and Development Results

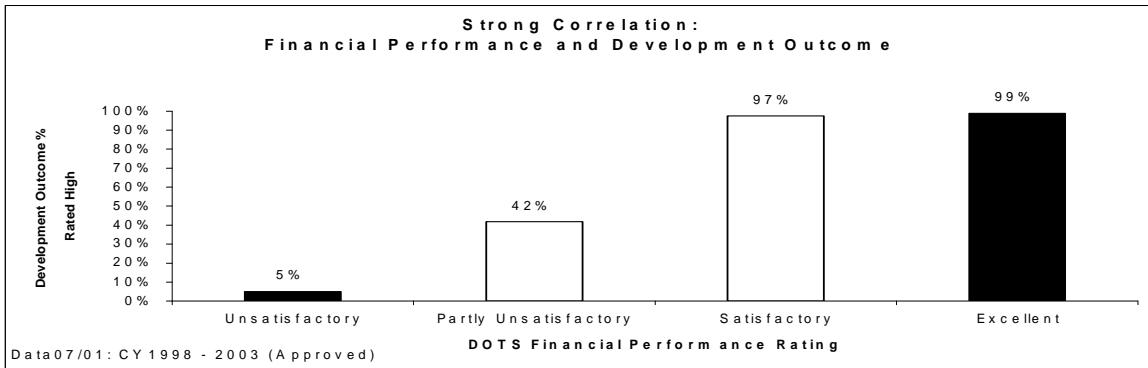
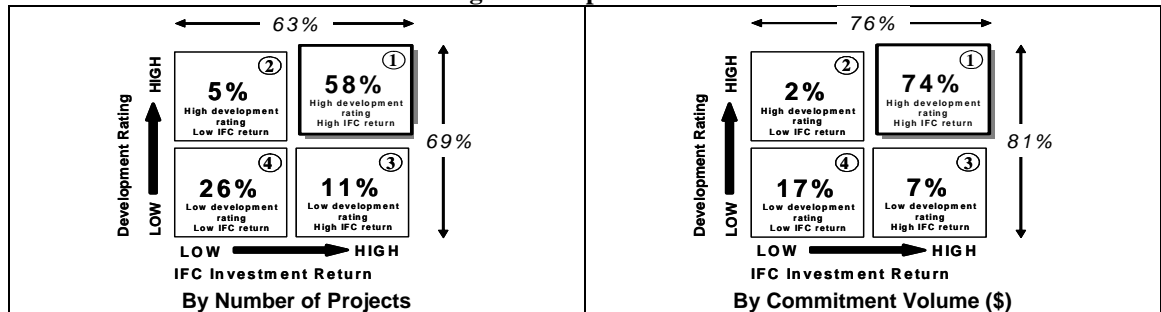


Chart III-2: IEG-IFC Evaluation Findings: Development Outcome and Investment Outcome



Box III-1: IEG-IFC Evaluation Findings: Informing IFC's Strategic Directions

As in previous years, IFC's current strategy has been informed by findings from independent evaluations from IEG-IFC, as well as self-evaluations and IFC-commissioned third party evaluations. Relevant findings from these evaluations include:

Counter Cyclical Investments: IEG-IFC's evaluation of IFC's experience in Middle Income Countries (MIC) found that IFC's counter cyclical investments (in Brazil, Indonesia, Korea, Mexico, Philippines, Russia and Turkey) had better outcomes than projects approved pre-crisis. Quick strategic response and rapid deployment of a strong restructuring team were largely credited for this performance. The severity of the crisis and the government's post-crisis adjustments partly explain the difference in the level of success in different countries. In Indonesia, IEG-IFC's Country Impact Review (CIR) found IFC's strategic response to be relevant and effective. IFC focused on restructuring liabilities of existing clients and provided them with working capital before developing new clients. IEG-IFC also found that IFC's good risk management at entry and strong committed sponsors proved crucial in the success of projects that were hit by crises.

Programmatic Approach: IEG-IFC evaluated IFC's programmatic approach to financing MSMEs through Financial Intermediaries (MSME-FIs) in IDA countries. IEG-IFC concluded IFC's strategy of supporting MSMEs through investments in FIs and relevant advisory services to be prudent and effective. IFC achieved better than average development outcome success rates in MSME-FI projects. SME-FI projects that received advisory services had a wider SME reach, averaging 16,000 borrowers per FI or 10 times more than those that did not receive advisory services. The evaluation also found that IFC's additionality proved crucial to the success of these projects, especially in MFIs where IFC championed the use of dedicated MFI holding companies to expand its reach efficiently. DOTS has also allowed IFC to start gauging the effectiveness of shifting its strategy from direct support to MSMEs to financial intermediaries. For example, in Africa, IFC used to reach about 50 MSMEs annually, but through financial intermediaries reached 166,000 last year.

Middle Income Countries (MICs): IEG-IFC's evaluation note on IFC's experience in MICs found that while regional differences exist, overall IFC achieved better development and investment outcomes in MICs relative to low income countries. Going forward, while MICs benefited from increased private sector investments, significant constraints to competitiveness remain and IFC has an important role to play in helping MICs address these impediments. The report concluded that IFC needs to be more agile in MICs and take advantage of opportunities to further development impact, such as supporting PPPs and pursuing other areas of additionality where IFC has a comparative advantage, especially beyond financing.

World Bank Group Cooperation: IEG-IFC evaluated World Bank/IFC collaboration in connection with the IEG-WB evaluation of the WB's experience in MICs and as part of the FY07 Independent Evaluation of Development Results (IEDR). IEG-IFC found that cooperation in the WBG remains to be fully exploited. Client needs and strong management encouragement were instrumental to successful cooperation. Other drivers of effective cooperation include on-the-ground presence of both the World Bank and IFC, open communication channels, conducive organizational structures, and good working relationships. Obstacles to cooperation include lack of understanding of each other's business models, differences in project timelines, and lack of incentives for cooperation. Cooperation in advisory services is more common than in investment operations.

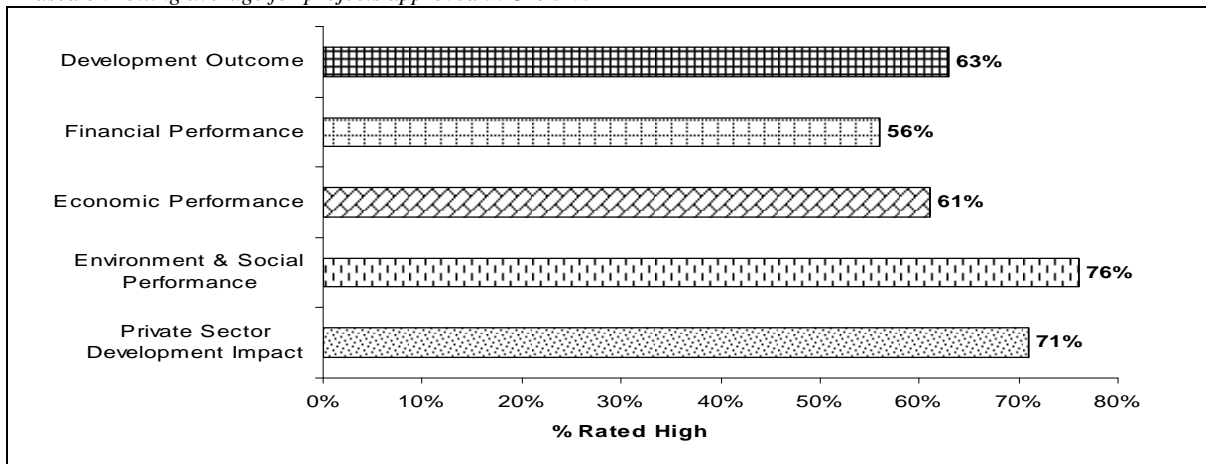
Global Local (Decentralization): IEG-IFC's country evaluations found that weak local presence in Ukraine was partly responsible for a relatively slow investment operations ramp-up in the 1990s while strong on the ground presence of a seasoned restructuring team was crucial to the success of IFC's crisis response in Indonesia. IEG-IFC's FY07 IEDR also noted that IFC improved risk management at approval and project supervision work quality with the earlier decentralization in South Asia. However, such achievements happened with a more modest growth in operations. These findings underscore the need to focus both on the growth agenda while also ensuring good work quality at entry and at supervision as IFC implements its phased decentralization.

Long-term partnerships: DOTS results have shown substantially higher success rates with repeat clients. These results support IFC's strategic pillar of long-term partnerships. They show that IFC needs to balance developing relationships with new clients and deepening the development impact of working with existing clients.

3.4 Development Outcome of IFC's Investments. The introduction of DOTS in 2005 has allowed IFC to track the development results for its entire portfolio continuously throughout the project cycle and provide earlier and more contemporaneous feedback. DOTS results show that in FY07, 63% of IFC's investment operations (based on rolling average for projects approved in CY98-03) had high development outcomes, meeting or exceeding market, financial, economic, environmental and social, and private sector development performance benchmarks and standards. Among the four performance components that inform the overall development outcome, high financial performance was hardest to achieve: 56% of IFC's projects met their benchmark, a financial return that exceeds the company's cost of capital. It is not surprising that financial performance has the lowest score as typically, only about half the companies can outperform the competition.

Chart III-3: Development Outcome of IFC's Investments (FY07)

Based on rolling average for projects approved in CY98-03



3.5 Highlights of IFC's development results for calendar year (CY) 06 portfolio and CY07 new business, as well as expected developmental reach for first half of FY08 are provided in the following tables.

Table III-1: Highlights of IFC's Development Reach*

	CY06 Portfolio	New Business Expectations CY07
MSME Loans (Volume)	\$57 billion	Average annual portfolio growth:
MSME Loans (Number)	5 million	SME: 23%, Microfinance: 40%
Power Generation	124 million customers	21.5 million customers
Power Distribution	9.5 million customers	2.3 million customers
Water Distribution	15.3 million customers	2.2 million customers
New Phone Connections	53 million	12 million
Railway Passengers	2.4 million	9.2 million
Patients Reached	4 million	5.2 million
Students Reached	353,000	684,000
Employment	653,621	143,000
Local Purchase of Goods & Services	\$31 billion	\$4.9 billion
Payments to Government	\$9.9 billion	\$841 million
Community Development Outlays	\$252 million	\$32 million

**Reach data is rounded and for selected industries only; Indicator definitions and reporting periods vary somewhat across select industries*

Table III-2: Highlights of IFC's Expected Development Reach (FY08 First Half Commitments)

Departments	Highlights of Expected Development Results for FY08 First Half Commitments
Agribusiness <i>13 projects</i>	<ul style="list-style-type: none"> - Provide direct employment for 74,313 individuals. - Reach over 14,220 farmers. - Reach over 7,777 downstream SMEs.
Global Financial Markets <i>65 MSME, housing finance and other projects; 55 trade finance projects</i>	<ul style="list-style-type: none"> - Microfinance: Portfolio of client companies is expected to grow by an average of 53% per annum. 330,000 new microfinance loans are expected to be issued by client companies. - SME Finance: Portfolio of client companies is expected to grow by an average of 19% per annum. 115,000 new SME loans are expected to be issued by client companies. - Housing Finance: Client companies with housing finance operations are expected to issue 19,000 new housing loans - Trade Finance: 512 guarantees issued, of which 78% support trade for SMEs, 34.4% trade between developing countries. In terms of volume, \$700 million of guarantees issued, 41% of which in Sub-Saharan Africa.
Global Information and Communication Technologies <i>8 projects</i>	<ul style="list-style-type: none"> - Contribute to the generation of jobs for 1,712 people. - Create 1.7 million new telephone connections. - Create 2 million new internet connections. - Contribute about \$35.2 million in taxes.
Global General Manufacturing <i>13 projects</i>	<ul style="list-style-type: none"> - Create permanent employment of over 11,194 workers. - Contribute income taxes of \$75.2 million. - Contribute around \$955 million to supply linkages.
Health and Education <i>5 projects</i>	<ul style="list-style-type: none"> - Serve 591,500 patients annually. - Contribute about \$5.9 million in taxes by 2012-2013.
Infrastructure <i>13 projects</i>	<ul style="list-style-type: none"> - Generate enough electricity for 3.3 million customers. - Enable 600,000 passengers and 1.7 million tons of freight to be transported by rail. - Enable 6.2 million passengers to travel by air. - Reach 1 million customers in the water sector. - Reach 13.2 million customers in the gas sector. - Treat 274.5 million m³ of wastewater per annum. - Enable 1.7 million containers to be transported by ports.
Oil, Gas, Mining and Chemicals <i>18 projects</i>	<ul style="list-style-type: none"> - Create or preserve about 12,879 direct jobs. - Contribute around \$534 million to supply linkages. - Spend almost \$4.3 million on community development programs. - Contribute over \$1 billion to government revenues.
Private Equity and Investment Funds <i>10 projects</i>	<ul style="list-style-type: none"> - Invest in 37 companies in frontier markets. - Invest in 37 MSMEs. - Support 46 high growth companies (growing over 20% p.a.). - Create an estimated 7,200 jobs.
Subnational Finance <i>1 project</i>	<ul style="list-style-type: none"> - Reach 200,000 transport and road customers by 2008 - Improve municipal finances by: increasing capital expenditures/total revenues from 9.5% in 2006 to 15% in 2008-10; increasing operating balance/total revenues from 2.5% in 2006 to 10% in 2008-10

PROGRESS ON WORLD BANK GROUP COOPERATION

3.6 Greater cooperation among World Bank Group members continues to be an important corporate goal for IFC. There are significant accomplishments and plans are underway to improve further the level of cooperation, as discussed in the following sections. Examples of good cooperation are seen in all regions, especially in advisory services and investment climate work, public-private partnerships (PPPs) and infrastructure, financial sector, mining and subnational work.

3.6.1 *IFC's Contribution to IDA*. As discussed in the IFC Road Map, FY09-11, IFC has now designated \$500 million from its retained earnings for IDA15 and approved an indicative program for designating up to a further \$1.25 billion for IDA15, subject to actual availability of IFC funds. Together with the newly established IDA-IFC Secretariat, this is expected to lead to increased focus on private sector development in IDA countries.

Box III-2: Examples of Work Bank Group Cooperation in Investment and Advisory Services

Central & Eastern Europe. Russia: IFC Russia Sustainable Energy Finance Program works closely with the World Bank to develop Energy Efficiency policy advice for the Russian government; World Bank and IFC working jointly to promote the passage of legislation to enable future subnational investments. Ukraine: IFC's business enabling environment and corporate governance operations are closely linked with World Bank's Development Policy loan and Private Sector Development programs on the regulatory environment for agribusiness, advice is jointly provided to the Ukrainian government on corporate governance legislation.

East Asia & the Pacific. Activities include: Business Enabling Environment Advisory Services (BEE): projects across the region, including through public-private fora, PSD diagnostics, "Doing Business" work including launch of 2008 report. Access to Finance: Strong and deepening collaboration in access to finance projects, including banking legislation reform in Lao PDR and PNG and collaboration in housing finance in China. Infrastructure: joint approaches to governments to support advisory mandates in the Philippines and Vietnam; joint work on infrastructure reform in Indonesia; and renewable energy in the Pacific. Climate Change: new collaboration on strategic responses to climate change agenda.

Latin America & the Caribbean. Activities include: BEE: World Bank-IFC cooperation in Central America, Mexico, Brazil. FIAS-IFC coordination on subnational Doing Business in Mexico, Brazil, Colombia, in regulatory issues in Brazil, and tourism in the Caribbean. Access to Finance Advisory Services: Cooperation on housing program in Brazil, Mexico, Peru and Central America and with MSME program in Mexico, and in approach with governments regarding leasing in Bolivia and Nicaragua. Forestry: Forestry projects (Nicaragua and Bolivia). Strong synergies: Enhancing Local Benefits (ELB) work on EITI efforts and active coordination with the World Bank, particularly in Colombia.

Middle East & North Africa. BEE: All IFC BEE work via PEP-MENA, 11 on-going projects, is directly linked to the World Bank activities, including two lending programs. Mining policy reform projects: in Egypt and Yemen, including joint missions. Alternate Dispute Resolution program: in Morocco, with IFC PEP-MENA, the World Bank country team and legal department. FIAS and PEP-MENA programs: under joint coordination. Financial markets: in Yemen; joint team has been established to coordinate support in the sector. PPP: proposals to Syria. Afghanistan: joint project development and design has taken place; currently, there is an attempt to use World Bank/IDA funding to scale up the successful horticulture development project in Kandahar.

Sub-Saharan Africa. BEE: Joint investment climate work. Extractive industries: collaboration on large-scale projects and enabling environment issues, in particular in Guinea and DRC; and in community development as in Lonmin. Infrastructure: cooperation on large scale and regional projects, particularly hydro, and also PPPs in power, as in Senegal, Ghana, Nigeria. ICT: cooperation on backbone and major infrastructure such as EASSY. IDA-IFC MSME pilot program: seven joint projects with IDA credits and IFC participation/investments, e.g. in Madagascar, Kenya, Nigeria. Financial sector development: cooperation especially in advisory programs such as Efficient Securities Markets Institutional Development (ESMID) on securities markets, credit bureaus and housing finance. Others: Joint work on Investment Climate Reform, e.g. in Madagascar, Nigeria, Burkina Faso, Mali, Kenya; Post conflict programs, e.g. in DRC; Lighting Africa initiatives in various countries involve the World Bank and IFC.

South Asia. Multi-donor PSD reform program in Bangladesh, IFC managing Bangladesh Investment Climate Fund (BICF) advisory program, World Bank providing investment funding for special economic zones. Climate Change: a joint working group is developing a strategy for the South Asia region; PPPs: a joint strategy for promoting PPPs agreed 18 months ago is under implementation, focusing mainly on infrastructure, and including subnational finance. Infrastructure Advisory: IPP in Bangladesh, water in India, urban finance in India. Investment Climate: the World Bank and IFC collaborate on country diagnostics and jointly design work programs, e.g. in Bangladesh, Nepal and India. Agribusiness in Bangladesh: memorandum of understanding (MOU) signed between the World Bank and IFC-SEDF (IFC advisory facility in Bangladesh) to work jointly on the development of five key sub-sectors; Financial sector: joint World Bank-IFC advisory program to deepen the bond market and develop low income housing market in India; joint World Bank-IFC SEDF MOU with Bhutan for IT systems for banks (World Bank investment, IFC advisory). Sri Lanka and Maldives: working closely to develop the IT and SME sector.

Southern Europe & Central Asia. Joint work on regulatory reform: in Central Asia and Azerbaijan, including Tajikistan National Development Strategy, housing policy in Uzbekistan, cotton pricing in Tajikistan, BEE projects in Azerbaijan and Kyrgyzstan. "One World Bank" approach: led to IFC assisting Albania with private sector participation in infrastructure and restructuring/privatization of power distribution company. IFC Alternative Dispute Resolution: work done in close coordination with the World Bank private sector development program. Integration of IFC and FIAS programs, especially in Croatia, Serbia, Bosnia; ICT Sector, capacity enhancement project in Bosnia-Herzegovina and Macedonia. Business Regulation: joint work on business regulation for Macedonia.

3.6.2 *Greater Sector-Level Cooperation.* Enhanced cooperation is also present in sectors such as: financial markets (e.g. joint credit bureau program, Global Emerging Markets Local Currency Bond Fund (Gemloc), housing finance, municipal funds, rural credit), and agribusiness.

Box III-3: Gemloc

The Gemloc (Global Bond Fund for Emerging Market Local Currencies) Program is designed to utilize the unique position of the World Bank and IFC to help develop local currency bonds markets in the emerging economies. Gemloc is based on three pillars: (i) a \$5 billion fund co-branded by the World Bank and a private sector fund manager to attract long-term investments to local bond markets; (ii) a new bond index co-branded by IFC and private sector to help transform emerging local bonds into a mainstream asset class; and (iii) advisory services by the World Bank Group to help emerging market stakeholders develop their fixed income market, for example, by facilitating related policy reforms. Gemloc combines a public-private partnership with a strategic vision in order to establish a clear link between reforms, advisory services, and private sector investments.

3.6.3 *Increased Interactions in Strategy and Business Information.* Processes are in place to increase interactions in strategy development and business information exchange, including: (i) World Bank senior-level staff participation in IFC’s strategy sessions; and (ii) joint meetings of staff in the regions. Greater engagement is taking place in Country Assistance Strategies and sector and other strategies, including the joint financial sector strategy.

3.6.4 *Cooperation in Advisory Services.* A new set of guidelines has been implemented to strengthen collaboration in advisory services (see paragraph 3.7.3), including joint attendance at strategy meetings, early project notice and consultation, peer-review, and flexible exchange of staff. In addition, regional World Bank-IFC advisory services consultations have been instituted in the field, the first completed in Sub-Saharan Africa.

3.6.5 *Increased Joint Consultations/Functions/Co-Locations.* There has been a considerable increase in joint consultations with governments, and on key projects with broad country issues, for example, in mining. The number of co-located offices, where appropriate, has also increased, as well as jointly funded advisory positions (e.g. in Belarus, Pacific, the Philippines, and Ukraine).

3.6.6 *Greater Corporate-Level Cooperation.* Greater corporate-level cooperation is being pursued, with focus on achieving goals in areas such as: (i) climate change and energy efficiency; (ii) oil, gas and mining (e.g. joint work on global programs including Extractive Industries Transparency Initiative (EITI), Global Gas Firing Reduction Public-Private Partnership (GGFR), Petroleum Governance Initiative (PGI), and Communities and Small-Scale Mining (CASM)); (iii) the “Six Themes” working groups; (iv) the World Bank Group-wide implementation of the Governance and Anti-Corruption strategy (see paragraph 3.32.1); and (v) on the results measurement agenda.

PROGRESS ON ADVISORY SERVICES

3.7 **Advisory Services.** IFC Advisory Services (AS) work is organized into five business lines: (i) Business Enabling Environment – to improve the business environment that will allow projects to be viable; (ii) Value Addition to Firms – to improve the business capability of companies (particularly in countries where IFC currently has limited opportunities to provide investment finance); (iii) Access to Finance – to expand the availability of financial services to micro and small businesses and low-income households; (iv) Infrastructure – to improve access to basic services in road infrastructure, telecommunications, water and energy utilities, health and education; and (v) Environmental and Social Sustainability – to improve sustainability of IFC clients and through them demonstrate to the market innovative environmental and social business models. Through its advisory service work, especially in the frontier markets, IFC addresses basic challenges and paves

the way for private sector investments and growth. Advisory services work in BEE is often the entry point product for IFC in a country.

3.7.1 *Increasing Reach to IDA and Conflict-Affected Countries.* In FY07, AS expenditure increased 28% over FY06 to \$197 million, of which 44% were spent in 60 frontier countries. Of the 35 conflicted-affected countries, IFC has advisory projects committed in 23, including Afghanistan, Haiti, Liberia, Nigeria and Rwanda. AS expenditure for FY08 is expected to be about \$250 million.

3.7.2 *Offering a Differentiated Business Model.* In FY08, AS made progress in the rollout of commercially viable business models related to sustainability and climate change mitigation to Brazil, China, India, the Philippines and Russia.

3.7.3 *Promoting further World Bank Group Cooperation.* Guidelines have been issued to IFC AS staff to enhance cooperation and alignment with other parts of the World Bank Group. Additionally, the World Bank Group Vice President for Financial & Private Sector Development and IFC Vice President and Chief Economist, has commenced a round of regular strategy development work planning meetings of key regional World Bank Group staff.

3.7.4 *Pricing of AS Work.* In FY08, IFC introduced Corporate-wide guidelines for pricing its AS work to: (i) ensure that any subsidies are justified on public good grounds; (ii) strengthen client commitment; (iii) strengthen business discipline; (iv) leverage funding resources; and (v) become more transparent about IFC AS not “subsidizing” (private goods) in its advisory services.

3.7.5 *Greater Alignment of Trust Fund Management.* Following discussion with the Board, IFC will align further its trust fund management arrangements with those of the World Bank. Key aspects of arrangements going forward are: (i) no new tied consultant trust funds will be accepted; (ii) a minimum size of \$250,000 for new trust funds; (iii) in collaboration with the World Bank, evaluation of the introduction of a proposed new “Externally Financed Output” instrument for smaller donor-funded IFC activities; and (v) in collaboration with the World Bank and donor partners, further improvements in donor reporting arrangements.

ADVANCES IN MEASUREMENT

3.8 IFC continues to make notable advancements in measuring the development impact of both its investments and advisory services, as well as in the area of environmental and social risk management. To date, IFC is the first and only private sector multilateral financial institution to publish the current development results of its entire portfolio¹, and to have this information validated by an external assurance provider. Assessments in 2005 and 2007 found IFC to be at the forefront in results measurement and reporting².

3.9 **Development Outcome Tracking System.** Development results continue to be an important focus for the Corporation, and IFC has introduced DOTS for investments and advisory services to track achievement of development objectives throughout the project cycle. The results are key components in the assessment of departments’ and individuals’ performances, as well as IFC’s Long Term Performance Awards. They also inform IFC’s strategy discussions at the corporate and departmental level, and serve to reinforce a results-based management culture.

3.9.1 *Improvement in Information Quality.* IFC is currently reviewing comprehensively all DOTS entries for companies with project approvals between 1999 and 2004 and for FY08 commitments. There has been significant improvement in the quality of the information entered

¹ IFC Annual Report 2007; More comprehensive development results can be found on www.ifc.org/results

² Based on a 2005 consultant study commissioned by the Evaluation Cooperation Group of the Multilateral Development Banks and a 2007 consultant study commissioned by IFC, available at www.ifc.org/results.

into DOTS due to IFC Management's continuous emphasis on development results, investment departments' efforts and diligent quality control exercises undertaken throughout the year. Since its launch in 2005, more than 2,300 IFC staff have received training on DOTS. To date in FY08, 21 training events have been conducted for 500 staff, and six more are planned for the remainder of FY08.

3.9.2 *DOTS II*. IFC plans to introduce DOTS II, an upgraded version of the current system, in FY09. It will allow: (i) better aggregation of specific development results indicators (e.g. number of people getting access to services); (ii) integration into project cycle documents; and (iii) tracking of IFC's project-level additionality, as well as the investment climate impediments that IFC's clients are facing.

3.10 Advisory Services Results Measurements. IFC's Advisory Services monitoring and evaluation (M&E) unit: (i) develops tools – including indicators on outputs, outcomes and impacts for project supervision and completion reports – across the five business lines and cost-benefit approaches; (ii) manages operational program reviews conducted by external experts and promotes learning and dissemination of lessons; (iii) implements experimental/ randomized trials which allow for better attribution of results back to IFC and its partners; and (iv) provides staff training and direct assistance in M&E. In addition, twice a year IFC organizes meetings to facilitate the exchange of ideas and experiences among academics, foundations, donors and other partners.

3.11 Environmental and Social Risk Management System. In 2007, IFC introduced an Environment and Social Management System (ESMS) with the coming into force of the IFC Sustainability Policy and Performance Standards. The system allows IFC to ensure that the Performance Standards and Disclosure Policy are applied correctly and systematically with quality in implementation. The ESMS is also a generator of knowledge about IFC's own performance, essential to IFC's convening and thought leadership role across the community of institutions that use IFC standards and more broadly in the universe of investors and development organizations and partners that work in emerging markets. Incorporating lessons learned from the first year of Performance Standards implementations, the Environmental and Social Review Procedure was updated July 31, 2007.

UPDATE ON EQUITY STRATEGY

3.12 Equity continues to play an important role in IFC's pursuit of its strategic priorities, and as a means of achieving IFC's private sector development goals, while maintaining its financial sustainability. IFC focuses on opportunities where it can provide additionality by assisting companies to realize their potential through its expertise and value-added services.

3.12.1 *Creation of an Equity Department.* In FY07, IFC established a small Equity Department to: (i) support investment departments in assessing equity opportunities and structuring IFC equity investments; (ii) monitor developments that may impact equities in emerging markets and report regularly to IFC Management and investment departments; (iii) develop divestment strategies once IFC's developmental role has been completed; and (iv) provide training – building on existing training, a new advanced equity training program was launched in late 2007. The responsibility for each new transaction and management of IFC's existing investments remains with the investment departments, which is consistent with IFC's approach of establishing execution capacity closer to clients.

RISK MANAGEMENT

3.13 As IFC scales up its activities and decentralizes further, management of risk, including maintenance of a sound financial structure and appropriate risk management practices, will become an even more critical issue. In addition to enhancing corporate tools for risk management as described in Section II of the Road Map, steps taken or planned include:

3.14 *Shifting Functions to the Field.* Credit review functions are being shifted to the field to parallel the decentralization of business decision-making. Since the end of 2006, the Credit Department has had two credit officers in Hong Kong covering both East Asia and South Asia; an additional credit officer will be added to Hong Kong in the coming year to accommodate business growth in Asia. In FY08-09, two to three credit officers will be relocated to Istanbul to support investments in Southern Europe and Central Asia (SECA), Middle East and North Africa (MENA), and Central and Eastern Europe, while two credit officers will move to Johannesburg. In addition, six Special Operations officers will be moved to the field to cover the southern cone of South America, MENA, SECA, and South and East Asia.

3.15 *A Formal Criteria-Based Policy.* A formal criteria-based policy for initiating involvement of IFC's Special Operations Department³ in problem investments was established last year and is being implemented on an enterprise-wide basis. The department is composed of a small number of workout professionals who have extensive experience in handling jeopardy projects. The department has also undertaken a review of actions needed to prepare for possible crises, and has designed contingency crisis response plans based on scenarios.

3.16 *Streamlining Business Processes.* This aims to increase productivity and enhance client responsiveness, and at the same time strengthen internal controls and operational procedures to promote accountability.

3.17 *Strengthening of Information Technology (IT).* As IFC responds to changes in markets and growth, the judicious and creative application of information technology (both hardware and operational tools) is essential to its success. Improving effective communication methods between field offices, along with IT infrastructure changes to support more efficient and effective document processing and management; are also important. As IFC continues to move its operations closer to its clients, IT capabilities will be essential to ensuring that the Corporation's global expertise is available to local clients. Simultaneously, decentralized operations demand more rigorous risk management, which can only be achieved through more sophisticated and robust business intelligence capabilities. All of this will require a different approach to developing and deploying IT assets. Steps taken to date include:

- Improvement in the reliability and performance of the core operational workflow application, iDesk, especially in remote field areas with difficult connections to corporate networks;
- Several improvements to the underlying software architecture to facilitate alternative decision making processes and enforce operational accountability in regions where there is delegated authority; and
- The communication networks themselves are methodically being redesigned and redeployed to facilitate country office to country office communications by linking them directly through a virtual web, rather than the traditional approach of having all communication links flow to headquarters in a hub-and-spoke model. This allows for more reliable communications among the many field-based specialist staff at substantially reduced cost.

³ The department is comprised of a small number of workout professionals who have extensive experience in handling jeopardy projects.

3.18 Looking ahead, the Corporation's IT function will focus on building Corporate-wide platforms, based on commercially available software implemented through outsourcing partners, rather than its traditional approach of building customized applications focused on individual departments. Some smaller, department-specific systems will still be required, but will be pursued on an exception basis rather than as a rule. This revised operating model is designed to mitigate operational and technological risk across several categories. Commercial software benefits from substantial ongoing vendor investment to enhance functionality, improve security and leverage new technology, which greatly extend the useful life of IT investments. Widely deployed software has a larger pool of skilled resources available in the market, lowering the Corporation's reliance on a single person or partner. Most importantly, these benefits create a virtuous cycle that will improve the responsiveness of IT to dynamic business requirements.

3.19 Setting the stage for this changed approach, the Corporation completed a thorough review of its IT operating model, sourcing strategy and organization structure during the first half of FY08. New approaches to each were initiated and implementation is well advanced. Staff skills and sourcing strategies are being aligned with market best practices to better leverage the deep understanding of IFC's unique business requirements with the broad industry knowledge of IFC's outsourcing partners. The convergence of all these factors has greatly improved the ability of the Corporation's IT functions to support Corporate-wide initiatives spanning multiple operational units.

3.20 *Integrating Carbon Footprint, Development Impact and Financial Risk-Return Framework.* IFC is moving toward analytical integration of its carbon footprint and its development impact with its financial risk-return framework and enhanced reporting of all metrics to support pro-active and strategic decision-making over time. The various elements of this new framework are in the process of being developed and will be brought to the Audit Committee and/or the Board as appropriate in due course.

3.21 IFC is now using the Board-approved Capital Pricing and Risk (CAPRI) economic capital approach for capital adequacy, capital allocation and internal risk management purposes⁴. The external auditors have also approved the use of this approach for setting loan loss general reserves. This approach brings IFC in line with industry best practice in the measurement of risk. The rating agencies have endorsed this approach for capital adequacy.

PROGRESS WITH THE FIVE PILLARS

Pillar 1: Strengthening the Focus on Frontier Markets

3.22 **Frontier Markets.** Frontier markets continue to be the focus of IFC's investments and advisory services programs. Over the last year, IFC has scaled up its activities aimed at creating opportunities in frontier markets. In addition, new important initiatives approved in FY07 include the IDA/IFC Secretariat, and InfraVentures, and IFC is also developing the IDA SME Equity Funds, (all as discussed in the IFC Road Map, FY09-11). IFC is also focusing on frontier regions in non-IDA countries such as north-east Brazil and Western China.

3.22.1 *Significant Increase in IDA Country and Frontier Region Commitments.* In FY07, commitments in IDA countries amounted to \$3 billion (\$1.6 billion in FY06) and 44% of advisory expenditures were in IDA countries. The number of projects in IDA countries accounted for 44% of IFC's total projects. Commitments for FY08 are expected to increase further. In FY07, commitments in frontier regions accounted for 10% of total commitments (8% in FY06) and are expected to increase slightly in FY08.

3.23 **Progress in Sub-Saharan Africa.** IFC has continued to make significant progress in supporting private sector development in Sub-Saharan Africa. In FY07, IFC doubled its

⁴ "Proposed Modifications to IFC's 1994 Capital Adequacy Framework," IFC/R2007-0093, April 25, 2007.

commitments from FY06 to almost \$1.4 billion and expects these to continue growing in FY08. Total commitments in the first half of FY08 were \$689 million. Key sectors behind the growth are financial markets, infrastructure and extractive industries.

3.23.1 *First Local Currency Bond Offering.* In mid-FY07, IFC issued its first local currency bond offering of \$45 million equivalent in Sub-Saharan Africa, and became the first nonresident international financial institution to issue a Communauté Financière Africaine (CFA) franc-denominated bond in West Africa. This bond issue broadens IFC's ability to meet client demands in the region through long-term local currency debt, and provides a model for future issuers, helps deepen the capital markets, and supports long-term local currency financing for local companies. The proceeds from this issue will be used to finance a variety of companies throughout the West African CFA zone.

3.23.2 *Expanding Country Coverage.* In FY07, IFC continued to move into smaller and more difficult countries. It committed projects in Angola, Burkina Faso, Guinea, Malawi and Rwanda, and in the first half of FY08, the Gambia, Liberia and Sierra Leone. In the past one and a half years, IFC has made 78 investments in a total of 27 countries in the region; 81% of these projects by number and 74% by volume are in IDA countries. The Global Trade Finance Program has allowed IFC to increase its reach to smaller and more difficult frontier markets like the Gambia, Liberia and Sierra Leone.

3.23.3 *Expanding Advisory Services.* There are a total of 68 Private Enterprise Partnership (PEP)-Africa programs currently being implemented. Priority areas for PEP-Africa are: (i) BEE; (ii) post-conflict countries; (iii) agribusiness; and (iv) health and education. In post-conflict countries, PEP-Africa is focusing on replicating proven concepts in improving business environments and developing the SME sector.

3.23.4 *Improving Access to Finance.* This continues to be the main strategic objective for financial markets investment and advisory services in Sub-Saharan Africa. IFC has expanded its Africa MSME Finance Program (see paragraph 3.53.1) with projects in Burkina Faso, Malawi, Nigeria, and in Central Africa. IFC has also implemented guarantee facilities under the joint IDA-IFC MSME program in Madagascar, and in FY08, Ghana, Mali, and Senegal. In FY07, IFC supported the establishment of six new microfinance banks, which in turn provided about 9,000 loans to micro-entrepreneurs reflecting an outstanding portfolio of roughly \$5 million. By FY11, IFC expects that a network of 15 microfinance banks across Sub-Saharan Africa will provide access to financial services for over 500 micro-entrepreneurs with a combined outstanding portfolio of \$250 million. The Global Trade Finance Program has grown rapidly, providing credit enhancement to banks in their correspondent banking relationships, which are particularly valuable in higher risk countries (see Box III-15).

3.23.5 *Developing Innovative Projects Combining Investment and Advisory Services.* IFC's proactive investment development efforts, combining investments with value-added through advisory services, have spurred innovation with projects such as: (i) Lonmin in South Africa, helping a major mining company improve its development impact through an active community linkages program, gender initiative and social development component; (ii) TUHF housing, IFC's first energy efficiency housing program in South Africa, which assisted developers in introducing energy efficiency in their renovation of decrepit downtown high rise buildings in Johannesburg for conversion to housing; and (iii) the Africa schools projects, pioneered in Ghana and Kenya, and now being replicated in Rwanda (see paragraph 3.50.2), providing financing through local banks to small private schools along with advisory assistance to help the schools better manage their growth.

3.23.6 *Strengthening and Building New Partnerships.* IFC has a productive relationship with the World Bank in Sub-Saharan Africa. The main areas of collaboration are: (i) Investment

Climate work – where all projects are developed in collaboration with the World Bank; (ii) Infrastructure and Information and Communications Technologies – on large-scale projects such as Bujagali, Inga3, EASSy projects; (iii) the IDA-IFC MSME pilot program, which has led to seven joint projects with IDA credits and IFC participation; and (iv) Extractive Industries – on large projects in Democratic Republic of Congo and Guinea and in community development as in Lonmin. IFC has strengthened its collaboration with the African Development Bank, for example, by: (i) providing joint financing for Nedbank, to help the bank expand its services to poor consumers and MSMEs; (ii) helping plan and finance three large power projects in Cameroon, Senegal, and Uganda; and (iii) on advisory services, jointly implementing a program for women entrepreneurs in Kenya. IFC is actively developing co-financing arrangements with the newly created Africa Finance Corporation, which has an initial focus on Nigeria.

3.23.7 *Supporting Investment Climate Reform.* In FY07, IFC undertook programs in 22 countries, with large-scale, comprehensive programs in eight of those countries. IFC hosted the first Africa Reformers' Club awards ceremony in Burkina Faso in November 2007, bringing attention to those African countries implementing business enabling environment reforms in the region.

3.23.8 *Decentralization of Operations.* Operations in Sub-Saharan Africa continue to be decentralized in anticipation of full Global-Local implementation beginning in FY09. In FY07, new IFC offices were established in Democratic Republic of Congo and Liberia, and Advisory Services staff was placed in Rwanda, Sierra Leone and Zambia.

3.24 **Progress in Middle East and North Africa (MENA).** IFC continued to scale up its investment and advisory services operations in the MENA region. The volume of annual investment commitments in MENA grew from \$315 million in FY05, \$668 million in FY06, to \$1.2 billion in FY07, and to around \$1.3-1.5 billion estimated for FY08.

3.24.1 *Reaching more IDA Countries.* In FY07, nearly one third of IFC's commitments were in three IDA countries – Afghanistan, Pakistan and Yemen – and in frontier regions in Egypt. In FY08, IFC expects to commit up to 30% of its investments in IDA countries and frontier regions despite some turmoil in countries such as Pakistan.

3.24.2 *South-South Investment Activity.* In addition to generating business in the region, IFC played a key role in catalyzing South-South investments to Sub-Saharan Africa and Asia. IFC is currently considering a greenfield cement project in Ethiopia with a Saudi Arabian sponsor. In order to encourage further South-South investments, in FY07, IFC organized meetings between Moroccan investors and business developers from IFC's Sub-Saharan Africa department.

3.24.3 *Advisory Services.* PEP-MENA is providing a platform to leverage partners' resources in delivering Advisory Services to IDA countries particularly in: (i) improving the business environment; (ii) providing enhanced support to the underserved such as SMEs; and (iii) supporting women entrepreneurs. In Jordan, PEP-MENA provided advisory services to Jordan's Microfund for Women, and one of IFC's clients (Egypt's Commercial International Bank) has joined the Global Banking Alliance for Women as the first member from MENA trying to reach out to women clients at the SME level. In addition to the advisory services associated with IFC's investment projects, PEP-MENA continued to engage in many projects in IDA countries including: (i) Afghanistan – working with authorities to put in place leasing; supporting farmers and traders in Kandahar to improve production and participate in international markets; (ii) Pakistan – strengthening the business enabling environment through initiatives in alternative dispute resolution and corporate governance; building capacity of financial intermediaries for housing finance; and providing access to finance to MSMEs; (iii) Yemen – building the

capacity of seven Business Edge⁵ training providers who have sold 17,587 training seats to Yemeni SMEs and entrepreneurs; undertaking policy reform projects in three areas: business start-up procedures, tax administration and mining policy; promoting leasing as a means to increase access to finance for MSMEs.

3.25 Post-Conflict Countries Initiatives. IFC continues collaborating with the World Bank and MIGA in engaging the local private sector from the outset in rebuilding conflict-affected countries. The World Bank Group approach is focusing on improving the investment climate supporting SME development and exploring opportunities in infrastructure and in health and education. Access to finance and the trade finance programs are also key elements of IFC's approach.

3.25.1 *Sub-Saharan Africa.* Implementation of the post-conflict initiative in four countries is proceeding well, with new investments identified and committed, and new advisory programs put in place.

- Central African Republic. IFC recently supported a regional telecommunications investment which will include a CAR component, initiated an SME capacity building program with the Chamber of Commerce, and started an investment climate reform program.
- DRC. IFC's country office is assisting in realizing new mining investments, supporting an ongoing SME program, and initiating an investment climate advisory program.
- Liberia. IFC has developed a partnership with the government, providing support with a comprehensive BEE advisory program, advisory support on introducing private participation and management in the electricity sector, assistance in reviewing natural resource concession policy, and other areas. New progress was made with the first investment booked in a trade finance guarantee for a Liberian bank, and the establishment of a new microfinance bank pending resolution of regulatory issues. An IFC office has been established in Liberia and is operating out of the World Bank office.
- Sierra Leone. IFC has expanded BEE advisory services to include support for the Business Forum, structured dialogue between government and the private sector on improving the business environment, and secured implementation of business startup simplification last year. IFC recently booked the first trade finance guarantee and is supporting a microfinance bank.

3.25.2 *Middle East and North Africa.* IFC has been undertaking investment and advisory activities in four conflict-affected countries in MENA. In addition to activities in Afghanistan mentioned above, IFC is engaging in Iraq, Lebanon and West Bank and Gaza.

- Iraq. IFC is partnering with the Iraqi American Chamber of Commerce and Industry to deliver Business Edge management training to SMEs; carrying out an assessment in cooperation with UN-HABITAT to determine the feasibility of a joint engagement to streamline regulatory procedures, enhance access to finance and provide firm-level assistance in the housing sector. This initiative builds on the Iraq Housing Construction Sector Study implemented jointly by the World Bank, the UN and IFC.
- Lebanon. IFC is rebuilding the investment and advisory services program, which was started immediately after the ceasefire (in late August 2006). Activities include: (i) a total of \$200 million investment program with four partner banks; (ii) \$75 million increase in funding under IFC's existing Global Trade Finance Program; (iii) one investment in a retail company; (iv) advisory support to the government's SME guarantee agency, Kafalat; (v) advisory services for an IPP; and (vi) corporate governance program focusing on improving transparency and

⁵ This is the brand name of IFC's management training products and services specially designed for owners and managers of SMEs. First launched by IFC in Asia, this product has been adapted for MENA and is available in Egypt, Iraq, Jordan, Oman, Palestine, UAE, and Yemen.

management practices in the private sector. Going forward IFC will focus on implementation of programs and will engage selectively in new activities.

- **West Bank and Gaza.** IFC has maintained its activities in West Bank and Gaza. In line with the renewed engagement of the international community the peace process and development of West Bank and Gaza in late 2007, IFC has explored opportunities to support the private sector. Advisory services activities are being undertaken in: (i) strengthening the olive oil sector by assisting bottling firms to improve production management; (ii) implementing a leasing sector development project; and (iii) supporting the microfinance sector. Looking ahead, IFC plans to collaborate with Overseas Private Investment Corporation and the Palestinian Investment Fund on investments in the financial sector focusing on housing finance and introducing the trade finance program to local banks.

3.26 Agribusiness. IFC provides additionality through risk mitigation, innovative financing (e.g. wholesaling) as well as expertise in safety, environmental and social standards. IFC's convening power to promote global public goods by, for instance, catalyzing the emergence of global commodity initiatives that require the broad support of multiple stakeholders (producers, traders, consumers and civil society) helps address commodity-specific emerging environmental and social issues. IFC can thus extend its impact well beyond its individual investments. (See paragraph 3.36 for more discussion of agribusiness and sustainability). IFC is also aiming for high additionality in the sector by strengthening supply chain development advisory services directly benefit more farmers. In FY07, IFC committed \$628 million in 23 projects (compared to \$456 million in 21 projects in FY06).

3.26.1 *Increasing Involvement.* IFC intends to increase its involvement in agribusiness and extend its reach to a wider range of companies and beneficiaries by being more programmatic in its approach and more ambitious in its initiatives, such as developing wholesale financing solutions using processors and traders as well as financial intermediaries. For the first half of FY08, it committed \$247 million in 13 projects, which will provide direct employment for more than 71,000 individuals, reach over 14,000 farmers and over 7,000 downstream SMEs.

Pillar 2: Building Long-Term Partnerships with Emerging Players in Developing Countries

3.27 Developing South-South Investments and New Projects. IFC's ability to remain engaged with clients through their business cycle and changing market environment is often cited by clients as an important aspect of IFC's additionality. Promoting South-South investments continues to be a priority for IFC as they help the spread of knowledge and expertise between developing countries and help the investing company become more sophisticated as it grows. DOTS data shows that repeat investments with the same clients have tended to have better development outcomes. IFC also adds value to these clients through its knowledge of the markets they wish to move into and its expertise on environment, social and corporate governance standards.

3.27.1 *South-South Investments.* IFC's South-South investments reached \$1.3 billion in FY07 (\$673 million in FY06) and are expected to continue growing in FY08.

3.27.2 *New Clients.* In FY07, 48% of the total number of commitments were with new clients, and further decentralization will have an impact in reaching larger numbers of new clients in future.

3.27.3 *New Projects with Existing Clients:* About 63% (50% in FY06) of the total number of commitments with existing clients involved IFC financing for new projects being developed by them, enabling IFC to promote its sustainability agenda and expand the development impact of IFC-supported projects. Excluding these, repeat projects account for only 19% of the total in FY07 (22% in FY06).

3.28 **Linkages.** Linkages programs are partnerships among IFC, large investment clients, SMEs, and rural communities, which are strengthening long-term competitiveness of local entrepreneurs. The Linkages Program aims to maximize the development impact of IFC's investments by: (i) integrating local SMEs into the supply chains of investment clients; (ii) improving the ability of small farmers to meet global standards, including food safety; and (iii) supporting implementation of technologies which reach the poor. The Program also helps to mitigate risks in large investment projects by helping companies obtain a "social license to operate" through: (i) the creation of income generating opportunities; and (ii) other local economic development programs for communities around clients' project sites. These objectives are carried out through a mix of interventions, such as local supplier development programs, training in business/technical skills for micro/SMEs, facilitating SMEs' access to finance and entry into new markets, as well as health and wellness programs on HIV/AIDS, malaria and others.

3.29 The Program focuses on: (i) IDA/conflict-affected countries, such as Guinea and Democratic Republic of Congo, where the Program is closely working with investment teams to identify opportunities and design interventions which will enable local businesses also to benefit from the new economic growth; (ii) standard setting, productivity increases, and wholesale farmer/financing in the agribusiness sector; (iii) climate change areas, such as sustainable farm forestry projects using carbon sequestration; (iv) use of technology to allow remote/rural areas and communities to access information through village phones, mobile banking and e-procurement projects; and (v) expanding knowledge sharing in partnerships with corporations through benchmarking, development and publication of manuals documenting successful experiences (e.g. MozLink-Business Linkages Manual with Mozal/BHP Billiton; Chad E-Procurement Manual with Exxon-Mobil; and Risk Capital Facility Manual with Anglo-American), and use of branded training tools (e.g. IFC Business Edge and SME Toolkit with IBM).

Box III-4: Examples of Linkages

Cairn India: Supporting Communities and Linking People

IFC and Cairn India, a leading oil and gas exploration company, have mobilized a transformation in the rural communities in Barmer, a remote district of Rajasthan, one of India's poorest states, by putting in place a linkage program that focuses on local supplier development, child and maternal health care, and dairy development. At the core is an Enterprise Center that provides training and information to help local small and medium firms become suppliers to Cairn and generate economic opportunities across the region. A thousand people, nearly half of them women, received vocational training in the first six months, with 60% obtaining new jobs.

ECOM Agroindustrial Corp. Ltd: Improving Agricultural Supply Chain in Central America

IFC, ECOM - the third largest coffee trader in the world - and Nestlé are developing a partnership to support small coffee farmers in Nicaragua and Southern Mexico to improve their sustainable practices and productivity levels. In the first year, over 4,000 farmers were trained, leading to payment of US\$930,000 in sales premiums by Nespresso, Nestlé's highest quality coffee brand. ECOM and IFC are discussing possible replication of similar linkage projects in other regions, including Africa.

3.29.1 *Increasing Reach.* By the end of FY07, the Program had helped SMEs win 1,750 contracts valued at \$1.3 billion, enabled \$25 million in financing to over 200 SMEs, and created over 2,600 jobs. As of December 2007, the Program had 66 projects (20 in IDA countries) under implementation and development, related to IFC investments of over \$2.2 billion. Clients, who value this important role of working with supply chains, are prepared to pay IFC for the service. Client contributions now represent about 50% of total funding, with IFC and other sources contributing 19% and 31%, respectively.

3.29.2 *Business Linkages Roundtables.* The Program, in partnership with the Harvard Kennedy School and the International Business Leaders Forum (IBLF), holds semi-annual Business Linkages Roundtables where corporations assemble and collaborate on sharing lessons and standardizing approaches to local supplier and community development around large investments in developing countries.

3.30 IFC Against AIDS. From its inception as a specialized advisory service, the mission of IFC Against AIDS has been to protect people and profitability by being a risk management partner, HIV/AIDS expert and catalyst for action where HIV/AIDS threatens sustainable development. The program helps develop the capacity of IFC clients to implement HIV/AIDS workplace and community programs, and will expand its services to advise clients on wellness issues (particularly in Sub-Saharan Africa) and basic health management issues (particularly in India).

3.30.1 *Increasing Reach.* As of January 2008, IFC Against AIDS had reached a total of 88,000 employees and an estimated outreach of over 628,000 communities.

3.30.2 *Integration with other IFC Advisory Services.* Systematic efforts are currently being undertaken to integrate the program within other IFC Advisory Services offerings, such as the Linkages Program, the Mozambique SME Initiative, SME Solution Centers, and the African Banking initiative. In the short to medium term, the program will seek to develop corporate and local NGO partnerships in priority countries to ensure rapid availability of localized services to clients.

3.30.3 *Independent Evaluation.* In December 2007, IFC initiated a comprehensive independent evaluation across Sub-Saharan Africa to evaluate the program's effectiveness and assess operational development priorities to support the expansion.

3.31 Corporate Governance. IFC's corporate governance assistance continues to be an important value-added for its clients. It is also an important contribution to both portfolio quality and long-term investee performance.

3.31.1 *Standard Setting.* In FY08, IFC hosted the signing of a Corporate Governance Approach Statement by 31 Development Finance Institutions (DFIs), committing the signatories to define and improve their approach to corporate governance in their investment strategies and operations. In FY09, IFC will work with its partners to expand the scale and scope of this cooperation and cement further its leadership position in this area.

3.31.2 *Enhancement of Corporate Governance Methodology.* In FY08, IFC revised its Corporate Governance Methodology to include tools that will allow investment staff to identify better corporate governance risks in investments. Training on the revised methodology will be conducted in FY09.

3.31.3 *Policies on Director Nomination.* In FY09, IFC will take steps to develop further the policies on director nomination, including a standard scoring system to aid in deciding when to nominate a director, improving the pool of potential nominees and rules surrounding the selection of nominees and devising a standard approach to budgeting for directorships when IFC does decide to nominate.

3.31.4 *Reaching a Wider Audience.* In addition to working directly with its own investment clients, through its Corporate Governance Advisory Services projects, IFC reaches a much wider audience, including governments, regulators, stock markets, institutes of directors and other private sector players, on corporate governance issues in emerging markets.

3.32 Governance, Anti-Corruption and Anti-Money Laundering/ Combating the Financing of Terrorism. IFC is working with the rest of the World Bank Group in the area of anti-corruption. It has implemented and is strengthening its Action Plan on Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) approved by the Audit Committee and the Board in 2005. Additional strengthening is based on the recommendations of Internal Audit Department and an independent consulting firm's report on IFC's AML/CFT strategy conducted in FY07.

3.32.1 *Involvement in World Bank Group-Wide Implementation on Governance and Anti-Corruption Strategy.* IFC is actively involved in the World Bank Group-wide implementation

of the Governance and Anti-Corruption strategy, including participation in the Governance Council and the Volcker Panel Working Group, and will be launching an anti-corruption toolkit for IFC staff to help their clients.

3.32.2 *More Focused Integrity Due Diligence Process.* IFC has developed a more focused Integrity Due Diligence Process for all projects, which is currently being piloted in Central Asia and Southern Europe and expects to deploy it corporate-wide in FY08.

3.32.3 *Strengthening the AML/CFT Risk Mitigation Framework.* To support decentralization and strengthen further its AML/CFT risk mitigation framework, IFC is focusing on improving staff's ability to: (i) evaluate and assess the risks of money laundering and terrorist financing; and (ii) introduce appropriate AML/CFT measures within projects.

Pillar 3: Addressing Climate Change and Environment and Social Sustainability

3.33 IFC continues to focus strongly on promoting its sustainability agenda through implementation of improved environment and social risk management policies and processes, expansion of a network of global partnerships, and incorporation of innovative products into corporate and sector strategies with large environmental and social impacts.

DEVELOPING CORPORATE AND SECTOR STRATEGIES

3.34 **Climate Change.** IFC has been an active collaborator with the World Bank in reporting to the Board on progress on the Clean Energy Investment Framework and in the first half of FY08 began formulating more specific elements for its strategic approach to climate change while continuing to support the larger efforts for an overall World Bank Group approach, which is expected to be completed in FY09. (See Section IV: IFC's Approach to Climate Change).

3.34.1 *Sustainable Energy.* With the Global Environmental Facility (GEF) and other donor support, IFC has been a leader in the development of innovative private sector business models and financing instruments designed to deliver environmental benefits, including clean energy. In FY07, IFC committed \$135 million in Sustainable Energy through financial institutions in seven projects, and expects to scale up in this area. Recently, IFC has also co-produced the annual clean energy progress report required as part of the World Bank Group's "Bonn Commitment" to increase clean energy lending by 20% per year, which for the first time focused on the importance of private sector investment and included numerous examples from IFC projects. As part of its commitment to share the benefits of its experience, IFC also produced a new publication "Selling Solar: Lessons from More than a Decade of IFC's Experience".

3.34.2 *Carbon Finance.* Carbon finance is an important element of IFC's approach to climate change. IFC currently manages \$185 million in two carbon finance donor-funded facilities. About \$100 million has been committed in eight projects and the balance will be fully committed by the end of FY08. IFC is also structuring on-balance sheet financial products for the carbon market, including the flagship Carbon Delivery Guarantee (CDG). As of December 2007, four projects had been approved by the Board and the first CDG transaction was committed in December 2007. IFC also expects to offer carbon-market-related advisory services to its clients, especially municipalities and financial institutions.

3.34.3 *Cleaner Technologies/Cleaner Production.* IFC's Cleaner Technologies investing focuses mainly on supporting small, high risk ventures with accelerated technology transfer and commercialization of intellectual property. IFC has directly invested in areas of increasing strategic interest, such as the water sector (see Box III-5), structured investments in "Cleantech" funds and has had an influential role in guiding the World Bank's incipient work on accelerating clean energy technology innovation. IFC's Cleaner Production technical assistance

work reduces the environmental footprint of its clients in a commercial manner. IFC is working on rolling out Cleaner Production on a wider scale, including: (i) launching a new small Cleaner Production loan investment product; (ii) launching Cleaner Production Technical Assistance programs in the regions; and (iii) launching a delegated authority pilot in general manufacturing sectors to provide small loans to existing clients, in support of Cleaner Production investments. IFC would aim to replicate this in other sectors on a programmatic basis.

Box III-5: Investing in Water

Provision of water has been a difficult area for the private sector to work in over the last decade, and increasingly a strategic area for IFC. Within this area access for the underserved has been a challenge that few private sector actors have been able to address in a financially sustainable manner.

WHI is a young company which supplies healthy drinking water to the underserved by leveraging new technology and using an innovative business model. IFC's Cleaner Technology group first engaged with WHI in November 2002 with a grant which was followed by a \$1.2 million equity investment in July 2004. IFC was WHI's first institutional investor and the period of our engagement has seen WHI increase turnover from just under \$100,000 in FY04 to \$3.8 million for the first ten months of 2007 and transform from an equipment supplier to a water provider. WHI now supplies about three quarters of a million low-income people with affordable and healthy drinking water in urban and rural contexts in India, Philippines, Mexico and Sri Lanka. WHI targets expansion of its services to about 10 million in the next three years.

3.35 Extractive Industries. Extractive industries are important for many of the poorest countries. While they hold enormous development potential, there are also well-recognized challenges. Engagement with these industries is highly complex, requiring diligent environmental management, as well as taking sensitive and inclusive approaches that generate sustainable benefits for local communities. IFC helps extractive projects achieve broad local support through careful mitigation of environmental and social impacts, including proactive engagement with affected communities to ensure that benefits are felt locally. IFC also helps its clients handle the diverse impacts of these complex projects, such as protecting the water supply and biodiversity, and managing resettlement. IFC broadens the positive impact of its projects through programs that link local businesses with these projects. With the World Bank, it also works to help ensure that revenues are accounted for and managed well. High oil and metals prices continue to drive strong investment flows and demand for IFC financing in this sector, especially from local and smaller international companies. IFC's activities continue to be guided by the Management Response to the Extractive Industries Review.

3.35.1 *Supporting Community Development.* To date, CommDev⁶, a program that engages and empowers local communities and government around IFC's investments in extractive industries, is implementing seven advisory service programs, in Colombia, Democratic Republic of Congo, Guatemala, Guinea, Madagascar, Peru, and South Africa. CommDev has also launched its Information Clearinghouse⁷, which supports its public learning goods/training materials for developing and implementing community development strategies in response to client needs.

3.35.2 *Governance and Revenue Expenditure Continue to be Key.* High revenue flows to governments are offering the opportunity for greater spending on development. The key continues to be governance, and in particular, the management of tax and investment flows, and ensuring that revenues are spent well. On a country basis, IFC is addressing these challenges in partnership with the World Bank, through its own focus on transparency, support for global initiatives such as EITI, and, in a number of countries, through support for local governance capacity building. At the community level, IFC's focus is to ensure that communities benefit from projects that impact them and in many of its projects, to continue working with investors and others to broaden the positive impacts of extractive industries developments.

⁶ IFC/World Bank Oil, Gas and Mining Sustainable Community Development Fund (CommDev)

⁷ www.commddev.org

3.35.3 *Helping Smaller Companies.* As part of the effort to enhance its additionality, IFC has in recent years increased investments in smaller companies in the extractive industries. IFC's willingness to take risks through equity, combined with its ability to provide value added services, particularly at early stage project development, has helped smaller companies facing constraints to access to capital. IFC also provides advice and assistance in key areas such as environmental and social performance based on its broad practical experience in developing countries. These companies, particularly in the mining sector, are playing a very important role in many of IFC's frontier markets. Commitments in such companies over the last five years amount to as much as 32% of IFC's total investments in the sector, and the share is expected to grow further.

3.35.4 *Implementation Progress Report.* Following the third meeting of the World Bank Group EI Advisory Group in September 2007, IFC made its third implementation progress report to the Board at the beginning of 2008.

3.36 **Agribusiness.** 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 natural resources. IFC will continue to add value in raising its clients' awareness of environmental and social sustainability issues and its assistance on these issues is being increasingly sought by companies that aspire to a higher level of social responsibility. At a global level, IFC continues to support an initiative launched in FY04: "Better Management Practices" for commodities (palm oil, sugar, soybean, and meat), which has mobilized a wide range of stakeholders, including IFC clients, and has established roundtables to develop a consensus view on better management practices in their respective industries. This progress has attracted the attention of other industry groups, such as those active in the cocoa sector, which are now contemplating instigating a similar process.

3.36.1 *Addressing the Growing Divide between Small and Commercial Farmers.* IFC is addressing the growing divide between small farmers and commercial farmers by focusing on supply chains and projects with strong links to individual farmers and promoting the emergence of commodity initiatives that need the support of multiple stakeholders to ensure sustainability. In addition, to broaden the impact on small farmers, IFC will continue to work with trading companies and financial intermediaries to channel financing and advisory services.

3.36.2 *Addressing Environmental and Social Challenge in the Supply Chain.* IFC will continue to support private sector partners to find solutions that address major environmental and social challenges in their supply chain. This is facilitated by the fact that export markets are increasingly requiring higher levels of food safety (e.g. traceability) as well as environmental and social responsibility from their suppliers. IFC's ultimate objective is to help its partners set benchmarks of responsible production for the sector that then become widely adopted throughout the industry.

3.37 **Gender Entrepreneurship Markets (GEM).** Three years since its inception, IFC's Gender Program is demonstrating that it makes good business sense for IFC to become more responsive to the needs of women in business. Through investments, advisory services and policy work, IFC is working to increase women's full participation in the private sector. IFC's Gender Program's activities are aligned with the World Bank Group Gender Action Plan (GAP). IFC hosts the Secretariat of the Global Banking Alliance for Women (GBA), a coalition of financial institutions that have successfully leveraged the women's market for profit and social good.

3.37.1 *Progress in Sub-Saharan Africa.* Thus far, under the GEM program, IFC has committed \$41 million to institutions in several countries to be on-lent to women entrepreneurs, trained over 500 women in business skills, contributed to the re-drafting of laws in Uganda and Kenya, and worked with two clients in the mining industry to implement gender inclusive strategies.

3.37.2 *Expanding Approach to Other Regions.* IFC will focus on expanding its approach, initially piloted in Sub-Saharan Africa, to other regions. IFC has now committed to standard gender indicators to be tracked in DOTS across industry departments and advisory services.

Box III-6: Access to Finance for Women Entrepreneurs

Julian N. Adyeri Omalla is the founder of Delight Uganda Limited, a firm that started small but today employs more than 400 people. The firm started with juice production and expanded to supply a range of food and cereals, relying on farming partnerships with rural women. Prior to her relationship with IFC, Julian experienced difficulty accessing finance to grow her business. She did not know how to apply for loans, and was not keeping records in the manner that formal commercial banks require. At the same time, her business was too large to qualify for microfinance. Business training through IFC's program has helped Julian obtain new financing and structure a plan for continued expansion. "The training has made all the difference to my confidence and ability to manage my loan and business. I am now employing 100 more people since getting an IFC Women in Business loan," said Julian.

3.38 **Social Responsibility.** IFC's Social Responsibility practice area identifies scalable products and processes which can achieve high impact addressing market barriers, such as ineffective business models or lack of technical know-how or expertise. The practice supports clients who are committed to engage in local community development and stakeholder engagement, sustainability and reporting, and leads IFC's work on labor and human rights (see Box III-7).

Box III-7: IFC's Better Work Program

Upholding international labor standards is becoming increasingly important for local suppliers to compete in global markets and also may also lead to enterprise quality and productivity improvements. This is particularly important for IFC as it works to implement Performance Standard 2 on labor. IFC partnered with the International Labor Organization (ILO) to launch the Better Work Program in August 2006 with the goal of improving labor standards and competitiveness in global supply chains. Better Work supports enterprises in improving their labor standards based on national labor law and core ILO labor standards. It provides independent needs assessments and capacity building services to help local companies compete in global markets where most international buyers demand compliance with labor standards from their suppliers. The Program develops sustainable solutions while building cooperation between government, employer and worker organizations, and international buyers. IFC and ILO will pilot Better Work in the apparel industries in Lesotho, Vietnam and Jordan, where the launch is expected early February 2008. The pilots alone are expected to establish best practice labor standards in industries key to the economy of these countries and will impact approximately 800,000 workers across 800 factories overall. Future Better Work industries may include: agribusiness, light manufacturing, transport, construction, and electronics.

3.39 **Sustainability in Financial Markets.** IFC's approach is two fold: (i) developing markets, products and business partnerships with the expectation that as new products mature they could be scaled up; and (ii) scaling up and mainstreaming the products where there is sufficient experience and up-take from the market. The target sectors for sustainability finance include: (i) climate change and sustainable energy (including energy efficiency and renewable energy); (ii) cleaner production; (iii) corporate governance and equity investments in MSME banks; and (iv) sustainable supply chains.

3.40 Focusing on asset managers and owners, IFC plans to expand its successful efforts in promoting sustainable investing, with particular focus on China and India, through supporting policy changes, knowledge and information tools and new investment products. Initiatives include: (i) working with regulators to encourage the promotion of sustainability risk management frameworks in banks; (ii) providing training to financial analysts and fund managers to incorporate environmental and social sustainability factors into their investment analysis; (iii) supporting market surveys and reports such as the Trucost Carbon footprint study and the Capturing Value report to address information gaps in equity research; (iv) supporting catalytic interventions such as the India Sustainability Index with Credit Rating Information Services of India Limited (CRISIL) to encourage changes in market behavior; and (v) raising the awareness of emerging market companies and their environmental and social practices.

IMPROVING POLICIES AND PROCESSES

3.41 Implementation of Performance Standards. In December 2007, IFC presented to the Board the 18-month Performance Standards Implementation Report (IFC/Sec M2007-0052). IFC's implementation of the new policy framework is sound and the new approach is strengthening projects. Based on data on projects approved by the Board between May 1, 2006, and September 30, 2007. The new tailored approach to risk management permits clients and IFC to specify appropriate and relevant requirements in the Performance Standards (PSs). All aspects of Performance Standards implementation will be further monitored by IFC in FY09 and FY10, and presented to the Board in the Three Year Performance Standards Implementation Report by the end of FY10. The report will be followed by independent reviews of the Performance Standards implementation conducted by IEG, CAO and an external reviewer. These reviews will contribute to the update of Sustainability Policy and Performance Standards for FY10.

3.42 Environmental, Health and Safety (EHS) Guidelines. On December 10, 2007, IFC completed the new version of the 56 World Bank Group Environmental, Health and Safety Guidelines (EHS Guidelines), a technical source of information used during project appraisal. These Guidelines are also used to support the implementation of the Common Approaches of OECD's Export Credit Guarantees, and the Equator Principles Financial Institutions and are in use by the private sector at large. The EHS Guidelines are "living documents" and will be updated on a regular basis.

3.43 Equator Principles. In order to maintain its environmental and social sustainability leadership, IFC will continue to provide support for the further adoption and implementation of the Equator Principles. To date, 56 banks and financial institutions are using the Equator Principles, which have been updated to refer to the new Performance Standards, thus catalyzing the swift convergence of standards for cross-border project finance. In addition, 32 export credit agencies of the OECD countries benchmark private sector projects against the Performance Standards and MIGA recently adopted the Performance Standards for its operations. IFC is sharing its experience and lessons learned in applying the PSs with these institutions, using its convening power to establish and maintain a Community of Learning (COL). In May 2008, IFC will host the second COL event⁸.

Pillar 4: Addressing Constraints to Private Sector Growth in Infrastructure and Health and Education

3.44 Infrastructure. Recognizing the critical role of infrastructure for both economic growth and poverty alleviation, IFC is scaling up its investments in infrastructure. High levels of additionality across infrastructure sectors come from a focus on more challenging market, working on early stage project development, and collaboration with the World Bank on policy advice and developing public-private partnerships. Increased emphasis on expanding the scope in early stage project preparation will be facilitated by rolling out InfraVentures, a \$100 million fund with the aim of ramping up the number of bankable projects in poorer countries. The current pipeline for InfraVentures indicates a strong demand for early stage project support in IDA countries in Sub-Saharan Africa, Central America and Central Asia. Going forward, IFC expects collaboration within the World Bank Group to deepen, especially for regional landmark projects in IDA countries using risk mitigation instruments within the World Bank Group, and for policy advice to governments on Public-Private Partnership (PPP). A strategic priority for IFC will be to "crowd in" the private sector in areas that typically suffer from low levels of private investment – like the water, sanitation, water treatment, waste, and gas sectors. In FY08, new priorities for infrastructure are related to

⁸ The event is being designed by the Planning Committee consisting of representatives of IFC, EPFIs, ECAs and MFIs. The first event was held in May 2007.

addressing climate change, and future focus will be in mainstreaming IFC response across sectors with a particular emphasis on Renewable Energy, Energy Efficiency, sustainable transport, and linkages with the water sector. During FY05-07, the average volume of IFC commitments in infrastructure was \$882 million p.a. The total FY08 commitments in infrastructure are estimated between \$1.8 billion to \$2.5 billion.

3.44.1 *Landmark Infrastructure Projects.* During FY07, IFC has completed several landmark infrastructure projects with significant demonstration and development impact: waste management in Mexico; PPP for water and sanitation in Egypt; privatization using a concession structure in Kenya/Uganda, and Bujagali hydro power project in Uganda (total project cost estimated at \$830 million) in close collaboration with the World Bank, MIGA, AfDB, European Investment Bank (EIB), and European bi-lateral donors. In first half of FY08, IFC completed two further landmark projects: Tanzania Railway and Magat Hydro.

Box III-8: Philippines: Magat Hydro

IFC investment of a \$105 million A Loan will partly finance the privatization of the Magat Hydroelectric Power Plant. This transaction is the first and only privatization deal successfully concluded with significant foreign participation and the first merchant power plant to be financed internationally in East Asia. The project has reinvigorated foreign investors' interest in the country's power privatization program after a decade of inertia, and is expected to continue to support power sector reform by restoring market confidence in the WESM mechanism and the institutional capacity of the Philippines in general. It will also provide proof of concept and demonstration effect of a successful privatization of a large scale merchant hydro power project to other East Asian countries who hesitate to embark in similar sector reform; and support improvement in the operations and the potential capacity expansion of an environmentally friendly source of energy.

3.45 **Advisory Services to Governments.** In close collaboration with the World Bank, IFC provides advisory services to governments in structuring and introducing private participation in infrastructure and social sectors on a sustainable basis. Advisory activity is most concentrated in Sub-Saharan Africa and the Middle East and North Africa, and is often supported by donors, principally the Private Infrastructure in Development Group (PIDG).

3.45.1 *Achievements.* Recent successful assignments have included structuring and implementing a PPP for a modernization and expansion of Lesotho's only full-service hospital, assisting the Government of Kenya in selling a majority stake in its backbone landline telecom network, and the concessioning of the international airport in Amman, Jordan.

Box III-9: Amman's Queen Alia International Airport.

On November 15, 2007, the Airports International Group, a private consortium, took control of the Jordanian capital's airport under an innovative 25-year concession that IFC helped the government structure, and then financed. The World Bank provided significant funding towards the preparation of the project under the USAID trust fund which it administers. The \$700 million project is the largest private investment in Jordan's history and one of IFC's highest-profile projects in the MENA region to date. Building on its earlier experience with airport PPPs in Saudi Arabia and other countries, the IFC advisory team helped the Jordanian government hold a fair and transparent competitive bidding process that attracted five respected industry leaders. Roughly six months later IFC had brought the project to financial close, providing a \$120 million, 17-year loan and mobilizing another \$160 million in a syndication that attracted French banks Calyon, Natixis, and Europe Arab Bank. IFC also worked with the Saudi-based Islamic Development Bank, which provided \$100 million in parallel Islamic financing.

3.45.2 *Continued Demand for IFC Services.* Demand for this type of advisory support continues to grow rapidly, reflecting its importance to IFC member governments, and the unique value IFC can bring to the table in this area, especially in balancing the demands of investors with public policy considerations. IFC expects to conclude over 20 assignments in the coming three-year period.

3.46 ***Subnational Finance***. On August 1, 2006, the Board endorsed a three-year joint World Bank-IFC subnational finance initiative, which was followed by the creation of the joint World Bank-IFC Subnational Finance Department. The program aims to scale up financial and capacity building support to subnational entities and facilitate the development of local credit markets and mobilize local private financing.

Box III-10: PNOC Energy Development Corporation

In December 2006, IFC made a \$50 million equity investment as a cornerstone investor in PNOC Energy Development Corporation, a geothermal power company as part of the state-owned enterprise's initial public offering on the Philippines Stock Exchange. IFC's participation in the IPO was accompanied by advisory support in the area of corporate governance that lead to improvements that went beyond the benchmarks required by the Securities and Exchange Commission and the Philippines Stock Exchange. PNOC-EDC is now a private company and is considering further opportunities for expansion, including outside the Philippines, and is set to become a model for privatizing state-owned enterprises in the Philippines and the wider region. The equity investment supports the Philippine government's goal of privatizing energy sector assets and will improve efficiency and aid expansion in the geothermal energy sector. It will assist the country's efforts to improve its energy mix toward the use of indigenous and renewable sources of energy. The amount raised through the primary offering will be used to rehabilitate, expand, and acquire new equipment for developing geothermal power, a clean and renewable energy source that is also cost competitive. Additional investments by PNOC-EDC that the IPO will support should help reduce the cost of power in the Philippines, contributing to private sector competitiveness, and make electricity more affordable for low-income households.

3.46.1 ***Catalyzing Investments in Infrastructure***. To date, IFC has concluded eight subnational transactions for a total of \$285 million, and catalyzed over \$800 million in infrastructure investments in Latin America, Sub-Saharan Africa, Eastern Europe and East Asia. In FY07, IFC successfully provided support to the geothermal arm of the Philippines National Oil Company's (PNOC), both as a cornerstone equity investor and on governance-related advisory services (see Box III-10). IFC also provided local currency financing to the Chuvash Republic in Russia to support critical investments in the roads sector. This will help improve access to schools, hospitals and other services to 90% of local communities by building and upgrading about 400 kilometers of all-weather roads in rural areas.

3.46.2 ***Scaling Up***. In partnership with the World Bank and other donors, IFC is setting up a dedicated facility for advisory services to assist municipalities to improve their creditworthiness, build their capacity and prepare viable projects.

3.47 ***Performance-Based Grants Initiative (PBGI)***. In December 2007⁹, IFC's Board of Directors authorized the drawdown of the remaining \$182.8 million of retained earnings as follows: (i) \$97.8 million to the Access to Infrastructure/Global Program for Output-Based Aid (GPOBA) component of PBGI; and (ii) \$85 million to the Access to Finance component of PBGI. As a result, IFC expects to enhance significantly access to basic services and increase its reach to MSMEs. Although results from the initial pilot phase were not fully available at this time, early indications were good. IFC is planning to provide the Board with an assessment of development effectiveness and IFC's long-term strategy in this area in December 2008. This initiative allows IFC to demonstrate the practicality of output-based aid approaches and foster adoption of such approaches among other development institutions, which remains a key objective of the initiative.

3.47.1 ***Access to Infrastructure and Finance***. Projects are expected to provide access to essential services to about 550,000 low income households, 80% of which in IDA countries, and all with daily household incomes of less than \$2/person. Taking into account the MSME portfolios of only the four most advanced banks in the Africa MSME program, more than 150,000 MSME loans, totaling approximately \$1.47 billion, are expected to be granted over five years.

⁹ Approved by the Board in May 2006, (IFC/R2007-0333).

3.48 Information and Communications Technologies (ICT). Developing countries, including poorer ones, have enjoyed rapid technological progress over the last two decades. With telephone networks of low-income countries progressing twice as fast as those of high-income countries, many countries have been able to use these gains to help pull millions of people out of poverty. Today, ICT is widely recognized as a fundamental catalyst for growth across many sectors of an economy and is proven to generate high development impact. ICT promotes opportunities for the underserved by making markets more efficient, improving government transparency and facilitating social inclusion and political involvement.

3.49 ICT remains a key focus for IFC, and its strategy is focused on three inter-related themes: (i) Access – the ability to access relevant information on any platform, anywhere, at an affordable price; (ii) Mainstreaming – the introduction of information and communication technologies to improve the delivery of public and private services; and (iii) Innovation – the use of information and communication technologies in transforming traditional sectors and fostering innovation and entrepreneurship, in addition to supporting SME development. IFC will continue to partner with private and public groups to develop and pilot innovative programs (see Box III-11) to address market gaps, particularly with respect to broadening access coverage and extending service to low-income populations and rural areas and to apply information technologies to enable the delivery of social and economic services to underserved populations. IFC provides additionality in this sector through the provision of debt and equity otherwise unavailable to companies with such risk profiles and from its ability to leverage the policy capabilities of the World Bank in such areas as public-private partnerships. To this end, strategy implementation will concentrate on: (i) improving access to basic services, such as voice communication and internet availability, through innovative means and public-private partnerships to lower tariffs, improve service quality and create better coverage, particularly in IDA countries and through South-South opportunities; (ii) increasing the availability of advanced technologies and application services for consumers and businesses; and (iii) supporting the development of downstream industries such as mobile-banking and mobile-commerce, e-Government and IT-enabled industries. IFC's commitments in this sector are projected to grow from \$400 million in FY07 to about \$430-450 million in FY08.

Box III-11: WIZZIT

Access to bank accounts is a key instrument to facilitate the progress of households out of poverty and to allow for full participation in the formal economy. An individual's ability to obtain and, on a sustainable basis, use financial services that are affordable and meet their financial needs facilitates participation in the broader economy and forms an important building block to economic development. Mobile banking and related technologies provide a new opportunity to make basic financial services more accessible to the poor, especially given the reach and penetration of mobile phone services in emerging markets today.

IFC is investing in and provide support to WIZZIT Payments (Pty) Limited (WIZZIT), a South African enterprise established to offer a transaction-based bank account accessible via mobile phone and debit card to South Africa's under-banked and un-banked population. Recognizing the potential for mobile banking early, WIZZIT is one of the first independent mobile payment operators in an emerging market today. Using existing mobile networks in South Africa and its low operating cost structure, WIZZIT is able to provide services at a fraction of what traditional banks would charge for similar transactions. Today, some 40% of WIZZIT's customers fall below the South African poverty line and its target market includes an estimated 16 million South Africans who lack or have difficulty accessing formal banking services, but who do own mobile telephones.

3.50 Health and Education. IFC has increased the scale and scope of its development impact in these sectors by expanding its investment and advisory services operations over the past three years and plans to continue doing so over the next three years. IFC plans to scale up its investments, focusing on emerging regional and global providers, and using new and innovative instruments to reach a larger number of smaller entities (individuals or companies). Many countries where IFC operates, especially poorer countries, rely on the private sector to deliver essential services to complement what the public sector is able to provide. Many governments are now seeking to

broaden the role of the private sector as a way to reach all segments of the population, increase efficiency and promote innovation. IFC provides additionality in this sector with risk mitigation for both innovative investments and difficult locations, as well as via financial and advisory expertise in new structures, such as student loans and wholesaling. In the new area of student financing (see Box III-12), IFC's role in structuring and bringing together universities, foundations, and financial institutions is critical, and the potential development impact – giving hundreds of thousands of students access to education – is substantial. In FY07, IFC committed \$199 million (\$126 million in FY06) in 17 projects across 13 countries. FY08 commitments are estimated to increase to \$200-300 million.

Box III-12: Duoc Student Loans, Chile

In 2007, IFC investment provided a \$ 18.75 million equivalent risk participation to Fundacion Duoc (Duoc), a higher education institution in Chile providing technical degrees and vocational training to a student body of approximately 40,000. IFC, together with Duoc and a Chilean bank, jointly developed a new student loan program, under which loans would be made by the bank to qualified Duoc students. The World Bank would then administer and collect the loans in cooperation with Duoc. This project is expected to increase access to higher education, especially among students from lower- and middle-income households. 64% of Duoc's students come from families classified as middle- and lower-income. In addition to increasing access to higher education, program will introduce to the financial markets in Chile an affordable student loan scheme that will demonstrate the creditworthiness of lower- and middle-income students graduating with technical and vocational degrees.

3.50.1 *Progress on the Private Health Sector in Sub-Saharan Africa.* In FY08, IFC, together with the Bill and Melinda Gates Foundation, completed a study on the private health sector in Sub-Saharan Africa. In December 2007, IFC presented to the Board the strategic recommendations emerging from the study (IFC/R2007-0351). Next steps include creating a private equity vehicle for health in Sub-Saharan Africa (presentation to the Board for approval expected in February/March 2008) and extending the schools financing model referenced above to health in Sub-Saharan Africa. Extensive advisory services through IFC's Advisory Services to benefit small health providers, and in joint efforts with World Bank/IDA to benefit governments, are expected.

3.50.2 *Replicating School Financing Facilities.* In FY08, IFC continued to develop school financing facilities similar to those in Ghana and Kenya. These projects have enormous potential development impact, improving the managerial capacity of small schools which cater largely to low- and middle-income households, increasing access to education, and improving the quality of education. Work is underway on a facility in Rwanda and the first facility of this type outside Sub-Saharan Africa is also being explored in Bangladesh and elsewhere in South Asia. In all cases, the investment facilities are expected to be accompanied by Advisory Services for the schools.

3.50.3 *Pursuing Broad Strategic Relationships.* IFC is pursuing broad strategic relationships with groups that are seeking more efficient modes of operation, new areas of specialization, movement across borders, and innovative means of financing their own operations and those of their clients. These clients are likely to be hospital groups and higher education institutions, and they are emerging in Brazil, India, Mexico, Russia and the MENA region (see Box III-13). IFC will also continue to seek out domestic institutions that aim to secure a strong position within local markets and have great potential to grow and to generate significant development impact as centers of excellence for their country or region.

Box III-13: Saudi German Hospitals Group, MENA Region

In 2007, IFC committed \$37 million in Islamic-compliant financing to Saudi German Hospitals Group, one of the largest private healthcare providers in the Middle East and North Africa, to support a new hospital in Sana'a, Yemen, and construction of a hospital in Cairo, Egypt. The hospital group seeks to improve healthcare across the region, especially in poorer, non-Gulf states. Before this hospital, there was a lack of quality tertiary care in Yemen, and about 120,000 Yemenis travel abroad for care annually, at a cost of \$300-400 million. The hospitals in Egypt and Yemen will relieve the growing burden on the public health system in these countries, stimulate the development of private health insurance, increase employment opportunities for local health care professionals, and facilitate the international exchange of best medical and management practice across the group.

Pillar 5: Developing Local Financial Markets through Institution Building, the Use of Innovative Financial Products and Mobilization

3.51 IFC enables greater access to finance in developing member countries through a combination of investment products and advisory services. IFC ensures additionality by taking on risks that private commercial market participants will not take on and by integrating IFC's investment products with advisory services that help develop or deepen markets in targeted sectors. In addition, IFC takes equity positions in selected financial institutions to assist in improving their corporate governance and risk management, helping drive these institutions into new markets and extend their reach to underserved populations.

3.52 IFC has adopted a three-pronged approach to developing financial markets: (i) working alongside the World Bank to create supportive policy, legal and regulatory frameworks; (ii) investing and providing advisory services to financial institutions; and (iii) helping build the necessary financial infrastructure and processes for such institutions to operate effectively, for example credit bureaus, leasing laws, and corporate governance frameworks. The key strategic areas for IFC are SME finance, microfinance, housing finance, trade finance, local currency finance, structured finance and sustainability in financial markets (as discussed in paragraph 3.39).

3.53 **MSME Finance.** IFC continues to focus on reaching MSMEs through investments and advisory services aimed at: (i) encouraging financial institutions to downscale into SME lending; (ii) promoting wholesale and structured finance vehicles to scale-up microfinance rapidly; (iii) creating greenfield microfinance institutions to tackle capacity constraints on the ground; (iv) strengthening credit infrastructure (e.g. rating agencies and credit bureaus); and (v) providing advisory services to improve organization, processes, credit assessment, monitoring capabilities and IT.

3.53.1 *Increase in MSME Commitments.* In FY07, IFC's MSME commitments were \$2 billion (extended to banks, microfinance institutions, leasing companies and other non-banking financial institutions), of which \$1.7 billion was targeted to SMEs. At end-FY07, IFC's outstanding MSME portfolio stood at \$4 billion for IFC's account, representing 23% of IFC's total outstanding portfolio. In calendar year 2006, IFC's clients disbursed an estimated 8.9 million MSME sub-loans totaling \$96.5 billion, and held a portfolio of five million MSME sub-loans for \$57.1 billion. In FY07, IFC launched the Africa MSME Finance Program, which combines advisory services and investments to commercial banks in Sub-Saharan Africa, allowing them to expand their financial services to MSMEs. This program is expected to facilitate an additional 10,000 loans to MSMEs for a total of \$200 million over the next five years. Under the LAC MSME Program, IFC expects to work with between 50 to 60 financial institutions, and reach 1.8 million sub-borrowers with \$2.5 billion in finance.

3.54 **Microfinance.** IFC's approach to increase development impact includes: (i) promoting collective investment vehicles; (ii) developing microfinance network partners; (iii) boosting strategic partnerships; (iv) engaging in selected advisory services projects at the financial infrastructure and policy levels; and (v) making selective direct equity investments in start-up microfinance institutions or other entities to establish market players and help overcome regulatory

issues in un-served markets. In addition, IFC will tailor its advisory services packages and experiment with new delivery technologies, and seeks to invest in new vehicles with Southern microfinance operators (e.g. BRAC in Bangladesh). IFC will also seek “product bundling” opportunities to combine microfinance with other products, such as micro-housing, micro-insurance, and savings for the “bottom of the pyramid”.

3.54.1 *Increasing Reach*. In FY07, microfinance commitments were \$196 million (extended to MSME banks and microfinance institutions) in 26 projects. IFC expects this to increase in FY08. IFC plans to scale up its activity to reach an estimated 10 million micro entrepreneurs over the next three years. Priority will also be placed on: (i) economies of scale in the delivery of development impact; and (ii) innovative programs with the potential to reach scale such as work with certain retailers (e.g., large pharmacy chains), or investments in mobile phone banking.

3.55 Housing Finance. Housing finance continues to be a growing line of business for the Corporation. IFC is working closely with the World Bank (see Box III-14) to develop an integrated approach to this business, as well as exploring ways to expand the availability and affordability of mortgages to lower income segments of the population and to frontier markets. New aspects of housing finance include projects that utilize Islamic finance products, sustainable housing construction, energy efficient home renovation products, and renovation of multi-family housing structures. IFC will also support private and public initiatives to improve energy efficiency in homes and schools, and the implementation of government policies to sustain the privatization of housing. Key initiatives include: the Housing Finance Toolkit¹⁰, training¹¹ and the Housing Finance Portal¹².

3.55.1 *Increase in Housing Finance-related Projects*. As of December 31, 2007, IFC had a housing finance portfolio of about \$2.6 billion, in more than 120 housing finance-specific transactions in over 40 countries. During FY00, new commitments in housing finance-related projects totaled approximately \$30 million, but in FY07 the level of new investments had grown to \$620 million. IFC expects to surpass this level in FY08.

Box III-14: Ghana Mortgage Market Initiative

In 2007, IFC announced that it will invest in four banks as part of its Ghana Mortgage Market Initiative, which is designed to boost residential mortgage lending and provide better access to housing finance for Ghanaians. The banks will also be the first institutions globally to begin using the innovative IFC Mortgage Toolkit. IFC, through the support of the State Secretariat of Economic Affairs of Switzerland (SECO), will also support the development of the enabling environment for mortgage lending. IFC is making available \$25 million in long-term local currency-denominated funds to Ecobank Ghana, Fidelity Bank, and Merchant Bank Ghana. This represents the first local currency financing provided by IFC in Ghana. The loans will be used to increase the banks' mortgage lending activities, as well as provide housing solutions for about 500 families and over 3,000 individuals. More importantly, it will demonstrate international best practice in residential mortgage lending, and standardization of mortgage products and loan file documentation. In addition the project will stimulate competitive forces in the marketplace, which is expected to improve pricing and customer services, thus making housing finance more affordable. For three years, the World Bank has run the Land Administrative Program that assists the Ghanaian Government in restructuring land titling and registry offices. IFC is in regular contact with the responsible program officers for consultation and information purposes.

¹⁰ Currently being used in Albania, Ghana, Mexico, Russia and Uganda.

¹¹ IFC successfully provided a 2-week housing finance training to 120 bankers representing 30 financial institutions in Pakistan.

¹² A web portal which will be run by an NGO, bringing together the World Bank, IFC, Wharton School and other donors.

3.56 Trade Finance. IFC's Global Trade Finance Program (GTFP) expanded to \$1 billion in FY07, and has a mandate to provide trade facilitation to underserved clients and markets. GTFP is delivering on its promise to bridge several important gaps in trade, including: (i) expanding the financing available to local banks in less advanced markets to support their import and export clients, particularly small and medium enterprises; (ii) making available longer tenors needed for the import of capital goods; (iii) enabling local banks to do business on an unsecured basis, releasing cash collateral requirements that constrain liquidity; (iv) promoting South-South trade, and; (v) capacity building of local banks through trade finance training programs¹³.

3.56.1 *The GTFP Continues to Exhibit Significant Results.* In FY07, total commitments reached \$767 million with the issue of 564 guarantees, of which \$377 million was in Sub-Saharan Africa (see Box III-15). Total commitments for the first six months of FY08 were \$700 million, of which \$287 million was in Sub-Saharan Africa. The program doubled its coverage in FY07 to include 96 banks across 51 countries. IFC extended its reach to small, frontier and conflict-affected countries, including Afghanistan, Angola, Burundi, Democratic Republic of Congo, the Gambia, Haiti, Liberia, Rwanda, Sierra Leone, Syria and Tajikistan. Approximately one-third of transaction volume represents South-South trade, such as traffic signal equipment from Thailand to Cambodia, rubber processing equipment from Malaysia to Liberia, tractors from China to Mongolia, ceramic tiles from Turkey to Azerbaijan, rice from Pakistan to Sierra Leone, and pharmaceuticals from India to Yemen.

Box III-15: Trade Finance in Sub-Saharan Africa

IFC's Global Trade Finance Program is particularly important in Sub-Saharan Africa, where many countries have not fully tapped the potential of trade to drive economic development and reduce poverty. Part of the problem is that banks in Sub-Saharan Africa are typically required to post cash as collateral for all of their trade-related transactions, making it very expensive for companies to trade with overseas counterparts. IFC's trade finance program addresses this problem by reducing the cost and risks that Sub-Saharan African institutions face when trading with other countries. IFC's trade finance program currently includes 27 issuing banks as participants in 14 countries in Sub-Saharan Africa. It has to date provided guarantees of \$921 million for banks in Sub-Saharan Africa, supporting \$1.42 billion worth of trade with the region. Globally, the program has issued guarantees of about \$1.8 billion to support \$2.5 billion worth of trade.

3.57 Short-Term Finance. IFC is developing a range of short-term debt and guarantee products to support IFC's increased focus on IDA countries and frontier markets, where access to credit, even short-term, is arguably equally or more important and appropriate than the availability of long-term funding (above five years). These instruments will significantly enhance IFC's ability to expand its activities, including (i) Supply Chain Finance (Suppliers and Distributors Finance) and SME Linkages; (ii) Working Capital and Warehousing Finance; and (iii) Agri-Finance, and support IFC's ongoing efforts to provide MSMEs access to finance in IDA Countries.

3.58 Access to Finance - Advisory Services. IFC's advisory services are provided at two levels: (i) building capabilities in financial institutions; and (ii) improving enabling environments. This includes developing and improving laws and regulations needed to enable MSME financing, housing finance and capital market development, as well as implementing programs to establish and strengthen credit bureaus and payment systems. IFC's advisory services are often implemented with the World Bank to coordinate policy advice and joint interventions.

3.58.1 *Significant Growth in Activities.* In the last five years, IFC's Access to Finance advisory services activities have grown significantly, from 86 projects and programs worth \$27 million in funding commitments in FY03, to 180 projects and programs worth over \$280 million in funding commitments in FY07. About 60% of these projects are in IDA countries and 53% of

¹³ Over 13 courses carried out in South Africa, Ethiopia, Rwanda, Kenya, Ghana and Mexico. 245 bankers trained; banks in Liberia and Sierra Leone benefited from on-site resident advisors.

total IDA countries are covered. Over 70% of IFC's access to finance advisory services projects/programs are combined with IFC investment financing, and about 40% of IFC's investments in financial institutions use access to finance advisory services. Over 75% of IFC's access to finance advisory services activities are for MSMEs.

Box III-16: IFC Global Credit Bureau Program

Over the past six years, the number of countries in which IFC has provided such advisory services is 44, with 10 credit bureaus created and/or significantly improved (Bosnia, Bulgaria, Costa Rica, Egypt, Guatemala, Honduras, Nicaragua, Pakistan, Romania and South Africa). The total number of credit bureau inquiries in those countries in CY07 reached 34.7 million and IFC drafted or contributed to the drafting of 19 new laws/regulations. IFC organized and supported roundtables, seminars, conferences and other outreach events around the world amounting to 57 events in 38 countries. It continues to monitor the credit reporting environment in 178 countries through the Doing Business Report. IFC has also assisted in setting up credit bureaus in Egypt and Nigeria, which are expected to be operational this year.

3.59 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 to \$1.6 billion in FY07, with a further \$935 million mobilized in the market. To date, IFC has provided local currency products in 26 emerging market currencies, up from 18 a year ago.

3.60 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. Long-term swap markets are developing rapidly in emerging markets and there are now about 31 emerging markets where such instruments are available. 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. IFC has placed particular emphasis on promoting the development of local currency derivatives in Sub-Saharan Africa.

3.61 IFC uses structured finance to provide clients with cost-effective forms of financing that would not otherwise be readily accessible. IFC has developed several categories of structured finance products including: (i) partial credit guarantees; (ii) structured liquidity facilities; (iii) portfolio risk transfer; (iv) securitizations; and (v) Islamic finance. Cross-border transactions are also pursued, including those that utilize IFC's guaranteed offshore liquidity facilities (see paragraph 3.61.2) to mitigate currency convertibility and transferability risk, 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.

3.61.1 *Derivatives-based Local Currency Products.* To date, IFC has committed over \$3.8 billion equivalent in local currency using derivatives for more than 137 transactions. In FY07, IFC committed over \$1.3 billion equivalent in derivatives-based local currency products in 18 currencies to 34 clients. It has recently signed its first local currency loans in Nigeria, Vietnam and Romania and is actively pursuing opportunities in other Sub-Saharan African countries. IFC has also disbursed its first local currency loan in Colombia.

3.61.2 *Structured and Securitized Products.* In FY07, IFC mobilized a total of \$2.1 billion for clients through structured finance, with only \$318 million for IFC's own account. IFC launched the Match Assets through Currency Hedging (MATCH), to provide local currency loans in selected markets in which liquid currency and interest rate swaps do not exist, focusing on clients in IDA countries in sectors such as health and education, and microfinance, and on SMEs. IFC committed its first loan under the MATCH pilot framework in 2007. IFC also

launched the Guarantee of an Offshore Liquidity Facility (GOLF) to help mitigate risk associated with currency convertibility and transferability. In addition, IFC issued its first partial credit guarantee that complies with Islamic finance rules as part of the first true securitization in the Gulf Cooperation Council countries, and issued its first.

3.62 Developing Local Securities Markets. The local financial markets remain dominated by the banking sector in many developing countries, and the lack of alternative financial intermediaries still presents constraints to private sector development. To help address this, IFC credit enhances bonds and securitization transactions for clients to: (i) introduce these products to new markets; (ii) introduce new borrowers to the market; (iii) introduce new asset classes to the market; (iv) improve credit ratings; (v) extend tenors; and/or (vi) increase size. Participation is generally in the form of a guarantee offered by IFC that acts as an enabling element to catalyze liquidity from domestic investors. In structured finance transactions, investors also benefit from IFC's direct involvement in structuring the transaction. Many of IFC's clients have returned to the market after their first successful issuance without further need for IFC's support.

3.62.1 *Innovative Securitizations.* Some recent examples of IFC's innovative securitizations include the first securitizations of residential mortgages in Colombia, Korea, Latvia, Mexico, Russia, Saudi Arabia, South Africa, and the United Arab Emirates, the first future flow securitization of student tuition payments in Chile, the first publicly placed bond by a microfinance company in Mexico, and the first bond issued by a non-bank microfinance institution in Peru.

3.62.2 *The Efficient Securities Market Institutional Development Program (ESMID).* This is a \$5.5 million joint World Bank-IFC program funded by the Swedish International Development Cooperation Agency, aimed at strengthening local securities markets, in particular bond markets, to finance housing and infrastructure investments where long-term local currency funds are necessary by providing advisory services for market and institutional capacity building. It will also support selected costs related to transactions that are expected to have a strong demonstration effect. The program will contribute to poverty reduction by increasing access to long-term local currency financing for key development needs and improve the demand and supply of long-term local currency products. The program's initial focus is on Sub-Saharan Africa, starting with East Africa, where it is providing advisory services to securities regulators, central banks, stock exchanges and intermediaries in Kenya, Uganda, Tanzania and Rwanda to: (i) simplify regulations and procedures for issuing and trading bonds; (ii) establish an appropriate market structure; (iii) strengthen secondary markets; (iv) build capacity of market participants; and (v) facilitate the regionalization of the markets. The program will be rolled out to Nigeria in 2008 and other countries over time.

3.63 Mobilization and IFC's B Loan Program. Mobilization continues to be a core part of IFC's catalytic role. The B Loan Program provides emerging market companies access to international banks, and selectively, other investors, which they would not otherwise have, and helps these investors get comfortable in markets which they might otherwise not have approached. Despite the continuing turmoil in financial markets, which began with the sub-prime crisis in the United States in August 2007, IFC continues to lead international banks and other investors towards more IDA countries, frontier regions and sectors, and second-tier borrowers. In furtherance of its catalytic role, IFC seeks to mobilize funding for developing countries in a number of ways. IFC is continuing to develop new applications for its B Loan structure, including the placement of subordinated debt, local currency syndications and Islamic Finance. IFC has also adapted the B Loan structure to assist the Corporation in managing its existing exposure through the development of A Loan Participation Sales. Through these new applications, IFC is developing new investor bases, bringing pension funds, insurance companies and other institutional investors to emerging markets.

3.63.1 *Significant Increase in Mobilization.* In FY07, IFC mobilized a total of \$3.9 billion (\$2.9 billion in FY06), of which \$1.8 billion through its B Loan program and \$2.1 billion through structured finance (see paragraph 3.61.2). For each dollar that IFC committed (IFC investments and IFC portion of structured finance), IFC mobilized \$0.47. The total size of all projects which IFC's investments supported in FY07 was \$29 billion (\$28 billion in FY06).

3.63.2 *Continued Access for Tier II Banks.* In FY08 to-date, IFC was able to provide continuing access to funding to six second-tier financial institutions in Latin America and Europe, including the first syndication for a microfinance institution in Latin America.

3.63.3 *Continued Growth and Reaching Frontier Countries.* In FY07, the program saw its third year of consecutive growth, with \$1.8 billion in new loan participations. Of the 29 deals, 12 were to borrowers in IDA countries, and 15% of the new loan participations were for Sub-Saharan African borrowers. The program is expected to continue to increase in volume, with approximately \$3 billion in B Loans expected to sign in FY08. Noticeable in FY08 is the increased level of participation in IFC's B Loans by developing country banks and their subsidiaries: approximately a third of B Loan participants in FY08 to-date. In addition, IFC has been able to introduce 17 new investors to a country they had not invested in before, and 44 new investors to a borrower to which they had not yet lent.

3.63.4 *Innovative Transactions.* FY07 saw the first syndication of Tier II capital (Banco Davivienda, Colombia), the first international syndication for a Pakistani borrower since the 1988 crisis loan (Dewan Petroleum) and a syndicated ruble-linked US Dollar loan (Concordia, Russia).