

### SECTION III. IFC'S PATH TO GROWTH, FY06-FY08

3.1 Since FY03, IFC has experienced strong growth in both investment and technical assistance activities, reflecting the growing demand for private sector development in emerging markets and IFC's strategic alignment with client needs. This growth has been accompanied by stronger net income, improvements in portfolio quality, and a resultant strengthening of the capital base. During this period, developing countries have been experiencing stronger economic growth and liquidity has become more available in a number of larger emerging economies. Nevertheless, the private sector in both frontier and middle-income countries continues to face serious challenges and has yet to realize its full potential. So, while IFC's countercyclical role has declined, the Strategic Directions endorsed by the Board in April 2004 continue to be as relevant as ever.

3.2 In this context, IFC has a choice. It can take advantage of its favorable external environment, its strong financial position and its comprehensive risk management and human resource platform to scale up and accelerate the implementation of its Strategic Directions; or alternatively, it could adopt a more conservative approach and keep maximum headroom available so that it could play its countercyclical role to the fullest extent possible in times of crisis. Management believes that IFC should choose the first course of action which would enable it to maximize its development impact in the years to come while optimizing the use of its capital. Looking forward, IFC has a number of growth opportunities (*See paragraphs 3.5-3.24 on pages 22-27*) which should enable it to achieve a step growth in its annual commitments from the current range of \$3.8-\$4.8 billion to \$5.9-\$7.2 billion by 2008 (a midpoint increase of 35 percent from the current level).

3.3 This increase will not be linear and there will be years when the Corporation will underachieve or overachieve. In addition, if a major financial crisis was to occur during this period, IFC would need, and would have the capacity, to adjust the level and composition of its activity in order to accommodate a resumption of its traditional countercyclical role of mobilizing scarce capital for the private sector in impacted countries. At this stage, the regional breakdown of expected commitments by the end of FY08 (*See Table 3.1*) is purely indicative of the orders of magnitude concerned, and will have to be refined as implementation plans are firmed up. It will also need to be kept under review to take into account potential developments in the business environment, whether negative or positive.

**Table 3.1. Total Commitments**

<b><u>Total Commitments</u></b>	<b>FY04 Actual</b>	<b>FY05 Plan*</b>		<b>FY08 Indicative</b>	
Sub-Saharan Africa	395	300	- 385	675	- 825
East Asia & the Pacific	730	590	- 750	900	- 1,100
Central & Eastern Europe	797	655	- 825	900	- 1,100
Latin America & Caribbean	1,218	1,000	- 1,260	1,350	- 1,650
Middle East & North Africa	186	220	- 275	450	- 550
South Asia	405	335	- 415	500	- 600
Southern Europe & Central Asia	705	610	- 775	900	- 1,100
World	317	90	- 115	225	- 275
<b>Total Commitments (\$ million)</b>	<b>4,753</b>	<b>3,800</b>	<b>4,800</b>	<b>5,900</b>	<b>- 7,200</b>
<b>% change from FY05**</b>				<b>23%</b>	<b>- 50%</b>

\* As per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

\*\* % change from the upper end of the FY05 Plan range.

3.4 IFC's growth strategy would entail, however, addressing a number of issues and challenges, including the need to allocate the necessary budgetary resources so that the Corporation can increase its operational capacity (especially the number of staff directly involved in project development, processing and supervision) to serve a larger number of clients, support more complex projects and enhance its development impact (*See paragraphs 3.25-3.37 on pages 27-30*).

### **Opportunities to Grow**

3.5 Looking forward, there are substantial opportunities for IFC to increase its investment volume and development impact by scaling up and accelerating the implementation of its strategic priorities. Growth opportunities include:

- reaching new clients in frontier countries and the frontier regions of the larger emerging economies;
- taking a more systematic approach to South-South business development;
- building on the Corporation's current experience and synergies within the World Bank Group to target market needs in infrastructure, especially in the areas of public-private partnerships and sub-national finance;
- expanding the Corporation's activities in the areas of MSME finance, housing and trade finance, and developing the domestic financial markets to reduce excessive reliance on banking sector finance; and
- supporting the sustainability efforts particularly of the agribusiness and natural resources businesses, and more actively promoting renewable energy and energy efficiency.

### **New Clients in Frontier Countries and Frontier Regions of Larger Countries**

3.6 IFC can develop new clients by expanding business development activities in frontier countries and in the frontier regions of larger middle income countries. In the frontier countries, IFC has increased its focus on business development and placed senior staff in the field, especially in Africa. This is expected to lead to the identification of new clients in the region. In larger countries such as China, Russia, India, and Brazil, IFC sees the potential of expanding the number of new clients in its portfolio by making investments outside of the traditional centers of commerce in "frontier" areas within these countries. For example, IFC plans to expand its geographical coverage in China and India, and deploy business developers to reach secondary markets where there are opportunities to help emerging domestic businesses. IFC also sees opportunities to grow through taking a more systematic approach to making South-South investments originating from these large countries. According to the 2004 client survey, 83 percent of clients value IFC's global knowledge and on-the-ground presence. This comparative advantage provides IFC with a huge opportunity to help clients enter new markets, and adopt international environmental, social and governance standards.

### **Infrastructure**

3.7 Across all regions there are substantial infrastructure needs to be addressed. However, it will take a systematic approach on public and private partnerships to tackle this issue. This presents an opportunity for IFC, which in collaboration with IBRD, IDA, and MIGA is in a unique position to respond to this challenge. There is also a burgeoning business helping sub-national governments finance their infrastructure requirements. Given the potential for strong development impact in this area, IFC in partnership with IBRD is actively exploring this avenue.

3.8 ***Public-private partnerships (PPP) in infrastructure.*** While the market is challenging and the projects are complex, demand for infrastructure financing and advice is strong and is expected to grow.

The challenge facing the Corporation is how to translate the need for infrastructure into feasible, bankable projects. As a recognized leader and innovator in the field, IFC is well positioned to ramp-up its activities in this area. IFC has recently established a unit within the Infrastructure Department to help respond to the opportunities emerging in many of our member countries for PPPs in infrastructure. However, the identification and development of PPP-type projects will require a comprehensive approach and systematic engagement across various parts of the World Bank Group. To accomplish this, IFC is seeking to integrate the resources of its technical assistance facilities and the expertise in its Advisory Services Group and build on greater collaboration across the World Bank Group. Specifically, IFC has been increasing the level of activity of its Advisory Services Group in follow-on transactional advice following World Bank sectoral reform work and is putting in place dedicated infrastructure-related resources in field-based facilities in several regions to increase up-front project development efforts.

**3.9 IFC and IDA.** Collaboration across the WBG is becoming much more significant in infrastructure, particularly in Africa. In particular, combined IDA and IFC efforts represent an effective way of creating public-private partnerships that make infrastructure programs possible and extend their reach to underserved and poor populations. The challenge for the WBG is to continue to advance an IDA-IFC partnership which is client-focused and efficient. Currently, the management and disbursement of IDA funds may not always be responsive to the scope or planning cycles of private sector projects. For instance, the lack of government capacity in client countries to respond in a timely manner to private sector initiatives may lead to missed opportunities to involve private companies and harness the resources and expertise they offer. Additionally, cross regional programs could be a more effective and efficient way to organize infrastructure projects. The extension of the concept of regional IDA operations to include private sector entities might be an important way to improve the efficacy of WBG support to the private sector.<sup>5</sup>

**3.10** The WBG is currently discussing ways to address these challenges and effectively leverage its various resources. The box below outlines one option that is being considered by IDA and IFC to increase the flexibility and timeliness of IDA resource use for the private sector.

**Box 3.1. IFC and IDA: Possible New Directions**

To date, IFC and IDA have worked together in a number of successful and pioneering projects in the infrastructure sector. However, the level of collaboration could be scaled up and become more efficient if there was a more effective mechanism to implement the use of IDA funds for private sector projects. One option, which was introduced to the IDA deputies during the IDA14 replenishment meeting in Athens in December 2004 for future consideration, is the potential to use IDA resources in private sector projects without a sovereign guarantee. This option would allow IDA resources to be used with more flexibility, which may be better suited to the private sector. It would open up funding for projects on a regional basis and facilitate cooperation across country borders. An additional benefit of such an arrangement is that it would provide for the use of IDA funds without adding to the sovereign debt burden of developing countries.

Taking on private sector credit exposure would be a significant change for IDA. Therefore, the concessional IDA funding would be available in conjunction with joint IDA-IFC projects only when such funding is critical (e.g. to extend the reach of infrastructure projects to underserved and poor populations). The IFC credit capabilities would be used to ensure that the IDA funds are used with effective private sector credit analysis. The WBG intends to look in detail at the issues regarding this proposal and will provide an analysis to the Board of Executive Directors and subsequently to the IDA Deputies at the time of the mid-term review in 2007.

<sup>5</sup> A pilot program for regional projects was started during IDA13 period and a review of the pilot will be carried out early in IDA 14 where it is proposed to explore ways to increase private sector involvement in regional projects.

3.11 **Sub-national finance.** The experience of the Municipal Fund pilot indicates that sub-national finance is a viable new business for IFC. It displaces neither the sovereign lending of the Bank nor the private sector financing of IFC. Rather it is supplemental to both. Indeed, it complements both core businesses, since sub-national financing would fill significant gaps in the Group's product lines, would enhance the depth and pragmatism of the Group's dialogue with national governments on decentralization and would build the infrastructure base for private economic growth.

3.12 The Corporation proposes to develop the pilot into a mainstream activity. IFC believes the market is large, that profitability will be acceptable (despite long project lead times and high supervision costs) and that development impact is very strong, both directly and through positive linkages with other product lines of the Group. Building client capacity is a core development objective in this sector, and a critical driver of credit quality. A FMTAAS allocation of \$5 million over three years will complement the proposed investment activity (*See Box 3.2*).

3.13 The Municipal Fund team would be converted into an industry department. It is expected that both IFC and Bank regional departments will originate project proposals, and incentives (such as budget and/or credit for business volume) are being designed to encourage origination by Bank regional staff. Adequate incentives already exist for IFC regional staff. Investment volumes are expected to build from \$150 million in FY06 to \$500 million by FY08. Joint World Bank Group structures are being considered to develop this business line on an even larger scale. IFC is participating actively in these discussions and believes that efforts to build the business will be wholly consistent with a future broadening of the Group's cooperation in this area. Equally, IFC believes that the opportunities (and needs) exist now and that WBG institutions should be engaging actively in this segment today.

#### **Box 3.2. Sub-national Technical Assistance**

IFC management has allocated US\$5.0 million of FMTAAS funding over the period FY06-08 to help build the capacity and creditworthiness of sub-national clients. This facility will complement IFC's investment activity in the sub-national sector. It will support:

- financial improvement plans, including measures to improve the administration of local revenues, the efficiency of municipal expenditure, and the quality of financial controls and disclosure;
- training of key municipal officials in financial management and project management;
- financial advisory services for project structuring;
- independent reviews to assure the quality of investment projects studies, including environmental and social assessments, and technical assistance to strengthen project implementation capacities;
- communication, public information and stakeholder consultation on sub-national projects.

3.14 Sub-nationals are natural partners for several other strategic priorities of IFC and the World Bank Group such as public-private partnerships, SMEs, housing finance, and energy conservation. A direct financial and advisory engagement with sub-nationals will provide a useful platform for pursuing these priorities. Conversely, the Group's capacities in these areas will strongly enhance its attractiveness as a partner to sub-national clients. IFC will actively manage these linkages.

### **Financial Markets**

3.15 Another area of growth for IFC is in the financial markets sector, including the introduction of new structured finance products. Providing funding to commercial banks remains a core strength for IFC and there is an opportunity to leverage this comparative advantage by expanding IFC's product line, and offering value-added products such as trade finance and local currency facilities. There is an unmet demand from clients in the housing finance, SME and microfinance sectors and IFC will increase its work with bank and non-bank clients to address these needs. In addition, there is scope to substantially grow

IFC's institution-building investments and advisory activities aimed at improving the efficiency of financial intermediation, and helping financial institutions address increasingly important environmental and social issues. IFC's strategy in the sector is greatly enhanced by the close synergies that exist between its Financial Markets and Treasury operations, which allow IFC to offer a broad range of financial products to its clients, including structured finance and local currency products (*See Box 3.3*).

**3.16 *Housing finance.*** In the housing finance sector, IFC's approach is to address strategically each country's needs in concert with its financial sector development, providing long-term lines of credit, partial guarantees of local currency credit issues to foster local currency mortgage lending, and warehouse lines to support securitization activities. Because there is a critical need in many markets to foster the production of affordable housing, IFC is also actively pursuing the establishment of construction financing facilities. IFC will focus on institution specific TA to improve mortgage operations of IFC's financial market client companies (new and in portfolio), underwriting guidelines and standardization, servicing techniques, and provide TA on legal and regulatory frameworks (e.g., land titling and registration) while working in full coordination with the World Bank, and IFC's Private Enterprise Partnerships.

**3.17 *Trade finance.*** IFC's flexible trade finance program will provide greater development impact and increase client focus as it enables IFC to respond quickly to clients' needs. IFC's global franchise in financial markets is key to the program's success in opening new markets and facilitating the growth of nascent but growing South-South trade. Through this program, IFC enhances trade finance capacity in local banks, both by facilitating trade credit and through technical assistance, and aims to build and improve institutional capacity for trade products within local banks, and to strengthen its relationship with local banks and develop opportunities for further operations. In most markets, this will have the greatest net effect on SMEs, which are most reliant on the support of local banks.

### **Box 3.3. Structured Finance and Local Currency Products**

IFC offers its clients new products customized to meet their needs depending on their asset size and the currency of their revenues. IFC plans on increasing and extending the diversity of its product offerings, and sees its ability to create new products as one of its main avenues of growth moving forward.

***Structured finance.*** In recent years, there has been an acceleration in demand for structured finance products and long-term derivative products as markets have become more developed. In the structured finance area, IFC now has sufficient capacity to undertake proactive business development. IFC utilizes its convening power to involve key players such as rating agencies, investment banks and legal firms and bring modern credit enhancement techniques to emerging markets. IFC's existing structured finance products are well received by its clients and IFC will continue to build on this success by further generating interest through active promotion. IFC will also focus on the development of new tailored products and credit enhancement techniques specific to local clients and local market realities that will meet their needs and satisfy their demands.

***Derivatives-based local currency products.*** IFC uses long-term derivatives markets to provide local currency loans and hedges to its clients. IFC 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. Such long-term swaps are currently available in over 15 emerging markets, and the trend has been towards increased liquidity and maturity in these markets. The swap market provides flexibility in allowing IFC to tailor the timing, size, maturity and amortization schedules of the loans to suit clients' needs. There is significant interest and demand from IFC's clients for derivative-based local currency loans, especially in larger countries such as Mexico, India and South Africa. Short-term demand for the product will be somewhat volatile at any given time, as it depends on the attractiveness of interest rate levels in local currencies, but the demand for the product is rising. Thus far, IFC has disbursed over \$1billion equivalent in local currency products using the derivatives markets.

IFC has also provided "index-linked" loans linked to the local currency in Russia and is currently seeking approval to provide similar index-linked products in China. IFC is very optimistic about the growth of this market, however, the ability to provide these derivative products is dependent on the country's regulatory authorities and the availability of swap counter-parts. In the near future, there is potential demand for derivative-based local currency financing in countries such as Brazil, Turkey and Vietnam, and a strong demand for local currency loans in countries such as Indonesia, Thailand and the Philippines.

3.18 ***SME Finance.*** IFC's strategy is to increase the access of SMEs to long-term financing by helping domestic banks downscale into SME lending, creating credit bureaus that provide information on small-scale borrowers, and expanding the use of leasing and other intermediaries as an SME financing tool. With donor assistance, IFC is currently exploring a different model for SME financing whereby IFC provides a credit facility to banks for SME on-lending, which is combined with technical assistance that improve banks' SME credit skills, and an incentive scheme that rewards banks that achieve certain volume targets and portfolio quality. The incentive program, which is intended to help the participant banks offset high program start-up costs, will decrease gradually as the banks become more sustainable and profitable in SME lending. This new model is designed to help increase the capacity of banks to expand their SME lending and ensure that IFC's credit lines for SMEs reach their intended targets and achieve the anticipated development impact.

3.19 ***Microfinance.*** In the microfinance sector, IFC has a four-pronged strategy for the promotion of commercial microfinance globally: (i) "greenfield" approach; (ii) NGO transformation approach; (iii) bank down-scaling approach; and (iv) microfinance investment vehicles approach. IFC contributes and leads in concept design of investments, as well as in structuring, due diligence, manager selection, marketing, investing, and corporate governance. Investments typically combine financing with well-targeted technical assistance to investee MFIs, banks and/or strategic partners. IFC implements its microfinance strategy through debt investments, equity and quasi-equity investments, credit enhancement products, risk management and risk sharing products and pooled investments targeting micro and small business financial intermediaries.

### **Renewables, Energy Efficiency and Sustainable Natural Resources and Agribusiness**

3.20 Supporting sustainable businesses at a time when there is a substantial increase in demand for commodities worldwide also provides IFC with many important areas of growth. Renewable energy is a leading example, as it is expected to meet 18 percent of electricity demand growth from 2000-2030. IFC will focus on the promotion of energy efficiency and renewable energy projects whose activities benefit the global environment and which allow environmental SMEs to develop new business opportunities and open profitable new markets for domestic financial institutions. IFC has created a strategic technical assistance program on the environmental and social aspects of finance and investment in the emerging markets. By providing technical support and innovative financing, IFC helps clients improve their operational efficiency by optimizing resource use. IFC is also developing co-financing relationships with bilateral and multilateral partners with an interest in this area.

3.21 The project-based trading mechanisms under the recently ratified Kyoto Protocol give IFC the opportunity to engage and facilitate the development of the carbon market. Project-based carbon trading is not a subsidy or a grant or a giveaway of some sort, but a market-based mechanism in which an exchange of value takes place. Within 10 years 'carbon' will be a key value driver in our operations and the private sector will be the primary conduit for trading and unlocking value. Carbon will be relevant in most of IFC's operations by 2015: Energy (power generation, oil & gas, mining); Infrastructure (utilities, transport, logistics); Industry (manufacturing, chemicals, agribusiness); and Financial Intermediaries (channels for new products) will all be affected.

3.22 IFC's engagement will allow it to enhance the sustainability impact of projects by helping (i) increase opportunities for environmentally-friendly projects by providing additional revenue, hence making them more profitable and less risky; (ii) monetize an environmental externality that will encourage investments in sustainable energy alternatives; (iii) reduce risks for buyers of carbon credits, which will encourage more buyers to transact with projects in developing countries; and (iv) develop structured finance products that IFC can offer specifically for the carbon market and which will facilitate

projects friendly to the global environment as well as enhance the competitiveness of IFC's traditional project and corporate finance products.

3.23 IFC expects to continue expanding its efforts in the promotion of sustainability for natural resource use and agribusiness. Currently, IFC is facing strong demand for its services in the extractive industry sector. Key challenges for IFC in the sector include ensuring more effective coordination of private sector investment support and policy work to help mitigate governance risks to expected extractive industry project benefits, managing the increased complexity involved in ensuring the sustained development impact of extractive industry projects, and increasing the value added IFC can bring to the sector.

3.24 The agribusiness sector also faces challenges across several dimensions (food safety, deforestation, water, biodiversity) that need to be addressed in order to strike a balance between the need to secure increased food production and the need to safeguard finite resources. The debate is also relevant to IFC's mission of poverty alleviation as, too often, poverty correlates with the degradation of natural resources. IFC will capitalize on the Business Management Practices (BMP) work initiated in FY04 to mobilize stakeholders around key principles of production for a selected number of commodities. Geographically, IFC's agribusiness support is aiming to expand outside of the Latin America and Caribbean region into East Asia and Eastern Europe. IFC uses linkages programs with SMEs to further develop agribusiness, and is looking to replicate the program in up to nine new agribusiness linkage projects through PEP Africa.

### **Issues and Challenges**

3.25 IFC is optimistic about the growth that lies ahead, however, the Corporation also recognizes that there are issues and challenges that need to be addressed if IFC is to be able to capture these opportunities for growth. While the Corporation is in a strong financial position and has the financial capacity to reach its growth targets, there are some specific single country or sector exposure issues in some of the larger countries that will need to be addressed. There are also signs of stretch in the Corporation's investment staff capacity. Implementation of IFC's strategy, which focuses on becoming an integrated finance and service provider, is resource intensive. IFC has increased its internal absorptive capacity for growth with enhanced internal controls and risk management, however, the number of investment staff executing the Corporation's strategy has remained relatively flat over the past five years. To grow the portfolio, provide integrated value-added services, and expand its development impact, IFC will need to increase the resources in its investment and supervision related areas.

### **Financial Capacity to Grow**

3.26 IFC's financial performance during FY04 was strong and the income outlook for FY05 is similar to the level achieved in FY04. These high income levels reflect in part favorable market environments and constitute a reversal of lower performance in prior years due to crises in a number of member countries. As a result, IFC's financial capacity has been strengthened and can support the strategy of a step-up in growth outlined in this paper, subject to some exposure concentration constraints.

3.27 IFC's capital is estimated to be able to support growth in aggregate commitment volumes of about 8 percent per annum, to potentially reach a mid-range annual commitment level of about \$6.5 billion by FY08, adding to the strong commitment volume levels of \$4.75 billion and \$3.85 billion achieved in FY04 and FY03 respectively. This 8 percent per annum level of growth is substantially higher than levels included in financial capacity estimates in past years, primarily due to recent strong financial performance. In terms of dollar volume, exposure in Russia, Brazil, Turkey, India and Mexico are

expected to range between 10 to 12 percent of the portfolio each, while exposure to China is also expected to grow significantly from current levels.

3.28 IFC has traditionally estimated sustainable growth levels based on stress tests assuming crises in two of its largest exposure countries, requiring levels of reserves around 50 percent of the affected portfolio. Stress tests of growth scenarios show that IFC has capacity to grow at about 8 percent per annum and also sustain a severe stress in one of its large exposure countries (representing about 12.5 percent of the portfolio), while continuing to be within all financial policy limits, with an adequate capital buffer, and a capacity to sustain a strong level of funding for technical assistance and advisory services activities. IFC's financial position also makes it possible to grow at these rates and sustain even more severe, but less likely, simultaneous stress events in two of its large exposure countries, or a higher exposure in one country, (representing about 25 percent of its overall portfolio). Although such a scenario would bring financial policy ratios closer to the limits and reduce the capital buffer, the ratios are estimated to remain within the policy limits during the 3 year planning horizon providing enough time to modify future strategies as such a scenario would probably not be consistent with continued high growth rates. In addition to adapting future commitments, Management would also be able to adjust the level of future designations for technical assistance and advisory services.

3.29 The above estimates are based on assumptions regarding key parameters such as portfolio growth, equity sales and income. These estimates will be refined in coming weeks and a more detailed analysis of capacity and financial implications will be provided in the forthcoming Annual Report on Financial Risk Management.

### **Human Resource Challenges**

3.30 Employing the *right* people to implement the strategy is an additional challenge facing the Corporation. IFC is confronting a number of constraints in trying to operate within the confines the World Bank Group's compensation framework. In recent months, IFC has begun to experience disturbing recruitment and exit trends which, if not addressed, will lead to erosion of core expertise and lack of operational capacity to grow the business and meet client demands. IFC has moved from a highly centralized institution to a decentralized organization committed to client focus. Recruiting and retaining the expertise needed in the field however, is often difficult. In transition economies such as Russia and China or in countries facing social change such as South Africa, there is a great deal of competition for local staff with the requisite language and business skills.

3.31 Another key challenge for IFC is to develop a business-oriented employment framework for staff who work on technical assistance (TA) activities. For IFC's business model to succeed, it is essential that its two core career streams, investment and TA, are managed within a coherent employment framework. The existing framework is too costly and inflexible for the TA line of business, and results in overpaying some staff and underpaying others. As IFC scales up its TA activities, particularly in strategic regions like Africa and the Middle East, a scalable HR framework for TA staff is an essential requirement. To meet this challenge, IFC is currently exploring a new approach to its TA employment framework that is cost-effective for the donors who look to IFC to manage this service delivery business efficiently.

3.32 Looking forward, the Board has requested a comprehensive review of the World Bank Group compensation framework in FY06. IFC Management believes this is an opportunity to develop and implement a modern compensation system that is both market-based and linked to results. A market and performance-driven framework would ensure a more disciplined, business-driven and cost efficient approach to human resource management, while allowing for sufficient flexibility to hire and retain top talent.

### **Managing Growth of Technical Assistance**

3.33 Managing the growth and strategic focus of technical assistance and advisory services (TAAS) is another area of challenge. IFC has seen rapid growth of the number of technical assistance programs it operates and corresponding increases in TA staff. IFC is currently institutionalizing a cadre of technical assistance professionals that will provide the backbone of IFC's TAAS throughout the world. IFC is also working hard to put in place systems which will monitor and evaluate the effectiveness of the Corporation's technical assistance. Going forward, IFC's first priority will be to make a success of its existing facilities.

### **Resource Implications for Growth**

3.34 To execute IFC's growth strategy, the Corporation will need to increase and strengthen its operational staff, and in particular its investment staff. For several years, the number of IFC investment staff has remained flat at approximately 380 investment officers. Because of this constraint, IFC's commitment growth in the past few years has been realized largely by increasing the size of the average project, rather than increasing the number of projects. IFC will need to do more projects, and projects with a more complex nature as it seeks to scale up the implementation of its strategic priorities. As operational capacity has become the limiting factor for investment activity, incremental resources now need to be concentrated on: (i) the operations departments and departments directly involved in project processing; (ii) planning and managing technical assistance and advisory activities; and (iii) a more proactive management of the equity portfolio.

3.35 In addition to the budget increase that would need to be directed to increasing operational capacity, there are substantial costs that must be incurred in FY06 and beyond for: (i) implementation of the Sarbanes-Oxley regulations; (ii) conversion to International Financial Reporting Standards; (iii) changes in World Bank Group benefits for field staff working in exceptionally difficult conditions; (iv) enhanced security in the field; and (v) depreciation of the US dollar.

3.36 If approved by the Board, IFC would begin to implement its staffing plan immediately. However given the substantial time required to recruit, train and integrate new investment staff, IFC anticipates that the impact of the budget increase will not be as great in FY06 as in FY07, by which time a large majority of the new staff will be on board. The above estimates are only indicative at this point. Specific IFC budget proposals will emerge from a detailed internal review of resource over the next two months and will be presented to the Board in June 2005.

#### **Box 3.4 Resource Needs for Investment Staff**

As noted in para 3.34 on page 29 the number of IFC investment staff has remained flat for the past few years, and the Corporation will need to increase and strengthen its investment staff in several areas, for example:

- ***Additional staff in key industry departments.*** As the investment program has grown, staff has become more stretched. Investment officers who process transactions are being asked not only to appraise and structure complex deals, but to oversee project development work, identify sustainability issues and coordinate advice on corporate governance and other issues. To grow the program over the next few years, IFC will need to recruit more investment related staff, including investment officers and transaction lawyers.
- ***Investment in business development.*** IFC's growth strategy assures expanded geographic coverage to more frontier countries, and frontier regions of larger countries in order to bring in a wider clientele and address the needs of underserved populations. IFC plans to establish a few key secondary centers of some of our larger member countries (such as China and India), or expand staffing in the existing offices to cover wider areas to reach this potential client base. Local and international staff would be used to conduct business development from these locations. Also, in key sectors such as infrastructure, IFC needs to place resources on the ground to facilitate coordination among key private sector participants, the government and other multilateral and bilateral institutions, to improve the understanding of alternative mechanisms (e.g., privatization, concession or PPP), to help put in place appropriate frameworks for private participation and to structure pilot transactions with appropriate risk sharing among the parties involved. (This approach has already been piloted in certain countries in Africa and it is replicable in parts of Asia and Latin America if IFC had the resources to do so.)
- ***Investment in Portfolio Supervision.*** Resource limitations are also arising in the areas of project supervision, and compliance functions that are essential for sustaining the quality of the debt portfolio. The intensity of supervision has grown substantially as IFC has increased debt financing to local companies and expanded its capacity building work with financial institutions. Enhanced monitoring/contribution by IFC is also required for the equity portfolio, especially in the financial sector. Here, substantial growth in equity commitments, coupled with the need to realize capital gains require added attention and resources. To protect and sustain this growth, added portfolio monitoring resources will be needed to provide counseling and advice to equity investee companies, supporting IFC nominated directorships, funding of senior resident advisors, and other external costs. There are no offsetting fees to compensate for this on the equity side. Moreover, to retain the quality of the overall portfolio, IFC must continue to maintain an adequate level of regionally based supervision, which is on-balance more costly but more effective than HQ-based supervision.

3.37 IFC would need to continue to seek vigorously further substantial economies and efficiency gains. In addition, IFC has demonstrated in the past that it can make budget cuts, when warranted, especially in difficult times as it did in FY03 when IFC made redundant 5 percent of its staff complement. IFC is determined therefore to maintain strict budgetary discipline in the upcoming years, improve cost-effectiveness and identify lower-priority activities that can be terminated while seeking to optimize the use of its capital base and maximize its development impact.