Executive Summary

Growth is good for the poor, but the impact of growth on poverty reduction depends on both the pace and the pattern of growth. A pattern of growth that enhances the ability of poor women and men to participate in, contribute to, and benefit from growth should not come at the expense of a slower pace of growth. Including the poor in the growth process is also good for the pace of growth. This relationship underscores the critical importance of the pattern of growth for poverty reduction.

The International Finance Corporation's (IFC) mission is to create opportunities for people to escape poverty and improve their lives. It pursues this mission by promoting growth through support for private sector development. Attention to the type of growth that the institution supports is therefore critical for the fulfillment of its mission. IFC's approach in this respect has evolved over the years: from support to private sector-led growth in general, to promoting environmentally and socially sustainable growth, to—more recently—beginning to pay explicit attention to inclusive growth. There have been different perspectives of how IFC's support for private sector development is helping to tackle poverty. Yet, there is not enough clarity about what poverty means within the IFC context and how its interventions reach and affect the poor.

In the context of IFC's business model, IEG defined poverty focus as support for private sector development that contributes not only to growth but equally to patterns of growth that enhance opportunities for the poor. This type of growth is often referred to as inclusive, pro-poor, or broad-based growth. IFC is on the right track in its poverty focus, including making development impact a key driver of strategy, testing development goals in operational activities, and participating in funding the International Development Association (IDA). But it can more fully exploit the vast potential for poverty orientation in its growth supporting activities.

This evaluation covering fiscal year (FY) 2000 to 2010, aims to contribute to the enhancement of IFC's poverty focus and its effectiveness for a greater poverty impact. Poverty focus is assessed in terms of how its strategies, projects, and results measurement framework contribute to growth and to distributional patterns of growth that create opportunities for the poor.

At the strategic level, IFC's priorities on frontier areas and sectors such as infrastructure, agribusiness, health and education, and financial markets are largely consistent with a poverty focus in that they reflect geographic, sectoral, and equity aspects that, as evidence suggests, are correlated with enhanced opportunities for the poor. But strategic sectors are defined in such broad terms that although they are consistent with a pro-poor orientation, they need to be designed and implemented in ways that actually enhance opportunities and the impact on poor people.

The emerging development goals offer an opportunity for a stronger poverty focus along strategic priorities. Beyond the identification of priorities, improvements are needed in three areas. First, although the priority given to frontier markets has led to increases in IFC investments in IDA countries, these investments need to be allocated in more than the few IDA countries where they are currently allocated. Second, targeted sectors are based on sound development rationale, but IFC investments need to increase in these sectors, beyond financial markets where trade finance has contributed most to the expansion of investments. Third, IFC needs to con-

tinue to strengthen its partnership and communication with the World Bank to enhance its poverty focus and results.

At the project level, the assessment of poverty focus is based on a project's contribution to growth and the extent to which it addresses distributional aspects, including the opportunities that the project creates for the poor. Projects are designed to contribute to growth and therefore may have poverty effects. However, it has been challenging for IFC to incorporate distributional issues in interventions. Fewer than half of projects reviewed included evidence of poverty and distributional aspects in project objectives, targeting of interventions, characteristics of intended beneficiaries, or tracking of impacts. Where projects reflected distributional aspects, targeted the poor, and monitored the results, they were more likely to achieve better poverty outcomes. Projects that paid attention to distribution issues performed as well, if not better than, other projects on development and investment outcomes; this suggest that poverty focus need not come at the expense of financial success. A broad range of IFC's interventions can therefore be simultaneously pro-growth and pro-poor, but this link is neither universal nor automatic. A project's poverty focus is positively associated with the development orientation of partners, the link with WBG country strategies, and the alignment of investment and advisory services.

On development results, most IFC investment projects generate satisfactory returns but do not provide evidence of identifiable opportunities for the poor to participate in, contribute to, or benefit from the economic activities that the project supports. The fact that projects do not provide evidence of enhanced opportunities for the poor does not necessarily mean that they do not contribute to poverty reduction. Achieving satisfactory economic returns suggests that they make a positive contribution to growth and therefore most likely to poverty reduction. However, the relatively high proportion of projects that do not generate identifiable opportunities for the poor suggests the primary reliance on the pace of growth for poverty reduction, at a time when IFC's strategies point to more attention to the pattern of growth that it supports. Greater effort is needed in translating the strategic intentions into actions in investment operations and advisory services to enhance IFC's poverty focus.

IFC needs to adopt a more strategic approach to addressing poverty, including sharpening the definition and shared understanding of poverty and poverty impact within the IFC context, and providing guidance to staff on how to operationalize it within the development effectiveness framework at the strategy and project level. In particular, IFC needs to adopt more nuanced concepts of poverty when defining frontier regions, taking into consideration the incidence of poverty, spatial distribution of the poor, and non-income dimensions of poverty. IFC would also benefit from establishing a consultative framework, including the participation of relevant networks of the World Bank Group and partner organizations to deepen understanding and develop innovative approaches for understanding, measuring, and reporting of poverty impacts within the IFC context.

At the project level, there is a need to re-examine the stakeholder framework to address distributional and poverty issues in project design. IFC needs to make explicit in its interventions the underlying assumptions about how projects can contribute to growth and patterns of growth that provide opportunities for the poor.

On measuring results, for projects with poverty reduction objectives, poverty outcomes ought to be defined ex-ante, then monitored and reported. For projects that focus primarily on growth

but anticipates poverty reduction outcomes the assumption underlying the expected relationship should be stated at PDS approval with a rationale based on prior results or lessons from similar projects. These assumptions need to be tested periodically using field data and selected in-depth evaluations to learn about what works, what does not work, why, and in what contexts. IFC needs to provide technical support and advice to help develop the capacity of willing clients to track, assess, and report the impacts of their interventions on identified beneficiary groups.

Poverty Focus at the Strategic Level

IFC's approach to addressing poverty has evolved. Yet, its ability to reduce poverty through support for the private sector needs to be based on a clear understanding of poverty within the IFC context. As a member of the World Bank Group, IFC is in close proximity to expertise, knowledge, and resources on poverty issues. However, IFC needs to think carefully about questions such as who the poor are, where they are located, and how they can be reached. Such insights, based on experience and evidence, can enhance its growth and poverty reduction agenda.

IFC's strategic pillars are important parts of its poverty agenda. Three of the five strategic pillars—frontier markets, real sectors with widespread engagement of the poor, and certain types of financial services—aim explicitly at supporting the kind of growth that provides enhanced opportunities to the poor to participate in, contribute to, or benefit from growth.

Investment Services

Focus of Frontier Markets: IFC increased the volume and share of investment commitments to IDA countries over the evaluation period. The share of its total commitments in IDA countries rose from 19 to 31 percent from 2001 to 2010. The number of IDA countries with investments nearly doubled, from 32 to 58 over the period. Investments and country coverage in Sub-Saharan Africa also increased significantly. Involvement in IDA countries accelerated starting in FY 05, mainly because of the Global Trade Finance Program (GTFP). IFC's relative investment share in IDA countries is higher than that of foreign direct investment (FDI). However, IFC's investments in IDA countries have been heavily concentrated in few countries. From 2000 to 2007, IFC's level of concentration in the top four IDA countries was higher than that of FDI flows as well as IDA's own lending. This pattern changed during the crisis. Since 2008 IFC's investments in the top four IDA countries have been less concentrated than FDI. This change reflects the effects of IFC's crisis response which focused mainly on smaller markets, developing countries, and SME clients.

IFC's relevance and additionality in middle-income countries (MICs) depends crucially on how well it defines its poverty agenda there. Frontier regions in MICs are defined on the basis of per capita income differential between country and regional averages. This criterion tends to focus IFC on the regions with the highest poverty rates. However, poverty maps show that the largest concentrations of poor people are not in the locations with the highest poverty rates. This, together with the diversity of poverty in MICs and the importance of non-income dimensions of poverty in providing access to opportunities, suggests the need for a broader set of criteria that incorporates income and non-income dimensions of poverty.

Focus on Targeted Sectors: IFC is also targeting sectors with the potential for widespread engagement of the poor, such as financial markets, infrastructure, health and education, and agribusiness. Within these targeted sectors, investments have also been highly concentrated. In FY10, commitments in financial markets accounted for 75 percent of total investments in targeted sectors. In IDA countries, the concentration was even higher. Within financial markets, investments are highly concentrated in the GTFP, which grew rapidly after 2005.

In principle, short-term trade finance can make important contributions to growth and poverty reduction by facilitating easier access to credit, helping importers, exporters, and SME clients with financing needs that support trade transactions. Through the GTFP, IFC increased its presence in the poorest countries, helped fill finance gaps for essential goods, and increased activity in

sectors such as agribusiness. Yet, the development and poverty impacts of these interventions have not been assessed at the project level. IFC is aware of this and is currently developing a results measurement framework for GTFP. In relative terms, IFC investments in infrastructure, agribusiness, and health and education have changed little over time. Investments in infrastructure, agribusiness, and health and education could have significant growth and poverty impacts. But the extent to which projects in these sectors actually benefit the poor depends on strategic choices relating to the type of projects selected; incorporation of design features that benefit the poor; and robustness of monitoring and evaluation systems to track progress, take corrective actions, and assess impacts on the poor.

IFC's strategic directions emphasize a focus on micro, small, and medium size enterprises (MSMEs) as major elements of its growth and poverty agenda. IFC's total investment commitments in MSMEs grew from $400 million in fiscal 2000 to $3.1 billion in 2010, accounting for 17 and 24 percent of investments respectively. IFC's strategy of supporting MSMEs through financial intermediaries has been effective in that it is reaching a large number of MSMEs. For example, IFC reports that the SME and microfinance loans extended by IFC clients almost doubled from 2006 to 2009 to reach $101.3 billion and $10.8 billion respectively.

MSMEs account for the largest part of the private sector in many developing countries, creating jobs and investment opportunities. The needs of MSMEs are substantial in both IDA and non-IDA countries. However, responding to these needs in an effective manner has been a challenge for the development community. Empirical evidence on the poverty impacts of microfinance institutions (MFIs) is mixed with some studies showing a positive impact on borrowers' welfare while others point to significant risks and downsides. SME's tend to face greater constraints to their growth compared to large firms. Thus there is strong development rationale for IFC's support. However, research shows that there are many questions about the efficacy and welfare impacts of interventions seeking to support SMEs that need to be addressed to enhance the impact of SMEs on growth and poverty reduction. The magnitude of the challenges imply that carefully targeting investments in these diverse situations will be critical in leveraging growth and poverty impacts in both IDA and non-IDA countries

Advisory Services

Advisory services have become an important pillar of IFC's operations, having grown more than tenfold in expenditures and sixfold in staffing between FY01 and FY10. Advisory services have been the primary vehicle for IFC's interventions in the poorest countries and those with more difficult and challenging business environments, where the opportunities to support private investments have been more limited. This is reflected in Advisory Services allocation today: Access to Finance is the largest business line, and IDA and Sub-Saharan Africa account for the largest share of expenditures and portfolio.

Improving the Investment Climate: Activities in this area have often been the entry point for IFC in IDA countries. Products in recent years have been adapted to needs and constraints in poor countries. Areas that tend to support a more inclusive growth pattern, such as formalization through entry and tax reforms, alternative dispute resolution mechanisms, and sub-national and rural investment climates, are beginning to receive more attention. In moving towards addressing sector-specific investment climate issues, IFC's effectiveness would be enhanced by aligning with investment activities in targeted sectors and clarifying the causal links and assumptions through which growth induced by improvements in the investment climate is translated into poverty impacts.

Integrating Small and Medium-Size Enterprises (SMEs) into Supply Chains: The ability of poor people to benefit from growth often depends critically on the extent to which they can take advantage of the opportunities created by the linkages to larger investments. This is an area where the potential for synergies between IFC's investment and advisory services for leveraged impact on the poor is particularly strong.

IFC is helping clients improve the efficiency of their supply chains by creating business opportunities for local suppliers, including local sourcing platforms and community investment strategies.

In recent years, an increase in these activities has been accompanied by a substantial shift in product mix, from community investment activities and local sourcing to a focus on inclusive supply chains. The potential of such operations to leverage benefits for the poor depends critically on building trust between the transacting parties and helping address capacity, information, and incentive issues associated with the reliability of supply and purchases—areas where a third party with a development focus like IFC can play a useful role.

Increasing Access to Finance: More than half of Access to Finance expenditures are in IDA countries. Support to institutions that provide access to finance at the micro and retail level make up around one-third of expenditures; this is closely followed by support to institutions that provide access to finance to SMEs. In FY10, 12 percent of funds were allocated to financial infrastructure work such as support for credit bureaus, securities markets, collateral registries, and payment systems. These activities have been shown to be critical in unlocking barriers to expanded access to financial services and financial sector deepening.

Going forward, there will need to be a careful balance between sector-wide approaches, such as supporting financial infrastructure, with approaches that provide support for access to finance through financial intermediaries. The impact that different types of intervention have on poverty is not always clear. A few carefully selected and rigorously conducted impact studies could thus provide valuable lessons of what works, does not work, why, and under what conditions.

Performance-Based Grants Initiative (PBGI): In 2005, IFC's Board approved funding for a result-based financing mechanism to enhance access to services to the poor in developing countries. PBGI focuses on delivery of infrastructure services and access to finance. In these areas, PBGI interventions show promise and there is appetite for mainstreaming PBGI. But before scaling up PBGI, greater consideration needs to be given to a number of key issues, including its long-run sustainability, effectiveness of delivery mechanisms, private sector incentives, and fiscal implications.

Poverty Focus in IFC Projects

Extent of Poverty Focus at the Project Level

The measure of poverty focus in this evaluation is broader than IFC's support to companies with inclusive business models, which is defined as companies and projects that offer goods, services, and livelihoods to the poor in financially sustainable and scalable ways.

At the project level, 481 investment projects approved between FY2000 and FY2010, including 158 projects evaluated between 2005 and 2009, were randomly selected to examine how projects addressed growth and distributional issues. A project's contribution to growth is measured by its expected economic rate of return (ERR), insofar as it is well estimated. The incorporation of distributional aspects of growth in projects was assessed based on design and implementation features using one or more of the following criteria:

- Project objective had an explicit focus on the poor and/or underserved.
- Project identified mechanisms, such as geographic and household criteria, for targeting the poor and underserved.
- Project design pays attention to distributional issues, measured by explicit consideration of poverty characteristics (geographic, community, individual) of intended beneficiaries.
- Mechanisms were incorporated to track poverty and social outcomes during project implementation.

The majority of IFC projects are designed to contribute to growth. Of 211 nonfinancial sector projects, 86 percent reported ERR estimates of more than 15 percent. Given a benchmark ERR of 10 percent, this shows that the majority of projects are expected to generate net positive returns in the economies in which they are being implemented.

The link from growth to poverty reduction is not automatic, particularly in situations where market failures and other inefficiencies limit participation of the poor in growth. Thus deliberate action is often required to incorporate distributional aspects of growth into project design and implementation.

With respect to distributional issues, based on IEG's definition, across the sample, 13 percent of projects had objectives with an explicit focus on poor people. Of projects with objectives that explicitly focused on the poor, 87 percent had interventions that engaged poor people directly through employment or provision of goods and services.

Few projects incorporated a clear mechanism for targeting the poor. In the cases where projects did target the poor, geographic targeting—such as focusing project activities in frontier and rural areas or urban slums—was the most frequently used mechanism. Identification of distributional effects on the intended beneficiaries was the most frequently used design feature to address poverty issues at this level.

Incorporating distributional issues into projects has been challenging for IFC. Despite the increase in poverty focus at the broader strategic level, less than half (43 percent) of projects had both (i) an expected ERR greater than the benchmark and (ii) included at least one type of mechanism that addressed distributional issues at design or implementation.

The choice of sponsors, joint investment and advisory services work, quality of analytical work, and links to Country Assistance Strategies are important drivers of attention to distributive issues in project. IFC's work quality did not significantly correlate with incorporation of distributional issues. This suggests that such issues were not considered adequately at project design.

In IDA countries, there was a significant difference in development outcome ratings when projects paid attention to distributional issues. By and large, greater attention to poverty-related distributional issues is associated with improved development outcomes in frontier countries.

Market failures and distortions tend to affect access to economic opportunities (access to markets, access to employment opportunities), assets (finance, land, information), or basic or essential services (electricity, justice) by the poor. Through its advisory services, IFC should seek to address market failures and distortions that limit the participation of the poor in the growth process. A review of 98 randomly selected projects indicates about one-third provided evidence of alleviating market failures or distortions that inhibit participation of poor people in markets and other growth opportunities. Of these projects, the most frequently addressed problems related to enhanced access to markets, business opportunities, and finance for disadvantaged groups. Issues related to access to land, employment opportunities, and basic and essential services receive relatively little attention. Greater attention on addressing these types of market failures can increase participation of the poor in markets and enhance growth opportunities that benefit them. Some projects addressed economy or sector wide issues with potentially significant growth and poverty reduction effects. However, there was limited evidence of the linkages between project outputs and poverty outcomes.

Impact through a Poverty Lens

Poverty Outcomes in Investment Services

In the evaluation, a distinction is made between projects that rely on growth in general to distribute benefits to the poor and those that support a more inclusive growth pattern. Data for the assessment come from 158 mature projects that were evaluated between 2005 and 2009, with Expanded Project Supervision Reports randomly selected from IEG's database of project evaluations.

Projects that supported a more inclusive growth pattern performed as well as, if not better than, the rest of IFC's projects on development and investment outcomes, suggesting that poverty focus should not come at the expense of financial success. Projects were more likely to provide evidence of poverty outcomes when there was a focus on the poor in expected development outcomes, project activities targeted the poor, distributional issues were made explicit, or poverty outcomes were tracked during project implementation.

IFC's evaluation framework does not quantify benefits to poor and vulnerable groups and thus has no specific indicator for measuring a project's poverty effects. Given the limited attention to distributional issues in the monitoring and evaluation framework, IEG used a poverty index to characterize project benefits on the basis of their contribution to growth and inclusion of the poor.

The majority of investment projects generated satisfactory economic returns but did not provide evidence of identifiable opportunities for the poor to participate, contribute to, or benefit from the economic activities that projects directly or indirectly support. The fact that projects did not provide evidence of identifiable opportunities for the poor does not necessarily mean that they did not contribute to poverty reduction. The findings reflect a failure to articulate the poverty effects of projects that focus primarily on economic growth. Achieving satisfactory economic returns suggests that they make a positive contribution to growth and therefore most likely to poverty reduction. However, the relatively high proportion of projects that do not provide evidence of identifiable opportunities for the poor suggests a primary reliance on the pace of growth for poverty reduction, at a time when IFC's strategies point to more attention to the pattern of growth that IFC supports.

Only a few of the sample projects both delivered high levels of growth and demonstrated evidence of inclusion of the poor. Such projects provide learning opportunities that can be used to enhance IFC's poverty focus. It will also be useful to understand the poverty implications on projects in the high-growth, evidence of low-poverty outcome quadrant to articulate and better understand how IFC's overall poverty focus can be enhanced.

Poverty Outcomes in Advisory Services

Analysis of development outcomes from advisory services was based on qualitative assessments and development effectiveness ratings. A review of 98randomly selected closed advisory services projects showed that 10 percent had identified benefits to the poor and 40 percent delivered benefits to society but did not provide evidence of enhanced opportunities to the poor. The rest consisted mainly of company level support or explorative market studies that helped prepared the ground for more substantive forms of engagement with stakeholders. This limited evidence on identifiable benefits to the poor may reflect difficulties in capturing poverty outcomes from projects where the main deliverable is knowledge, a product that is intangible and very difficult to measure.

Looking Forward

As part of its commitment to achieve financial sustainability and greater development impact IFC is working to enhance its poverty focus and emphasize a shift from a volume output culture to development impact and financial sustainability, as well as measurement of development results. This shift is coalescing around the IFC Development Goals (IDG), a new set of development goals that is being piloted in selected investment operations and advisory services, and the creation of the Development Impact Department. The newly created Inclusive Business Models Group aims to enable IFC to expand its investment and advisory services support to companies with financially sustainable inclusive business models that provide goods, services, and livelihoods to populations at the base of the pyramid. . Most recent regional and sectoral strategies reflect an increasing focus on reaching the poor and linking with development objectives.

The evaluation findings provide lessons that can be used to help IFC translate its strategic intentions into further actions that enhances its poverty focus:

Lesson 1: Both the rate of growth and the distributional pattern of growth are key elements of a sound private sector-led strategy that creates opportunities for the poor.

Lesson 2: IFC's relevance and effectiveness in engaging the poor needs to move beyond a company-by-company orientation toward a focus on achieving broader development impact.

Lesson 3: Experimentation and innovation, combined with effective monitoring and evaluation, are key elements of a strategy to engage the poor for broader development impact.

Lesson 4: An enhanced understanding of the intended beneficiaries is key to creating opportunities for them.

Lesson 5: Acceleration of supportive activities that complement each other within IFC, the World Bank Group, and other partners can enhance effectiveness in delivering development impact.

Conclusions and Recommendations

IFC is on the right track to enhance its poverty focus, yet strategic intentions need to be more strongly translated into actions and impacts.

At the strategic level, IFC needs to:

- Adopt a more strategic approach to addressing poverty, including sharpening the definition and shared understanding of poverty and poverty impact within the IFC context, and providing guidance to staff on how to operationalize it within the development effectiveness framework at the strategy and project level. In particular, in MICs adopt more nuanced concepts of poverty when defining frontier regions, taking into consideration the incidence of poverty, spatial distribution of the poor, and non-income dimensions of poverty.
- Establish a consultative framework to support institutional efforts on understanding, measuring, and reporting of poverty impacts within the IFC context, including the participation of Poverty Reduction and Economic Management, Development Economics, and Finance and Private Sector Development networks of the World Bank Group as well as partner organizations to better address poverty and distributional issues, beyond company level impacts.

At the project level, IFC needs to:

- Re-examine the stakeholder framework to address distributional and poverty issues in project design.
- Make explicit the causal pathways, transmission channels, and underlying assumptions about how projects can contribute to growth and patterns of growth that provide opportunities for the poor.

With respect to its result measurement, IFC needs to:

- Define, monitor, and report poverty outcomes for projects with poverty reduction objectives; for projects that focus primarily on growth with anticipated poverty reduction outcomes, the assumption underlying the expected relationship should be stated at PDS approval with a rationale based on prior results or lessons from similar projects.
- Periodically test assumptions on how IFC interventions contribute to growth and poverty reduction through select in-depth evaluations to learn lessons about what works, what does not work, why, and in what contexts.
- Provide technical support and advice to help develop the capacity of willing clients to track, assess, and report the impacts of their interventions on identified beneficiary groups.