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Independent Evaluation of IFC's Development Results 2009

Knowledge for Private Sector Development

The Independent Evaluation of IFC's Development Results 2009[1] assesses the development outcomes and additionality (unique role and contribution) of IFC interventions. It analyzes factors driving results, and reviews performance patterns on a thematic topic. This year's thematic is IFC's Advisory Services (AS), knowledge services that IFC provides to either private companies or governments in support of private sector development. The report's main findings are:

- Investment Services (IS) results improved overall. Seventy-two percent of IS operations maturing between 2006-08 achieved high development outcome ratings, compared to 63 percent between 2005-07 (Fig. 1). Performance was especially strong in Europe and Central Asia (ECA) and Latin America and the Caribbean (LAC). But there was no improvement, from a low base of around 50 percent, in East Asia and Pacific (EAP), Middle East and North Africa (MENA), and Sub-Saharan Africa (SSA). Most operations were implemented prior to the crisis and thus results do not yet reflect the deterioration in global economic conditions.

- The rapid growth of AS has changed the nature of IFC. The 1,262 AS staff make up nearly half of all IFC's operational staff, and AS teams now dominate IFC's presence in the field. Quality trade-offs are possible, given the high reliance on relatively new staff, outsourcing work through some 1,300 short–term consultants, and considerable organizational change. An overall strategy has been lacking.

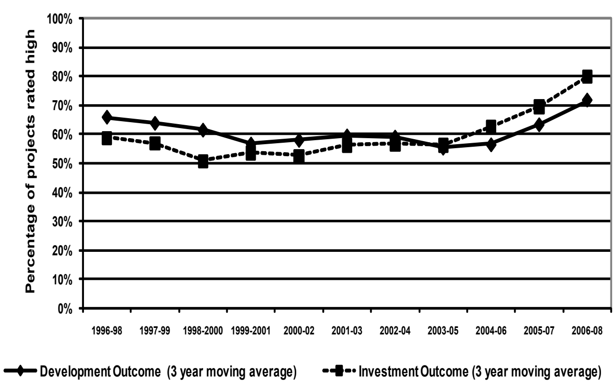
- In terms of results, 70 percent of reviewed AS operations achieved high development ratings. Performance has been strongest in Southern Europe and Central Asia (SECA) and weakest in LAC. As shown in Figure 2, results were significantly better for infrastructure (INF), business enabling environment (BEE), and corporate advice (CA) operations and weaker in the case of environmental and social sustainability (ESS).

- Key drivers of AS performance have been: client commitment; programmatic approaches; IFC's additionality including through some, though not all, AS-IS links; and local presence and ownership and monitoring and evaluation (M&E) quality. Charging for AS has been associated with better performance.

The Independent Evaluation of IFC's Development Results 2009 was discussed at a Committee on Development Effectiveness meeting on March 11, 2009.

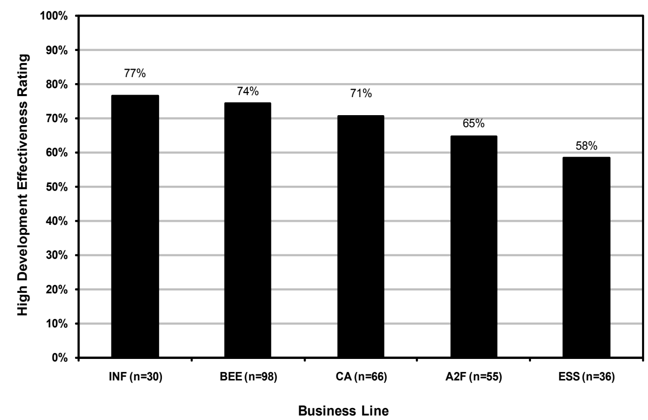
- To enhance development impact, the report recommends that IFC: i) Effectively manage the tension between protecting the portfolio and responding to opportunities during crisis; ii) Set out an overall strategy for IFC advisory services, addressing the need for a clear vision and business framework and more closely linked with IFC's global corporate strategy; iii) Pursue more programmatic AS interventions; iv) Improve execution of the AS pricing policy; and v) Strengthen AS performance measurement and internal knowledge management.

Figure 1: Development outcomes of IFC investment operations improved in the last three years



Note: Three year moving averages; 'High' = met or exceeded benchmarks

Figure 2: In Advisory Services, environment and social sustainability project ratings have lagged those of other business lines [2]



Note: Excludes cases where it was too early to rate, or where data was insufficient

Background

Over the last decade, many developing countries have experienced strong economic growth, typically accompanied by falling levels of poverty. The private sector has been a key contributor to this growth, through new capital investment, but also through innovation and entrepreneurship, helping create jobs and opening up new markets. Developing countries with the highest levels of private investment and that have made the widest strides in bridging knowledge and technology gaps with the developed world—from India to the Baltic states—have generally grown the quickest.

The current global financial crisis places many of these hard won gains under severe threat. The crisis began in the developed world, but has since spread to the developing world, and has particularly affected countries with economies more connected to global markets. Import demand from developed countries is falling, and companies in developing countries, both large and small (particularly small), have also found that funds for new investment have dried up, or have become much more expensive and more difficult to obtain. Private capital flows to developing countries in 2009 are expected to be, at best, around half their level in 2007 (of $1 trillion). Past crises suggest that it may take some years for these flows to return to their pre–crisis levels. More generally, the crisis has led policy makers and analysts to reevaluate the role of markets and the private sector, particularly where the value of effective regulation, prudential oversight and fiduciary management was wrongly de–emphasized or ignored.

In times like these, IFC's dual role as a financier and as a provider of knowledge (together with the World Bank) assumes particular importance. Concerning the first role, IFC's founding articles state that it should invest in viable private sector projects in developing countries for which 'sufficient private capital is not available on reasonable terms'.[3] In such crisis times, the onus is on IFC to ramp up its financing efforts. But IFC's role as a knowledge provider (together with the World Bank) is also important, particularly as policymakers and administrators focus on business regulations, good governance, and the environmental and social sustainability of growth. The role entails providing advice that helps shape the conditions for sustainable private sector development —through, for example, promoting more effective regulation—and to enhance the capacity, skills and behavior of actors involved with private sector enterprise on the ground (including effective management of the social and environmental effects of private activities).

This year's Independent Evaluation of IFC's Development Results (IEDR) looks at each of these roles in turn: IFC's effectiveness in financing development, through its growing portfolio of investment operations, with an emphasis on IFC's experience during previous crises and helping clients mitigate investment risks (Part I); and, for the first time and thus the main theme of the report, IFC's experience organizing and delivering its Advisory Services (AS) interventions—knowledge services that IFC provides to either private companies or governments in support of private sector development (Part II). In

terms of results, the report focuses on IFC investment operations that reached early operating maturity between 2006 and 2008 and IFC AS projects with Project Completion Reports during the same period. The review of AS development effectiveness comes with certain caveats, given the M&E system was only introduced in 2006, and considering the often intangible nature of knowledge transmission. Nonetheless, the report for the first time provides a combined account of both arms of IFC's business (i.e. investments and AS), including situations where these instruments have been offered to the same client. The report also complements a recent IEG evaluation of the effectiveness of World Bank Economic and Sector Work and Technical Assistance, which was completed in 2008.[4]

Financing Development

IFC's portfolio of investment operations (loans, equity, and other financial products) continued to grow in the last year. The cumulative volume of active investment activities increased by around a quarter, from $32.7 billion in fiscal year (FY) 2007 to $40 billion in FY 2008. The number of investments rose by a lesser order (8 percent), reflecting a general preference for larger investment operations (increasingly involving corporate finance rather than project finance), and a more wholesale approach to reaching SMEs, i.e. through financial intermediaries and larger companies.

A growing portfolio provides opportunities to extend IFC's development reach. IEG's evaluations of investment operations that reached early operating maturity between 2006–08,[5] show that IFC's project development results (along with IFC's financial returns) improved overall. More specifically, 72 percent of evaluated projects (85 percent by volume) achieved outcomes that, on balance, met or exceeded project financial, economic, environmental and social benchmarks and standards, and made positive contributions to private sector development beyond the project. This compares with 63 percent of projects (75 percent by volume) achieving high outcomes in 2005–07. On a cumulative basis, since independent evaluation started in 1996 up to and including 2008, 62 percent of projects (70 percent by volume) have achieved high development outcome ratings.

Stronger overall results in the outer years reflected several factors: i) the exit of a particularly weak performing cohort of projects that matured in 2005 (51 percent of projects maturing in 2005 realized high development outcomes, compared to 75 percent maturing in 2008); ii) more favorable economic conditions in much of the developing world (until late 2008, by which time most evaluated projects had been substantially implemented); iii) improving IFC project appraisal and structuring quality; iv) the conscious move by IFC toward larger projects, which have been more likely to achieve high ratings than smaller projects, due in part to greater internal scrutiny; and v) especially strong performance in ECA and LAC, where the majority of mature operations are located. In these regions, business conditions were most supportive and IFC work quality strongest. South Asia (SA) exhibited improving performance, with higher IFC work quality than in the past.

Performance lagged considerably in EAP, and in the mainly low income MENA, and SSA—with barely a half of the projects in these regions meeting or exceeding specified benchmarks and standards. External conditions were partly responsible—projects in SSA and MENA generally featured high levels of country, sponsor and product competitiveness risks—but the quality of IFC's work and contribution to the project tended to have a larger impact. This was especially the case in EAP, where nearly 40 percent of projects exhibited low quality IFC additionality. There is evidence of better screening and appraisal work in MENA and improved supervision quality in SSA.

Among IFC's strategic sectors, project performance showed continued improvement in health and education, was better in agribusiness, and remained strong in infrastructure and financial markets. At the same time, performance lagged in non–telecommunications information technology (software and internet).[6] In other sectors, oil, gas, mining and chemicals projects achieved relatively poor ratings. Risk exposure was clearly a factor in weak non–telecommunications information technology projects, most of which were small operations involving inexperienced sponsors and unclear product competitiveness. However, work quality in this sector was also well below par: high in just 40 percent of cases. Improved IFC work quality was in evidence in the health sector, where IFC showed that it had learned lessons from past experience, but the portfolio has not achieved much diversity. Oil, gas, mining and chemicals projects did not meet benchmarks for a number of reasons: sponsor technical weaknesses; higher than expected asset acquisition cost, and one case of unsatisfactory environmental compliance. Environmental and social effects ratings were stable for real sector projects, but remained weak in financial intermediary (FI) operations, reflecting the need to strengthen client capacity and securing commitment, as well as addressing shortfalls in IFC supervision and additionality.

The development results reported above do not yet reflect the sharp deterioration in global economic conditions, which has just now begun to affect investment returns in most developing countries. The development results reported here largely reflect project experience during 2003–08, a period of unprecedented growth in emerging markets. Most evaluated projects had been substantially implemented, and some had been closed, by late 2008 when the crisis started to affect the developing world.

The development results of maturing operations are, however, expected to decline in the coming years. Past evaluation shows that projects approved in the years prior to the crisis (and being implemented during the downturn) are most at risk from a development perspective. Approximately 40 percent of IFC's

portfolio (62 percent by volume) falls into this category, thus IFC is exposed to considerable downside development risk. At the same time, IFC has strengthened considerably its internal risk management processes and its capacity to bear and manage financial risks appears to have improved significantly in recent years. Importantly, evaluation suggests that investments approved in the wake of the crisis, i.e. at the bottom of the business cycle, will tend to have better development results. Thus, there are also upside opportunities to be grasped.

The experience of past crises underlines two key responses by IFC: first, careful portfolio risk management, particularly for projects in early implementation; and second, IFC additionality. The latter is particularly important in two respects: i) acting as an honest broker in restructurings; and, ii) in pursuing a well timed and targeted approach to new operations particularly through the signaling effect IFC interventions can provide to other investors.

Knowledge for Development

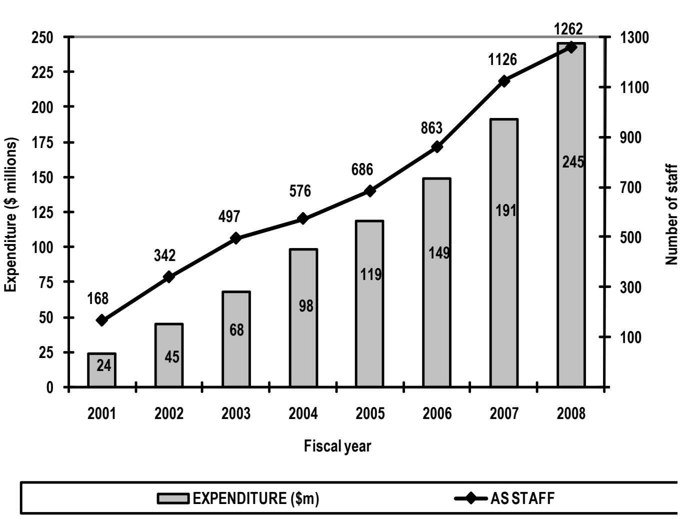
IFC AS have been growing rapidly, with an active portfolio approaching $1 billion and employing 1,262 staff, a sevenfold increase in the last seven years (figure 3). The nature and face of IFC has changed significantly: AS staff now make up the majority of IFC's presence on the ground in developing countries.[7] The rapid growth of AS has happened in a largely unchecked manner. This is well illustrated in the emergence of more than 50 AS products, 18 regional facilities covering seven regions, 13 global business units, and around a half of AS work being contracted out to consultants.

Important strategic questions follow. These include whether, in grafting such a substantial knowledge business onto a financing institution, IFC has the appropriate balance of effort between AS and investment services (IS) to ensure greatest development impact. Quality trade–offs are also possible, given substantial organizational change, a high reliance on relatively new staff (60 percent have been with IFC less than three years), and outsourcing work through some 1,300 short–term consultants each year. There is also increased possibility of conflict of interest or market distortion—where AS is offered together with financing, or is provided at less than market value.

IFC deploys its AS in the pursuit of general objectives that are common with those for IFC investments. These objectives include focusing on frontier markets including International Development Association (IDA) countries and frontier regions of non–IDA countries, as well as small and medium-sized enterprises (SMEs) and agribusiness, the strategic sectors of finance, infrastructure, health and education, and support for environmental and social sustainability (including climate change). The allocation of AS resources has been largely aligned with these priorities. That is, IFC AS have generally targeted high need destinations such as IDA countries and Africa in particular.

Relevance, however, does not guarantee impact. Fifty–two percent of IFC's AS projects, where ratings could be assigned, were rated high on achieved development impact. Projects rated substantially higher on other dimensions of performance such as strategic relevance, output, and outcome achievement with an overall development effectiveness success rate of 70 percent. Ratings did not change

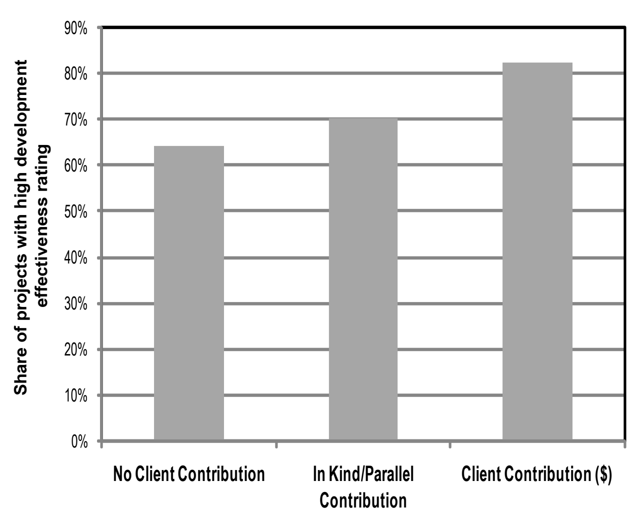
Figure 3: Advisory Services and AS staff have grown rapidly



Sources: IFC Human Resources; donor-funded operations quarterly AS financial reports.

Note: Includes activities of the foreign Investment Advisory Services, which are partly funded by the World Bank and Multilateral Investment Guarantee Agency (MIGA) (IFC is the main funds provider and manager). In FY08, IFC provided $11.8 million, MIGA provided $4 million (for investment policy and promotion activities), and the World Bank provided $2 million.

Figure 4: Stronger AS performance when clients make cash contributions



Source: Independent Evaluation Group

significantly for projects that began before, as opposed to projects initiated after, the major organizational changes in 2005-06. By region, ratings have been substantially better in SECA, and weaker in LAC. Evaluated global projects also did not perform well. By business line, infrastructure (INF), business enabling environment (BEE), corporate advice (CA) and access to finance (A2F) tend to perform better than environmental and social sustainability (ESS).

Looking at the main drivers of results, the review found a strong connection between client commitment (evidenced by contribution to project costs and especially so for ESS projects), (figure 4) strong project design and implementation, IFC's proximity to the client as defined by IFC's local presence and involvement, programmatic (rather than one off) interventions, and effective monitoring and evaluation (M&E)—and the achievement of development objectives. Strong additionality is fundamental for better performance. High additionality has been particularly noticeable among BEE operations in IDA countries with high business climate risk, and has been evident through some packages of services, such as SME linkage projects in agribusiness, manufacturing and extractive sectors. Such packaging raises potential conflicts of interest, which need to be tackled effectively, and needs appropriate pricing. Intrinsic constraints in capturing the impact of AS are compounded by the relatively weak application of M&E guidelines to date by IFC staff.

Over the last five years, IFC's management has taken actions to enhance its AS effectiveness, through efforts aimed at strengthening their organizational alignment and delivery processes. Efforts to bring greater structure and clarity to IFC's AS in the last few years include: categorizing AS activities into five business lines; consolidating some global and regional facilities; categorizing products by level of maturity; developing AS staff competencies; AS training; and establishing an AS Vice Presidency. IFC's attention to the delivery of advisory services has focused on establishing mechanisms and systems to ensure: adequate, sustainable funding; client commitment; sound project design and implementation, and robust M&E of performance. IFC's efforts in these areas appear to compare favorably with measures taken by other multilateral development banks, for example in the introduction of a pricing policy (that broadly seeks to build client commitment and reduce possible market distortion by limiting any subsidies to public goods), and an M&E system that seeks to capture outcomes and impacts, as opposed to just outputs. The momentum of transformation continues with the recent introduction of new policies, procedures and guidelines related to pricing, conflict of interest, funding and governance.

The professionalization of AS, however, remains a work in progress and significant organizational issues still persist: overlapping and parallel implementation structures in several regions (SSA, EAP and SA); few well established products outside of finance and infrastructure; lack of clarity about how AS and IS are best integrated in different contexts; limited consideration of IFC's comparative advantages relative to other knowledge service providers at the strategic and project levels; and no umbrella AS strategic framework to weave different strands together.

There are also substantial gaps in delivery that need to be addressed —particularly in matching corporate intent with consistent implementation on the ground. This applies with respect to the execution of the pricing policy, as well as ensuring good quality project design and implementation, and effective collaboration with other actors, including the World Bank. Getting the right staffing mix has been a particular challenge, with a heavy reliance on external, short–term consultants, and relatively new staff (compared to those involved with investment operations). The chosen mix has major implications for the quality and continuity of IFC's AS, and preservation of global knowledge leadership. At all stages of delivery, M&E data provided by staff and consultants (in particular) has remained unreliable. Relatedly, IFC–commissioned reviews of AS facilities, products and projects, while offering insights on the organization and delivery of AS, have exhibited shortcomings in independence and design.

Charging effectively for IFC's advisory services is perhaps the most important step going forward. Effectively charging clients for services will introduce a market test for AS and is likely to have a positive impact on all aspects of the business: in creating incentives for greater client buy in, stronger project design and implementation, stronger M&E, the development of products that best meet demand, and ensuring IFC additionality. In the immediate term, IFC would need to strictly implement the current pricing policy, which is largely cost–based, i.e. the price the client is expected to pay is a proportion of the cost of the project. Over time, efforts should be made to move to a market value–based approach to pricing, such that IFC does not run the risk of crowding out other knowledge providers. IFC investments are priced according to this principle for the same reason. The current economic crisis, and its likely effects on donor and IFC funding, is an opportunity for IFC to push harder in the direction of value–based pricing, and to encourage other development institutions to do likewise.

ENDNOTES

[1]The full-text IEDR, which includes IFC's management response, Chairperson's Summary: Committee on Development Effectiveness, and Advisory Panel statement can be accessed at http://ifc.org/ieg/reports.

[2] Business Lines: INF=Infrastructure; BEE=Business Enabling Environment; CA= Corporate Advice; A2F=Access to Finance; ESS=Environmental and Social Sustainability.

[3]IFC Articles of Agreement: Article 1 - Purpose.

[4]Using Knowledge to Improve Development Effectiveness: An Evaluation of World Bank Economic and Sector Work and Technical Assistance, 2000-06, Independent Evaluation Group, 2008.

[5]At early operating maturity, operations have generally recorded at least eighteen months of operating revenue, which is typically five years after approval;

[6]These results patterns across regions and sectors are broadly consistent with IFC's own self-assessments, although with some optimism bias in self-ratings, which were on average 5 percent higher than those assigned by IEG.

[7]In many country offices, outside regional hubs, IFC Advisory Services staff significantly outnumber investment officers and are the face of IFC in the country.

RECOMMENDATIONS FOR IFC

The review comes at a time of deep distress in financial markets and a severe downsizing in private economic activities. It reminds us of the critical importance of sustainable development in the private sector, for which regulatory frameworks are important and excessive deregulation costly. In these circumstances, the review provides further findings on what IFC might do to enhance development effectiveness and additionality:

IFC's operations during the crisis:

- **Effectively manage the tension between protecting the portfolio and responding to opportunities during crisis.** In the past, this tension has not always been managed adequately and IFC has missed opportunities to have a deeper impact. Experience suggests the importance of arrangements to isolate portfolio problems from new business development, to mitigate conflicts of interest that may impede effective collaboration with the World Bank and the International Monetary Fund (IMF), and to establish clear rules of engagement in crisis response, particularly for staff in the field. Experience also indicates the important role IFC and the World Bank Group (WBG) must play in promoting sound frameworks for prudent financial risk management and safeguards to ensure sustainable private sector development. This is especially relevant today, as the world reexamines the roles of governments and markets in the wake of the financial crisis.

IFC's role in Advisory Services:

- **Set out an overall strategy for IFC advisory services, that addresses the need for a clear vision and business framework, and is closely linked with IFC's global corporate strategy.** Following years of unchecked growth and recent organizational changes, the role of AS in IFC's business model needs to be addressed. The strategy would need to better articulate IFC's comparative advantages in AS, objectives and goals for AS in different contexts (a source of confusion among staff), and to consider the best staffing combinations (with respect to internal or external as well as global or local staff), delivery unit organization, incentives and performance measures to help realize these objectives and goals.
- **Pursue more programmatic AS interventions.** Evaluation shows that IFC has achieved better results in AS projects that have been carried out in conjunction with other AS interventions. One–off activities have been less effective. However, programmatic efforts of this kind have been in the minority (about a fifth of all AS projects), and IFC should accordingly seek to expand this type of intervention.
- **Improve execution of the AS pricing policy, through greater client contributions.** Over the longer term, it would be important to seek client contributions that reflect value and impact, i.e. not just cost, to create a true test of client demand, incentives for better AS delivery, and ensure IFC is being additional.
- **Strengthen AS performance measurement and internal knowledge management.** In the short term, it would be important to have more hands–on M&E support in the field, post–project completion follow up, lessons-capture (including from dropped or terminated projects), and more arms–length facility, product and project reviews. In the medium term, it would pay to introduce an expanded project completion report (XPCR) system (akin to the expanded project supervision report (XPSR) system for investment operations, and carried out later than the PCR to better capture impacts), more programmatic impact evaluation and impact research, setting results–based targets for AS in its corporate scorecard, and regular benchmarking of IFC AS activities and systems with other providers of knowledge services, including other multilateral development banks and commercial providers. In the longer term, the aim could be to establish a specialized research unit focusing on generating and bringing together private sector development knowledge work.

The IEDR was reviewed by a Panel of international experts in the area of knowledge and development. Panel members were: Professor Carl Dahlman, Luce Associate Professor of International Relations and Information Technology, Georgetown University School of Foreign Service; Acha Leke, Partner, McKinsey & Company; and Laurence Prusak, founder and former Director, Institute for Knowledge Management. In a joint statement, which was submitted to the Board under separate cover, the panel agreed with the above recommendations, and suggested additional steps IFC may take in the same direction. The Panel's report can found at http://www:ifc.org/ieg/reports.

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