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Europe

Poland and Hungary are roaring economically, thanks in part to sound banking privatizations that have attracted top foreign partners—something the Czech Republic has lacked, helping keep it lagging behind them despite its considerable potential. But the country made a major breakthrough on June 24: after working closely with IFC for more than two years, it sold a controlling stake in one of its three big state-owned banks to a foreign strategic investor for more than $1 billion.

IFC had kickstarted the process back in 1997 by offering to invest $75 million alongside whoever emerged as the eventual buyer of Czechoslovenska Obchodni Banka (CSOB, the Czechoslovak Trade Bank). The vote of confidence from the World Bank Group helped attract strong offers earlier this year from Germany's Deutsche Bank and HypoVereinsbank as well as KBC Bank of Belgium, with KBC ultimately winning with a $1.4 billion bid for a 66 percent stake. IFC will hold 4.3% and help influence the strategic direction by joining the board of CSOB, now the first Czech bank with long-term debt upgraded to investment grade status by the major rating agencies. New parent KBC also owns a smaller stake in Hungary's privatized K&H Bank.

The transfer of CSOB to new management and ownership is the cornerstone of the Czech government's market-oriented reform plan for the financial sector and should help pave the way for future privatizations of the larger Komercni Bank and Ceska Skopitelna. UK investment bank Shroders advised the government in the transaction—the largest foreign investment to date in the Czech Republic, when KBC's anticipated purchase of the Slovak government's former 24 percent stake in CSOB is included.

Asia

In one of the largest corporate restructurings yet in the country where the East Asian financial crisis began, longtime IFC client Siam City Cement Co. and its 63 creditor banks have agreed on a plan that will enable the Thai company to gradually repay all of its $540 million of foreign currency debt and return to financial health.

The deal closed in Bangkok July 14, ending an intensive 18-month period in which IFC first advised Siam City on drafting its restructuring plan, then switched to the other side of the table, co-chairing (with Citibank) the committee of international banks that hammered it out with the company during extensive negotiations.

At the signing ceremony Thai central bank governor M.R. Chatumongol Sonakul called the agreement a model transaction he hoped others could follow. With the debt problems resolved, the firm is now “financially very robust and able to withstand significant future economic and market downturns,” IFC's Kip Thompson added.

IFC first financed Siam City in the late 1970s, when it was a little-known local company with only one plant. Over time it grew into a regional cement industry leader, one with excellent access to global capital until the Thai baht collapsed in July 1997. The resulting exchange rate volatility severely drove up the cost of servicing foreign debt, plunging the otherwise-strong company into sudden duress. For help it retained IFC, which organized an advisory team producing a transparent and viable workout proposal in July 1998 that all sides accepted as fair. That clear sign of progress then helped Siam City obtain critical new investment: one of the world's largest cement companies, Switzerland's Holderbank, bought a controlling interest for $153 million the following month, with Thailand's Ratanarak family and other existing shareholders adding another $150 million in fresh equity soon thereafter.

Under the new restructuring agreement Siam City has paid off an initial $250 million of its debt at full face value. The creditors, including IFC, have also rescheduled the remaining $290 million over 8.5 years based on updated cash flow and macroeconomic projections IFC produced. The company has thus gained valuable time to repay its debts, including a three-year grace period for principal only, and can begin selling non-core assets in order to rebuild its competitive position. Peter Redhead of ING Barings in Bangkok called the deal “one of the best examples of a Thai company that has embarked on both corporate and debt restructuring at the same time.”
Corporate Governance Goes Global

Rob Wright
IFC Corporate Relations Unit

Nobody said it would be easy. But the shareholder revolution is starting to spread...

He is a Chilean investor, and he is mad at what he has just learned.

A $1.5 billion friendly takeover bid for one of his most important holdings has turned out to be rife with hidden gains for its top executives. Conflict of interest charges abound: management has shafted the shareholders, secretly cutting a far sweeter deal for itself than was available to Cruz and other players on the Santiago Stock Exchange. The memory would still burn in his mind two years later.

“We felt we were being cheated, and were really angry,” he recalls today. “On a per share basis, the insiders were going to be receiving 580 times the amount we would be getting. So we investigated our legal options to see if there was the basis for a fight.”

Master of a $12 billion emerging market portfolio, he is happy about a victory he has just won.

Leaders of the company that represented his largest investment in Hungary had been making disastrous decisions. Their muddled moves helped drive down its stock — bad news for the legions of small investors entrusting their money to the Templeton funds Mobius runs. With all appeals exhausted, he saw only two options remaining: lose more money or try to topple the CEO and his backers on the board. He chose the latter, a high-risk move virtually unprecedented in Central and Eastern Europe.

It worked.

A new management team arrived to cheers from the Budapest financial community. It quickly brought in McKinsey & Co. and Andersen Consulting advisers to try to turn the company around. The stock price showed immediate recovery.

He runs a Korean mutual fund company, and he is amazed at the change in his country.

After three decades of cozy government protection, the Korean economy has done an about-face, opening to global capital as never before. The early results are promising, especially on the booming local stock market. Khwang’s shop has seen the money it manages rise by a factor of seven in six months, with mom and pop investors rushing into the markets, keenly watching the performance of the local companies they now owned. En route, a little-known business school professor named Jang Ha-sung suddenly gained folk hero status as the country’s first grassroots shareholder activist, launching battle after battle to rein in the country’s most powerful firms. He was a new David taking on Korea’s corporate Goliaths.
Five years ago such stories would have been unthinkable. But today they are the new face of finance.

Cruz, Mobius, Khwarg — important IFC partners all — are just some of those around the world who are fast moving corporate governance near the top of the development agenda. In an era when private capital is king, and crony capitalism is widely credited with plunging East Asia and Russia into economic crisis, a tough new message is starting to go out to the developing world’s CEOs and the controlling shareholders who appoint them: play fair, or be forgotten.

Just ask Mark Mobius.

“Corporate governance is the single most important issue facing developing countries,” he says.

A veteran IFC adviser, he has long been a hairless crusader working to make the process of investing in developing countries “FELT”: fair, efficient, liquid, and transparent. Otherwise, he argues, the mountain of capital these countries need, and that is available to them, will always prefer the safer havens of home. The facts back him up. Institutional investors in the US, Europe and Japan have more than $21 trillion at their disposal, according to a recent report by the New York-based Conference Board. Yet the total amount of private capital reaching developing countries in 1998 was only a little more than 1% of that ($233 billion).

“There is no lack of money out there, but it will not find its way into these markets under current conditions,” Mobius says with conviction. “And without good corporate governance and protection of shareholder rights, investment is simply not going to be effective over the long term.”

The issues at stake go far beyond the concerns of investors. To World Bank and IFC President James D. Wolfensohn, the process of keeping companies accountable to their owners is “a vital element in a modern democracy.” Why? Because, he says, “free markets do not work behind closed doors.”

“Good corporate governance can make a difference by broadening ownership and reducing concentrations of power within societies,” Wolfensohn wrote in The Economist. “It bolsters capital markets and stimulates innovation. It fosters long-term foreign direct investment, reduces volatility and deters capital flight. Moreover, it is only when high corporate standards are adopted that the public will trust their savings to companies to provide their pensions. This is a daunting concern for countries with weak social-security systems.”

Daunting, definitely. Maybe even downright scary. Imagine a 21st century world where aid budgets are increasingly constrained, making developing countries ever more dependent on their ability to attract private capital. It could also be one where industrialized nations grow ever richer, still investing almost exclusively in themselves because they can’t find enough companies from developing countries willing to disclose their true financial state...to allow independent voices onto their boards of directors...to stop management insiders from treating outside investors with disdain. Under these conditions, the private capital on which the developing world depends would never arrive in sufficient quantities. The fight against poverty would grow ever harder.

It is out of this fear that the Organization for Economic Cooperation and Development (OECD) and the World Bank have recently agreed to form a Global Forum on Corporate Governance. Their goal is to raise the profile of reform and help individual countries develop their own course of action. The initiative will bring together relevant international institutions (including IFC), developing and developed country governments, private sector participants, and other stakeholders to reach better consensus on how to proceed in this complex and difficult area.

**Life Lessons**

The time has definitely come.

“Good corporate governance is important for enhancing individual countries’ long-term economic performance and strengthening the international financial system,” an OECD-World Bank paper says. “This is one of the basic lessons that the world has learned from the recent crisis in emerging markets.”

Like many basic lessons, this one did not come without pain. By Institute of International Finance estimates, foreign equity investors lost $240 billion in the East Asian and Russian crises — blowing much of it, no doubt, on companies whose poor corporate governance standards were clearly visible long ago.

Badly bruised by this experience, the world is at last trying to mend its ways. The OECD has lately held conferences on corporate governance in Korea and Russia and adopted nonbinding global guidelines (www.oecd.org/daf/governance/principles.htm) that stem in part from the “shareholder value” movement that many call a key to the US productivity revolution of the 1990s. After all, nothing raises one’s output like having a demanding boss, and Wall Street increasingly believes companies perform best when watched closely by their owners.

Research proving this link is hard to find. But in one widely quoted study, Wilshire Associates found that 42 formerly poor-performing companies beat the New York Stock Exchange’s Standard & Poor’s 500 index by 41% in the five years after they felt heat from shareholders at the California Public Employees Retirement System (CalPERS). McKinsey & Co.
discovered that US investors will pay an average of 11% more for shares of companies whose boards
- have a clear majority of outsiders with no management ties
- are paid, to a large extent, in company stock and undergo formal performance evaluations
- respond to investor requests for information.

There are skeptics, of course. Arguments are made, sometimes with good reason, that the CEO doesn't always need nosy outsiders telling him how to do his job. And many investors clearly will continue risking money on poorly governed companies as long as the chance of high financial returns exists. What applies in the US, with well-developed bankruptcy and civil courts and company ownership widely dispersed among many small investors, also does not apply easily to developing countries, where the reverse is often true.

But who wouldn't want to be like Pfizer? The world's most admired pharmaceutical company, according to a Fortune magazine survey of international executives, it more than doubled its annual revenues between 1993 and 1998, with the increase in its stock price making more than $65 billion for its shareholders in that time.

Pfizer attributes much of this success to a checks-and-balance system of governance that is widely considered a model for others. Its board, which meets 10 times a year, makes all major decisions and has outsiders as 11 of its 14 members. All, including CEO William C. Steere Jr., have the same incentive for the company to do well: they are paid primarily in stock. Steere is one of the most active background voices in the corporate governance debate, seeing shareholders as friend, not foe. Corporate chieftains, he says, have "both a fiduciary and a moral responsibility" to their investors.

Unfortunately, not all his counterparts in the developing world agree. That makes today's sudden high-level governmental attention...
to an essential topic that had long been largely ignored in the developing world is good news indeed. But in the end corporate governance is a job for the private sector itself to carry out. And it is there that the real action has started taking place. The battles are in the boardrooms.

In developed countries, many of them are fought by pension funds. Entrusted with the retirement savings of large numbers of workers or retirees, they are a key constituency that listed companies must go to when trying to raise debt or equity. Their success at playing the markets gives people an essential source of ongoing income in their later years beyond personal savings and the government social security system. And whatever success they achieve does not come by flying blind: two giant US pension funds, the $260 billion Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF) and the $155 billion CalPERS are the trendsetters of corporate governance. In many ways they have set the standards for information disclosure and management accountability that the rest of the world is now starting to embrace. TIAA-CREF's John Biggs is one of the new OECD-World Bank initiative’s key advisers, along with Mobius and others.

"What corporate governance comes down to is an alignment of interests between a company's owners and its management," says Joe Chulick of the San Francisco–based Lombard Group, an investment house managing money from CalPERS and others. "Management often thinks they are the company, even though they really don't have that much money in it. They forget they have something else called shareholders."

It's hard to imagine how global financial centers like New York, London, Tokyo or Hong Kong could exist without private pension funds. In the developing world, though, privately managed pension funds are still in early stages. Most of those that do exist are modeled at least in part on Chile, the pioneer in the field with an 18-year history and $33 billion in privately managed assets. It was probably no accident that Chile was also the site of one of the first big victories for developing world shareholders.

**Chilly Winds**

In 1994 IFC put up $10.2 million to help launch both a new Chilean investment company called Moneda Asset Management S.A. and one of its groundbreaking domestic investment vehicles backed primarily by local private pension funds. Among Moneda’s early investments was Luz, one of five publicly listed holding companies for the country’s dominant electric utility, Enersis. The capital of these entities was divided between “Series A” shares available to the public and "Series B" shares held exclusively by Enersis's top management, led by CEO José Yuraszeck. Although representing only 0.06% of the holding companies’ capital, ownership of the latter in practice allowed management to appoint the majority of the Enersis board and thus exert effective control.

Enersis was a highly successful company, spinning out money left and right by producing an essential good in a high-growth region. It wasn’t long before it found a suitor. In July 1997 a major utility from Madrid, Endesa de España (EdE), announced a $1.5 billion tender offer for all of the holding companies' Series A shares.

Coming at roughly a 25% premium to the market price, the offer might have appeared good to public investors such as Moneda. But news to the contrary soon emerged.

A Chilean newspaper obtained records in New York indicating that Yuraszeck’s team had negotiated lucrative additional terms for themselves based on important agreements concerning the future strategic direction of Enersis that they never told the Series A shareholders about. Moneda’s Antonio Cruz did not like it a bit, and swung into action.

Realizing he was in effect being asked to sell his investors’ stake at a price far below the one Yuraszeck’s insider group planned to get, Cruz called his lawyers. He had them examine EdE’s American Depositary Receipt filings, which under US law required the disclosure of much more information than was available in Santiago.

The truth came out. “There were many side agreements being made with the Spaniards that did not represent the interests of the shareholders,” Cruz recalled. “And Enersis’s board had not been given all the information about them.”

Although Moneda by itself owned only a tiny portion of Enersis through its holding in Luz, it rallied several of the country’s private pension funds together and called for a special meeting of Luz’s shareholders. There it was decided to liquidate the holding
company, convert its underlying assets into shares in Enersis, and sell them to EdE at the higher Enersis price. The move ultimately earned Moneda's shareholders almost $50 million more than they would originally have received.

Perhaps more important, though, was the legal fallout the battle helped provoke: in November 1997 the Chilean government slapped Yuraszeck and two of his colleagues with a $55 million fine for a variety of infractions, including conflicts of interests and failure to disclose necessary information to Enersis's board on the single most important transaction in the company's history. Soon thereafter the board fired him.

Although the fine remains unpaid to this day, the case has had an important effect. It opened the door for IFC to advise the Chilean Finance Ministry on ways to reform its takeover legislation. A new set of laws based in part on this advisory work is soon expected to be passed, and the local corporate governance climate has already improved greatly, in Cruz' view. When EdE did ultimately win control of Enersis in a separate transaction this spring, he says, it was through "a very open process where all minority investors received a fair price."

Lesson: Honesty is still the best policy.

The CEO Must Go

Booting a bad boss like Yuraszeck is the ultimate sign of a board's independence. Never enjoyable, it sometimes must be done if the board truly is to represent the entire ownership of the company and not just the insiders—something that global leaders like Pfizer swear by. A prolonged fall in stock prices often foments such rebellions.

That was the case this spring in Hungary. Frustrated with endless bad news at TVK, a privatized chemical company where he held a 10% stake, Templeton's Mobius made his move.

Strange things had been happening. Despite a depressed price environment for TVK's products, CEO Milos Varhegyi and his team had blithely spent the equivalent of $75 million to buy an Austrian packaging materials company that proved extremely difficult to absorb and showed what one Credit Suisse First Boston (CSFB) analyst called "few obvious synergies." Although Varhegyi had outside directors on TVK's board at the time, he reportedly gave them little information about the acquisition, or about another risky attempt to hedge future prices of a key feedstock that backfired, losing the company millions. By CSFB's estimates, TVK's net income for 1998 was almost a third lower than the previous year's. Its Budapest-listed shares plummeted.

Outside shareholders then questioned TVK management's decision to retain $85 million in cash rather than invest it in new production or distribute it as dividends. When the company decided to increase that cash position by selling another 11% stake in the company into the markets at a time when the share price had bottomed out, things seemed to be out of control.

Never one to stand idly by, Mobius enlisted another TVK investor, the Croesus Central European Restructuring Fund, for support at the company's April 27 annual meeting. Although Templeton and Croesus together held less than 30% of TVK, they were able to gain approval for their motion to fire Varhegyi, replace him with his chief financial officer, and then remake the board with Croesus's Csaba Barta as chairman. TVK's share price rallied by about 25% upon news of the shakeup.

This hardball maneuver would have seemed commonplace on Wall Street. But it was considered among the first of its kind in Central and Eastern Europe, where "shareholder activism is still in its infancy," a regional newsletter published by The Economist noted. "Few Hungarian funds have either the experience or capital to initiate restructuring, and there are only a handful of Western funds willing to take on the burden of forcing companies to shape up," it added.

"This was a very positive step, as it was a case where management had become a bit overpowered," says a Hungarian business leader. "But now the company has a real board that is more professional, exerts supervision over management, and helps set effective strategy. Corporate governance is much improved."

Lesson: Prestigious foreign investors can be demanding, but help a market mature.

Seoul Survivor

Similar stories are starting to be told the world over. IFC recently backed a revamped local investment house called SEI-Asset Korea, which aims to set standards for that country's nascent mutual fund industry based on the best international examples it can find. As proof of the way shareholder activism is taking root
among Koreans, its CEO, Thae Khwarg, points to the rise of local crusader Jang Ha-sung.

Jang, a professor at elite Korea University, has become a national phenomenon in the past year for his campaigns to hold the country’s powerful industrial groups (chaebol) more accountable. He often buys tiny stakes in the chaebol to gain entry to their annual meetings and put them on the spot, recalling the pioneering tactics of consumer advocate Ralph Nader, whose successful proxy war against General Motors in 1970 is often credited with starting the shareholder activism movement in the US. When that’s not enough, Jang also files suit to stop companies from taking steps he considers contrary to investor interests. Among his victories: getting giants such as Samsung Electronics to increase the transparency of their financial statements.

"Small steps maybe, but they are moving Korea in the right direction" is how Business Week described them.

In another recent challenge, Jang joined forces with the third largest investor in cellular leader SK Telecom, New York-based hedge fund Tiger Management LLC. Tiger claimed the parent chaebol, SK Group, was improperly trying to weaken minority investors’ ownership position with a planned $1.1 billion equity offering primarily sold to SK itself.

"It’s not just a matter between Tiger and SK," Jang said. "Korea invited foreigners to enter its equity, capital, and mergers markets and should respect their legitimate rights."

Nevertheless, a Seoul civil court ruled against Tiger, apparently ending the argument. Some foreign investors took that as a sign that corporate governance still had a long way to go in Korea. Seeming to point in the same direction: news that since the country’s financial crisis broke in late 1997 the top five chaebol (Hyundai, Daewoo, Samsung, LG, and SK), although barred from owning banks, had greatly increased their control of securities houses, insurance companies, and investment funds. The Korea Herald warned this trend ran dangerously against "the long-held principle of separation of industrial and financial capital."

But a more optimistic reading came from Khwarg, who worked with IFC to sell control of his formerly chaebol-controlled company to a respected $40 billion US mutual fund house, SEI, as a way to gain greater expertise and a competitive edge. Among his funds’ investment criteria are factors Korean investors used to overlook to their peril: the character of a company’s controlling shareholders, the transparency of their financial statements, their willingness to tell major shareholders of important moves in advance, and to keep debt and internal lending at workable levels.

"Things have really changed in the last two years here, and it’s a trend that will continue," Khwarg said. "It’s partly because of the greater presence of foreigners in the market, but also because of the new reliance on financing growth by raising equity rather than debt. To do that means pleasing shareholders through far more consistent investor relations efforts."

Lesson: It’s the information age, baby; the old rules do not apply.

Private Matters

So far, much of the world’s new focus on corporate governance has centered on companies that have publicly traded shares as their mechanism of accountability. But in many developing countries, the majority of private sector output does not show up on any stock market, however imperfect. The key check on company performance is thus private equity investors — those risk-tolerant players who buy a big piece of a company before
its listing, and often take board seats to ensure that management will be responsive.

Chulick’s $2 billion Lombard Group has long been doing this with promising Silicon Valley start-ups: investing, sitting on boards, getting a value-creating business plan from managers, and holding them accountable to it. Post-Asia crisis restructuring opportunities have allowed it to take this same governance-centered approach to the far less open business world across the Pacific. “Asian companies should realize they face a simple choice: they can either fight against this inevitable international trend — and become the weaker for it — or they can embrace it and build stronger, more modern companies,” says Chulick’s Hong Kong colleague David Chiang.

For this reason, IFC has long taken part in leading private equity funds as a way to improve local corporate governance standards. The Corporation’s largest investment ever is its $250 million of support for the new Asia Opportunity Fund. Backed by the private equity arm of Chase Manhattan, this vehicle will take controlling stakes in ailing large companies in Korea, Thailand, Indonesia, and elsewhere and turn them around, in no small part through improved corporate governance. Early investment from an IFC-backed Central Europe fund sponsored by Advent International also helped the owners of Poland’s leading cable and satellite television service, Wisza TV, reach the point where they could raise $200 million in 1997 by going public on New York’s NASDAQ stock exchange. The straightforward financial reporting required for a publicly traded company in the US enabled investors to closely monitor the company’s growth. With a million subscribers in Central Europe’s fastest-growing economy, it was sold earlier this summer to one of the continent’s largest cable players, Amsterdam-based United Pan-Europe Communications. The price: $1.5 billion.

But it almost goes without saying that not all are success stories. Much more needs to be done before corporate governance truly takes root around the developing world — more shareholder activism by domestic institutional investors like Chile’s Moneda, more involvement by foreign players, more legal reform, and more secretive family-owned companies being willing to open up to increase their chances of long-term survival.

Some more big wins would help, too — nowhere more, it would seem, than in Russia, where many foreign investors are furious about the way they have been treated and are staying away in droves, leaving the economy in dire shape.

At the OECD’s corporate governance conference in Moscow this spring much discussion centered on one key case that respected local brokerage Troika Dialog detailed in a report titled, aptly, “How to Steal an Oil Company.” It began after the ruble’s collapse last summer, when one of Russia’s key financial institutions, Menatep, defaulted on $236 million in loans to Germany’s Westdeutsche Landesbank, Daiwa Securities of Japan and Standard Bank of South Africa. The loans had been collateralized by a pledged 30 percent stake in the enormous oil company Yukos that was also controlled by Menatep’s billionaire owner, Mikhail Khodorkovsky. But before the foreign institutions could act, Yukos — whose reserves are considered by some to be equal to Texaco’s — received local court approval to bar minority investors from shareholders meetings of its key subsidiaries. Meetings were then held where the subsidiaries were transferred almost free of charge to obscure offshore companies also suspected to be part of Khodorkovsky’s empire. That left the foreign banks with nothing more than shares in a holding company that suddenly had no holdings — and thus was almost worthless.

The banks fumed, never having been consulted in the transaction — as reportedly was required under Russian law. Exasperated, they began supporting another large investor in the Yukos subsidiaries, Dart Management of the US, which shared their reaction to the high-stakes shell game. Dart soon began a legal battle that within a few months convinced the Federal Securities Commission in Moscow to suspend trading of Yukos and its subsidiaries and request a full investigation of alleged illegality in the affair. How much trading there could really be, though, was another question: the companies’ shares had fallen to less than 1% of their prior value as a result of the affair that Troika Dialog calls “so blatant and extreme as to defy simple description.”

Dart’s deep-pocketed backer, financier Kenneth Dart, is one of the largest foreign investors in Russia. He has been badly burned, and vows to fight back on the Yukos case as long as necessary to help rebuild the rule of law. But many are skeptical, and no one is yet predicting what, if any, lasting improvement will result from a case widely considered to exemplify the reasons Russia is scaring off the foreign investment it so badly needs. The social cost is high: World Bank data indicate that by 2000 as much as 20% of the country may be living in conditions of extreme poverty. In 1994 the comparable figure was only 11%, and alcoholism and drug abuse have risen, as have the suicide and divorce rates. There seems to be little hope for a Russian revival unless major steps are taken to restore foreign investor confidence and restart economic growth.

In other words, the global corporate governance battle has just begun, and it’s a tough one, with well-entrenched vested interests leading the opposition in many cases. But it needs to be fought, as James Wolfensohn makes so clear.

“As the battered economies of the emerging markets piece themselves back together in 1999, one lesson will not be forgotten: rotten economies spring from rotten corporations,” he argues. “If business life is not run on open and honest lines, there is little chance the wider economy will be.”
ost of us would like to agree that infrastructure privatization brings better delivery of essential public services: transportation, communications, water and sanitation, electrical power, and the like.

Unfortunately, it doesn't always work that way.

It isn't enough to sell off an inefficient state company, sit back, and say, "There, we've done it." It takes something more. What people want is better performance, not just dollars to the owners. Changing the captain, sadly, does not always mean the ship sails better.

To illustrate, let me give an example from my adopted homeland of Jamaica. In the late 1970s, its government decided to reform Kingston's urban transport sector. The state-owned bus company was a complete disaster. Rightly deciding that it was beyond rehabilitation, the government closed it down. In its place, the government opened up the sector to small-scale minibus operators, most of whom were laid-off bus drivers. Pretty soon anyone with a driver's license and an old Volkswagen bus in the back yard was out on the streets picking up passengers. But there was one big missing piece in the jigsaw puzzle: regulation. There wasn't any. The single most important consideration, safety, soon went by the wayside.

The government's understaffed transport board was incapable of controlling the hundreds of murderous minibuses that soon started careening around Kingston's streets, and the police had more important things to do. The end result: a worsening of the urban transport system, with deplorable vehicles fighting to pick up passengers on the main road while leaving the low-revenue routes virtually ignored. Traffic and chaos worsened in an already chaotic city. In the good old days I, like virtually all children, had gone to and from school by bus. But now nobody who could afford otherwise would entrust their children to these instruments of motorized destruction.

Successful privatization, in other words, requires more than just opening the door to private enterprise. In Jamaica, insufficient attention was paid to ensuring that the new transport system was fairly distributed, safe, and properly operated.

The issues are much the same in the privatization of any infrastructure sector. It is not enough to sell a telephone or electricity or water company in a back room deal and then stand up and declare success. It takes more than that, as Africa now knows so well.
Delivering the Goods

More and more African governments are beginning to realize that the old ways of state ownership of an economy's "commanding heights" cannot be sustained. Simply put, that approach failed to deliver the goods. Today, the vast majority of Africans are still living without access to the most basic infrastructure services of electricity and water, let alone telephones. In many cases, coverage is lower now than it was two or three decades ago. People are no longer willing to accept the old status quo. Where possible, they are working through new and thriving democracies to make the message loud and clear: give us the services we need, or we will vote you out.

The pressure is on. But the treasuries are bare, forcing African policymakers to come up with innovative ways of increasing and improving the delivery of infrastructure services. Hence privatization. Thus far, however, Africa has accounted for only a small fraction of worldwide privatization activity. To appreciate Africa's reluctance to embrace this global trend, it pays to recall historical factors that have shaped the development of the continent, starting with the legacy of colonialism. Not long ago, I sat next to an African telecommunications minister at dinner. We were talking about the poor state of the telecommunications network in Africa, and every argument I advanced in favor of privatization was expertly parried by a counterargument. Finally, the minister banged on the table and exclaimed, "Listen, we fought a war for this, and we're not giving it up!"

What could I say? The minister's argument has a compelling emotional component that is hard to counteract with cold economic statistics. No one likes to see their country's "Crown Jewels" sold out to foreigners. The issues are the same for Africa as for anywhere else in the world. When Japanese companies invest in landmark US institutions, similar noises are made in the media about "foreign domination". In the African

IFC-assisted privatizations whose track records speak for themselves.

Kenya Airways

The Goal: Removing an underperforming airline from the government's books attracting a credible international airline partner and retaining majority ownership in the hands of Kenya investors

The Deal: The Kenyan Treasury received $75 million from the sale of 75% of its shares in 1999 via a series of competitive bidding auctions. Strategic investor KLM Royal Dutch Airlines acquired 32.5% interest with local investors remaining in control.

The Results: Privatization has drastically improved the reliability and performance of the national carrier which in industry journal ranked "African Airline of the Year" in June 1999. After investing $150 million in four new Boeing 737's Kenya Airways is now the market leader in flights both between Europe and Africa and within Africa, and is generally seen as operating at the standards of other major international airlines worldwide.

The Impact: With privatization has come a major increase in routes served making the African business traveler's life far less difficult. Some 30% of Kenya Airways' revenue now come from a greatly increased domestic service including 60 weekly Nairobi-Mombasa flights and others to secondary Kenyan cities not previously served. The airline has also added frequent flights in and out of Cameroon, Malawi, Nigeria, Uganda, Zambia and other countries using Nairobi as a hub.

Jobs Created: 400

IFC Role: Advised government on the structuring and implementation of the privatization in 1995-1996

MTN Uganda

The Goal: Opening the Ugandan telecommunications sector to competition by licensing a second national operator

The Deal: In a competitive tender held in December 1997, the license was awarded for $5.6 million to a group led by Mobile Telephone Networks (MTN) of South Africa.

The Results: Within a year MTN Uganda began a $70 million rollout of new products starting with an Ericsson-equipped wireless system. Costs at 50% less than the existing private cellular monopoly's service. It has made cellular an affordable mass market phenomenon. Since August 1998, MTN signed up 35,000 subscribers in less than a year, well ahead of the concession agreement's schedule, and almost two-thirds the state-run carrier's total of fixed-line subscribers. Uganda now has the same number of cellular subscribers as fixed-line phones, a remarkable outcome for Africa.

The Impact: By offering affordable wireless service nationwide, MTN has increased communication in a country with one of the world's lowest rates of fixed-line penetration. Goods that used to sit for two weeks at the Kenyan border, unable to clear customs because their owners could not be reached by phone or fax, now can move in and out much faster. MTN subscribers in Kampala can also call friends and relatives in secondary cities and the countryside, where people have begun to pool their resources and go wireless if fixed-line service is not available.

Jobs Created: 96

IFC Role: Advised government both on awarding the license that ultimately went to MTN and on the upcoming privatization of Uganda Telecom Ltd.

context, the investors most qualified to run the enterprises are frequently from the former colonial power and are politically unpopular at home. In addition to the emotional arguments, there are economic consequences of privatization which are sometimes hard to bear.

Tariffs do not always fall — in fact they often have been highly subsidized in the past, and must rise to the levels required by the laws of economics. Jobs often are lost, at least in the short term. But things are changing.

A New Beginning
The continent’s new breed of leaders has shown readiness to break with the past and engage in fundamental restructuring of their economies. Angola, Ghana, Kenya, Mozambique, South Africa, Tanzania, Uganda, and Zambia have all launched ambitious privatization programs. The francophone countries of Senegal, Côte d’Ivoire, Gabon and Cameroon have all completed extensive privatization programs involving the electricity, telecoms, water and banking sectors.

Uganda started by giving back to the Asian business community the property confiscated during the Idi Amin era, and then privatized dozens of small-scale enterprises, mostly to local investors. It is therefore not surprising that it has consistently achieved one of the highest growth rates in Africa over the past 10 years. The Zambian Privatization Agency is also implementing a far-reaching program, including the restructuring and sale of the huge ZCCM copper mining conglomerate, itself a minieconomy. Further south, the ground-breaking sales of 30% of Telkom South Africa to a consortium of Southwestern Bell of the United States and Telekom Malaysia for $1.3 billion and of 20% of South African Airways to Swissair’s holding company for $230 million have sent a signal to other multinational investors: Africa can indeed be fertile ground for investment.

The average size of African privatizations to date, however, has been relatively small — approximately $1 million. The most common method of sale has been through competitive tender, whether of shares or of assets. In countries with an established capital market, public floats have also been popular, often as part of an integrated strategy involving the sale of a block of shares to a strategic investor. Governments have also begun to tackle privatization in the infrastructure sectors, where there is need for complex sector restructuring involving legislative and regulatory change plus a host of social and political issues. Of the 2,689 privatization transactions in Sub-Saharan Africa reported between 1986 and 1996, fewer than 60 were in the power, telecommunications, and utility sectors. In the infrastructure sectors, international investors are usually required to supply both technical and managerial expertise as well as the vast amount of capital needed.

A Long Road
So that’s the good news. But there’s also some bad: the road to privatization is long, winding, and littered with potholes. There are many obstacles to attracting the necessary investment. Among them:

1. Small market size: As a US businessman once said to me, “Africa is a big country.” Although the continent may be big in terms of population, its individual nations are not. Moreover, urban dwellers with spending power generally form a small proportion of the total. Thus Africa is often below the radar screen of many large emerging market investors — why go for Malawi when you can get Mexico?

2. Low per capita income: The perception is that most Africans, particularly those in rural communities, cannot afford to pay the full economic costs of private infrastructure services. So, although an “opportunity gap” may exist because few people have access to service, this need may not translate into effective demand.

3. Improper legal and regulatory framework: In moving from a state-dominated to a liberalized environment, African countries need to redefine the rules of the game and create strong, independent regulatory agencies. Foreign investors need reassurance that critical matters such as rate increases will be dealt with in an impartial and professional manner.

4. Poor financial performance: State enterprises usually have a history of financial losses, are overstaffed, and are burdened with excessive debts. This is usually why they’re being sold in the first place. How do you convince investors that a company has value when its financial records paint the opposite picture?

5. Political risk: Recently, war and political uncertainty have increased on the continent. The conflict in the former Zaire, for example, resulted in sensational media accounts and brought fear and loathing to the minds of international investors. Although many African countries enjoy domestic peace and stability, a few bad apples spoil the lot.

6. Lack of a domestic capital market: In the absence of an effective domestic capital market, investors have to come up with more cash to pay for privatized enterprises and meet investment costs. This dampens their appetite for African ventures. Other financial issues, such as exchange rate instability and the lack of currency convertibility, also reduce the attractiveness of privatization in unstable economies.
Still, a few obstacles shouldn’t keep investors out. They just make the job more challenging.

Some may view the constraints and conclude that Africa is not ready for investment. At IFC, we draw exactly the opposite conclusion and are playing an important role in assisting this privatization process in Africa, both as investor and adviser. Thus far, IFC has provided financing commitments of $234 million to 30 recently privatized companies in Africa.

The privatization of Tanzania Breweries, for example, assisted by a $6 million investment from IFC, transformed the company from a loss-making, underutilized state enterprise into one of the most profitable blue chip companies in Tanzania. In Ghana, IFC has recently disbursed funds for a project to rehabilitate and expand a formerly government-owned coffee plantation, planning to increase production from the current level of 28 metric tons per year to 650 tons by the year 2000. Working alongside Amalgamated Bank of South Africa, IFC has also invested $27.8 million in loans and equity to support the privatization of Commercial Bank of Zimbabwe.

If the history of privatization in the developing world teaches anything, it is that when the business environment is especially challenging, governments need good advisers to get good investors. Governments value IFC’s status as an international organization, our understanding of governmental objectives, and our experience in structuring complex infrastructure transactions based on the fundamentals of transparency, efficiency, and impartiality. One factor they appreciate is IFC’s tendency to go the extra mile in providing service to our government clients, often sticking with them longer than would purely commercial advisers who lack a development mandate. You tend to do that when your client is also your shareholder!

None of our assignments is easy. Two years ago, I was so pleased to be quoted in the Wall Street Journal, saying “We like the difficult ones.” Little did I know how that phrase would come back to haunt me. Here are some examples of our recent privatization advisory activity in Africa:

**Gabon**

*Société d’Energie et d’Eau du Gabon (SEEG)*

This 1997 transaction was not only Gabon’s first major privatization, but the first full water and electricity concession in Africa where the concessionaire accepted complete responsibility for financing and management. Before the bidding, investors’ perceptions of significant economic and political risks were heightened by the fact that an existing consortium of French and Canadian companies already had a management contract with SEEG and were well positioned with an inside track to bid for the privatization. Generating true competition for the market was going to be difficult. In order to increase the attractiveness of the opportunity, it was decided not to separate the component parts of SEEG, as each would be too small to attract serious players. At the time of the privatization, the capacity of the Gabonese government to regulate the water and power sectors was limited. We therefore tried to pin down the rules of the game as much as possible by defining in the concession contract the respective rights and obligations of concessionaire and government. Bidders had to bid on the average reduction in tariffs they would implement if awarded the concession. Compagnie Générale des Eaux of France (since renamed Vivendi), in a consortium with the Electricity Supply Board of Ireland, won with a proposed cut of 17.25% and an investment requirement of at least $200 million. The strategic sale was followed by Gabon’s first Initial Public Offer (IPO), a challenging task in a country with no stock exchange. Nevertheless, the IPO was a success and has considerably broadened the ownership base of the privatized company. Since privatization, Gabon’s former money-losing utility has not only turned profitable, but cut its water losses to 13% and enabled public use of electricity to rise by more than 10% and of water by more than 8%.

**Uganda**

*Telecom Sector Restructuring and Privatization*

With only 55,000 fixed lines for a population of roughly 20 million, Uganda has one of the lowest levels of telephone penetration in the world, and what services the state company does offer are antiquated and unreliable. In looking at telecom policy, the government did not want to swap a state monopoly for a private one and therefore decided to sell a license for a second national operator to compete with the incumbent, Uganda Telecom Ltd. IFC signed on as adviser in mid-1995, and when it became apparent that the restructuring was going to be a long, drawn-out process, the government decided to give a shot in the arm by licensing the second operator first. The bidding, which took place in December 1997, was won for $5.6 million by a group led by Mobile Telephone Networks, a South African company launched with backing from Cable and Wireless of the UK and southwestern Bell (see box). In the meantime, the struggle continues regarding privatization of the incumbent, Uganda Telecom Ltd. In November 1998 the government held a tender for 51% of UTL, which was won with a bid of $23 million by a consortium of Detecon (a Deutsche Telekom subsidiary) and WorldTel; but before the deal could be finalized, the consortium broke up through no fault of the government, which was left with no alternative but to cancel the tender and start again. IFC is still advising the government in this challenging assignment.
Cameroon
Société Nationale d'Electricité (SONEL)

Here is a classic case of the need for IFC involvement: a company in dire need of privatization, a questionable commitment to privatization among key stakeholders, an inadequate regulatory structure, and investor concerns about transparency. Production at SONEL has stagnated in recent years, and commercial and technical losses have increased, causing revenues to fall. Tariffs have also fallen in real terms following the devaluation of the CFA franc in 1994. The debt burden has grown, and the company recently stopped servicing its debt. Cameroon’s hydroelectric potential, however, allows it to produce some of the lowest-cost electricity in the world, and the company still has a core of competent technical staff. The electricity sector is fundamental to the country’s development, and its current poor performance directly affects the lives of millions of Cameroonians. Tenders are likely to be issued in late 1999, with competitive bids expected from several major international power sector investors. If the transaction is completed successfully, IFC will have made an important contribution to Cameroon’s development.

Senegal
Private Participation in the Water Sector

Currently, the city of Dakar’s water supply falls substantially short of demand, and the government of Senegal has decided to turn to private sector operators for investing in and managing the facilities required to transport bulk water from the Senegal River basin, 240 kilometers north of the capital. IFC acted as lead adviser to the government to structure and implement an optimal method for private sector participation. We assisted in assessing the technical options, structuring the transaction, identifying potential investors, marketing the project, and organizing an international call for tenders. Various contractual arrangements were studied, such as build-operate-transfer, build-transfer, and concession. In 1995-1996, under the World Bank’s guidance, the government of Senegal privatized the production and distribution operations for drinking water in urban areas through a 10-year lease contract (affermage). This did not, however, resolve the growing water deficit in Dakar. IFC projected the demand over 30 years, compared the various investment options, and succeeded in convincing the authorities to abandon their dream of building a 250-km canal in favor of a 70-km pipe with the relevant treatment station to meet the needs of the next 10 years. This change of scale was hailed as a major accomplishment by all the donors involved in the sector. While the 70-km pipe could have been financed by the private sector, structuring it would have been complex and time-consuming, and, among other things, required significant increases in water tariffs. The World Bank therefore agreed to finance the $80 million project. This solution can be implemented with minimum institutional disruption and within the existing affermage contract, thereby speeding up the delivery of badly needed water to the city of Dakar. This is a case where IFC’s developmental mandate overshadowed its profit-making one, since on our own recommendation we effectively agreed to forgo our success fees on the aborted transaction.

At the Threshold

In any country privatization involves difficult choices, and as always, in Africa there are special circumstances.

Imagine you are a new African leader, brave enough to make the break with a past that is only a generation old. Issues of sovereignty and national self-determination figure strongly in your country’s privatization debate, and there are many forces opposed to any sort of reform. On the other hand, you’ve seen privatization work in Latin America and Europe — and now in countries like Gabon, Mozambique and Uganda you’re starting to see the benefits it can bring in Africa too. You need these benefits, right now, because the situation is urgent. But you’re afraid of doing it wrong — and selling out to foreign capital. And you know that the people will not be slow to cast blame your way if it goes wrong.

The best advice? Stay focused on results. What Africa’s people need is more stories like those of SEEU in Gabon, MTN Uganda, and Kenya Airways. This is precisely what IFC’s advisory work in Africa is intended to help accomplish.

The author is based in IFC’s Harare office. He would like to acknowledge the contribution of David Donaldson and the entire Corporate Finance Services team in the writing of this article.
1. **THOU CANST LEAD THY HORSE TO WATER, BUT VERILY...**

Thou canst not make it drink. Privatization cannot be imposed from outside; it must be home-grown. Make sure you have full political commitment at the outset. And not just apparent commitment, REAL commitment from all stakeholders, particularly the most important ones (e.g., the president of the country). In the case of Kenya Airways, there was excellent commitment from the top, when the president got fed up with the airline’s continual financial losses and poor performance, sacked the entire board and appointed a new one with the mandate to turn the airline around, “no matter what.” When the new chairman reported that the real problem facing the airline was its ownership structure, the president did not flinch: he went ahead and sold it.

2. **KNOW THY PRIORITIES**

Privatization is all things to all people, but some of these goals are conflicting, and governments need to be prepared to sacrifice some in order to get others. For example, you can’t say you want high sales proceeds, high foreign investment, and low tariffs. Something has to give.

3. **AND THERE SHALL COME FORTH A HOST OF THINE ENEMIES...**

And they have cogent arguments. Privatization does have real social and economic costs, in addition to the “soft” arguments of sovereignty etc, which are impossible to counter with cold facts and figures. Developing countries resent being pressured into adopting privatization policies. This gives more ammunition to the anti-reform forces.

4. **PRIVATIZATION MUST BRING FORTH THE BENEFITS**

Privatization is not some political or economic Holy Grail; if it does not bring tangible benefits in one form or another, the opponents of privatization (of which there are many) will argue that the benefits are not worth the cost. Let’s face it: most politicians are privatizing reluctantly; they would prefer that state ownership had worked. But on the other hand, a few privatization success stories can quickly spread the message: privatization really works. The consuming public isn’t bothered about economic philosophy; they just want better service at lower prices.

5. **MONEY IS NOT THE ROOT OF ALL PRIVATIZATION**

Often, sales proceeds are the least significant benefit, but the most difficult hurdle for the politicians to overcome. “It’s only worth that?!” All too often, the enterprise in question has a negative value when viewed by every valuation methodology except future potential (after a heavy dose of new management, investment, technology, etc). Sales proceeds are used to fund the expenses involved in the process, redundancy payments, loan write-offs, etc. Governments should not go into the program expecting huge financial windfalls. The biggest benefits usually accrue after privatization: investment, better service, and (eventually) more employment.

6. **FATTEN THY CALF BEFORE THE SLAUGHTER**

Nine times out of ten, the “jewel” in question is heavily tarnished by years of state abuse. Two big problems: excess labor and excess debt. Make unpalatable changes before privatization.
OF AFRICAN PRIVATIZATION

The government can’t expect the new owner to clean up its mess. In the case of Kenya Airways, the government had taken the difficult decisions well before the privatization, so they went to market with a track record of profitability (albeit a short one) and a slimmed-down airline.

7. COMPETITIVE BIDS BRINGETH BETTER BARGAINS

Without competition, you’ll always hear the question: Was that the best deal we could have gotten? You’ll never know the answer, but usually it wasn’t. Nothing spurs investors to put their hands deeper into their pockets than the fear that their rivals may beat them to the punch. Bids also reduce the possibility of collusion, thereby enhancing the image of the government and the country as a whole. Investors prefer to have their privatization deals validated by open bidding procedures, rather than risk the wrath of an incoming administration looking suspiciously at deals negotiated by the previous government. It may sound hackneyed, but transparency pays.

8. INVOLVETH ALL STAKEHOLDERS

Because any one of them can derail the process at any time. All stakeholders are affected by privatization in one way or another, and they usually have different objectives. Before and during the privatization process, someone credible has to play a consensus-building role; talking to stakeholders, articulating and incorporating objectives into an acceptable transaction structure. And let’s not forget a major player in all this: the consuming public. Money spent on a good domestic public relations campaign will be a good investment in ensuring public acceptance of the privatization concept.

9. PRIVATIZATION COSTETH MONEY (A LOT OF IT)

Before embarking on a privatization program, governments must make sure they have the necessary financial, human and administrative resources to carry it through. In addition to the staff & organization costs (which can usually be funded by the World Bank or other donors), there are the enterprise-specific costs, such as redundancies, debt write-offs and capital improvements.

And then there is the army of consultants.

10. THOU SHALT REGULATE

Privatization of infrastructure companies without effective regulation invariably yields sub-standard results in terms of welfare gains. Not only must new regulatory agencies be set up, they must be independent and staffed by trained professionals. One way to ensure independence is to ensure that the funding and staffing of the regulatory agency is enshrined in statute and separate from government. Usually, the regulatory agency is being set up just before or concurrent with privatization. In the absence of an effective independent track record, investors will want objective regulatory provisions (e.g. tariff-setting) built into their concession or other contracts.

Now, as this is clearly NOT the Bible, I feel at liberty to change the rules.

Therefore let us add an Eleventh Commandment:

11. THOU SHALT CHOOSE GOOD ADVISERS

The business of restructuring and privatizing infrastructure enterprises is a long and complicated process. A tiny and seemingly inconsequential change in technospeak deep in the annexes of a telecom license, for example, can have enormous effects on the level of service provided thereafter, and it behooves governments to have people on their side who understand what it all means. Choose advisers who have a successful track record in implementing similar privatizations in similar environments; the cheapest is not necessarily the best.

And nothing helps more than international comparison, to learn that some seemingly new and innovative idea has been tried in Bucharest, Accra and Caracas and found to be a total disaster. There is no need to re-invent the wheel every time because verily, it might turn out square!

AMEN!

— S. Brian Samuel
Few around the world noticed at the time. But two years ago Argentina did something no other country had ever done: it sold its post office.

Others like Great Britain, Sweden, the Netherlands, and New Zealand had already begun progressing in this same direction. But Argentina was the first to wrap all its postal services into one convenient package and mail them off to the highest bidder, cash on delivery.

The public has responded well to Correo's increased efficiency, now sending 10% more mail than in the past. But there is no way to maintain the momentum without substantial additional investment, and accessing large-scale commercial financing for an infant industry in Latin America is all but impossible today without multilateral support. So IFC has collaborated with the Inter-American Development Bank (IDB) to raise a new $258 million package that should help keep the innovative Argentine system's expansion on schedule well into the next decade.

Correo's brightly colored new branches have the look of full-service retail outlets—seeming like anything but the typical shoe-boxed neighborhood post office. They are the result of a long process that began in 1993, when a reformist government intent on privatizing as much infrastructure as possible decided to end a distressed state postal system known mainly for poor service at high prices.

Back then anyone who used the post office took quite a gamble, since mail could easily be lost or stolen. Argentines shunned the system, sending only about one piece of mail per month, well below the norm in other countries at similar income levels. But they clearly wanted something better, and gave private mail delivery services two-thirds of a postal market that was already open to a surprising degree of competition.

The signal was not lost on the Menem government. In 1997 it offered interested bidders the right to run all postal services in the country for the next 30 years.

A good deal? Maybe, maybe not.

The existing state-run operation had lost about $50 million in 1996, and
To get started, Correo's sponsors put in $64.8 million in equity, then took out a $150 million one-year bridge loan from a syndicate of Galicia, Banco Santander, and Citibank in early 1998 and began installing the infrastructure needed to upgrade service. By the end of that year the company had

- begun building a new central sorting facility in Buenos Aires featuring state-of-the-art Siemens equipment
- introduced new efficiency-enhancing postal codes
- brought the bloated payroll down by almost a third through voluntary retirement.

These steps helped Correo exceed the concession agreement's service improvement standards, averaging next-day delivery for 90% of all mail sent within the same city, and two or three days for 90% of the mail sent between cities. At the same time it began to generate income from a variety of new sources, including

- subletting retail space in the spruced-up post offices to stationery stores and Galicia bank branches
- offering new corporate products such as domestic parcel delivery, utility bill collection services, and mailroom management
- taking on DHL, FedEx, and other rivals with an air courier service to surrounding countries

The new corporate products now generate the majority of Correo annual revenues, which have climbed to more than $500 million. Profitability is projected next year.

Once this initial work was done Correo needed to raise long-term money, both to refinance the $150 million bridge loan and cover additional investment needs. But commercial banks were skittish in January 1999. The loud financial hiccup in neighboring Brazil scared them. The uncertain nature of cash flows in a business as untested as private mail also proved to be more risk than they
It's no cinch to turn a state-owned albatross into an instant winner. Not in a highly
competitive market, especially when the industry is one that has never been privatized
before. Correo's CEO, 20-year cutback veteran Pablo González Isla, told Impact
that he saw four major issues ahead of him when he arrived in September 1997.

1) Building a service culture from within ("This meant championing values
like honesty, integrity, continuous improvement, and putting the customer first,
and installing a true meritocracy, where only the best performers progress ")

2) Changing the market's perceptions ("We could only do this by moving our
mail faster, which involved reengineering our sorting and distribution facilities
and improving our back office functions with SAP business process software.
Then we also became the first in our industry in Argentina to obtain ISO
9002 certification of high-level quality, and began using Siemens automated
sorting equipment, just as the postal system of the US and Europe use ")

3) Changing the company's image ("To show that we were no longer a state-
nun company that didn't care about its customers, we brought in image consul-
tants from a firm in New York who gave us bright blue and yellow colors and a
new way of presenting ourselves. Recently, we were named on a local maga-
zine's list of the 100 most admired companies in Argentina.")

4) Earning a profit — expected next year in part because of the attractive
rates of financing available under the IFC/ADB financing package. "IFC has a
reputation for doing extensive research on the companies in which it invests,
and having it on board makes it much easier for us to take the capital at rea-
sonable rates. I would call this a real breakthrough in financing for IFC. In
the next five years, a
great many postal administrations around
the world are going to be privatized, both in
developed and developing countries. The
postal world is really changing.")

Facing difficulty in raising financing,
Correo went to IFC. Having previously
financed cosponsor Sideco's parent
company as well as several other land-
mark infrastructure privatizations in
Argentina, IFC could offer detailed
analysis that would put banks at ease,
and was also willing to risk its own
funds. It also saw the assignment ful-
filling one of its key strategic goals:
attracting the first major wave of pri-
vate capital for under-invested sectors
of major emerging markets.

After several months, a final package
was worked out that teamed IFC with
the IDB to provide a dual $258 mil-
lion long-term financing for Correo.
Together the two multilaterals are
making an eight-year, $138 million
loan from their own resources and
arranging a total of $108 million more
in six-year loans from commercial
institutions. IFC is also becoming a
shareholder in the company, making
equity and quasi-equity investments
of $12 million.

Private Postmaster: Pablo González Isla, CEO of
Argentina's for-profit mail system
The money will allow Correo to carry out a five-year investment program that includes installation of customized business process software from Germany’s SAP as well as other technological upgrades, worker training, refurbishment of facilities, and purchasing of new handling equipment. Its mailbag is full of other new ideas for continued improvements in service. At a time when the Philippines is also considering selling off its postal service and Germany’s Deutsche Post is preparing for a landmark initial public offering next year, the deal is one this fast-emerging global industry is watching closely.

"The success of this pioneering investment will help prove that the private sector can provide national postal services in a highly competitive environment," said Declan Duff, director of IFC’s Telecommunications, Transportation, and Utilities Department. "It is also likely to be a model for consideration in other countries."

**Correction**

An article in the Spring 1999 issue of Impact (“Champion of Change,” p. 18) wrongly stated the kind of IBM servers IFC uses. The correct name is RS/6000.
It is the heart of entrepreneurship: that special ability to sense unmet demand ... to say “This isn’t what people want. I can do better.”

Entrepreneurs thrive on risk. They believe in their ability to compete, to innovate. They can do so in almost any field, even many that aren’t usually seen as part of the business world — like education.

Education?

It’s one of the most important of all products, the refinery for the ultimate raw material — people. Yet it is also something governments everywhere tend to dominate. Why, we don’t know, but it is somehow seen as different from all other basic human needs: food, water, and shelter; transportation, health care, and clothing — not an absolute monopoly of the state, but generally considered something private enterprise should not produce, price, and distribute at significant levels. Or if so, only for the rich.

Maybe some of that thinking needs to change. Maybe it already has.

This summer IFC hosted “Investment Opportunities in Private Education in Developing Countries,” the world’s first conference of its kind. Organized in close cooperation with the World Bank, it drew 200 specialists from around the world, offering a global overview of the private sector’s role in education and matching entrepreneurs with potential sources of financing. The many case studies presented did not fit any one pattern: sometimes the private sector complemented the public sector in education; other times it competed with it. But things were clearly happening.

In Brazil a group of private educational institutions called Objetivo has a total enrollment of 500,000 and $400 million in annual revenues. It was the first school in the country to put computers in the classroom. In India, a company called NIIT earns annual revenues of $73 million by providing computer training to 140,000 students nationwide. Its ability to fill in the gaps of public universities gives it a vital role in a $2 billion Indian software industry, the envy of many developing economies.

But it is not all big business. Especially not in Africa, where, a recent Oxfam International education report notes, meeting the demand for education is “clearly beyond” the means of government. Côte d’Ivoire understands. It has now put 60% of its secondary schools in private hands, a trend the government actively supports through the provision of financial incentives.

IFC has recently invested $41.4 million in an initial 11 education projects around the world, seven of them in Africa. Why? Because educational entrepreneurs have great difficulty raising financing from commercial lenders. They need a development institution’s support at this early stage in their industry. All of IFC’s investments are in “private” schools, but not all are for-profit — some are run by foundations or other non-profit groups, yet with as much managerial rigor as any successful business. But they have a major development role, supplementing the important role of the state in building up the skill level in their countries and offering quality education at prices working families can afford.
Name: Harriet Ndow  
Title: Founder, Ndow Middle and High School (NMHS), Banjul, The Gambia  
Enrollment: 900 in grades 7 through 12, two-thirds of them girls  
Tuition: $300 per year  
Background: Upon retiring as a public school headmistress in 1992, began looking for a better way to educate girls: after receiving donated land and tax-exempt status from government, started NMHS “as one woman’s contribution to development”; added high school in 1995  
IFC Role: Guaranteed a Gambian bank’s five-year local currency loan to NMHS in 1998 for the equivalent of $238,000; financing used to build new science and computer laboratories, a home economics classroom, a carpentry and metal workshop, and other facilities.

Name: Mary Okelo  
Title: Cofounder, Makini School, Nairobi, Kenya  
Enrollment: 2,000 (kindergarten through 12th grade)  
Tuition: $500 to $1,600 per year  
Background: After being the first woman manager at Barclays Bank in Kenya and senior adviser to the president of the African Development Bank, started Makini with her husband in 1978; it soon grew into a respected primary school, adding grades 9–12 in 1996 in response to parental demand  
IFC Role: Provided a $545,000 six-year loan in 1996 to complete the new secondary school and add a second K–12 campus in Nairobi, increasing enrollment by 500; advised sponsors to have the new K–12 school be co-ed rather than boys-only, as originally planned.

After the conference, Impact spoke to a pair of hard-nosed businesswomen who also happen to be educators, African school owners Harriet Ndow and Mary Okelo. Both started respected private schools in countries where the public sector leaves many education needs unfilled. Their IFC-supported schools primarily target middle-class children, but also offer scholarships for the poor.

One thing was clear from talking to these ladies: education is everybody’s business.

IFC: We understand that you actually started with a small nursery school back in 1966, so perhaps this isn’t as new a business as we think.

Ndow: That’s true, and when things at the nursery began to pick up fast, I went to the president of The Gambia and explained that the school was growing and that we needed some land to cut the expense of renting people’s houses for the school. The president immediately approved my request. If I had had then the sense I have today, I would have been able to acquire a whole street, because the government was willing to give me as much land as I wanted.

IFC: And you were working full-time as a headmistress in the public schools at the time?

Ndow: Yes, I started our school on a volunteer basis, although as time went on, we had to charge a small fee. But I never thought of starting a primary school. It was only when the parents saw that the students were so good — writing letters at age eight, for example — that they said they did not want to send them back to the ordinary school. So they told me, “You get on with it.” They went to the minister of education, who in turn was pleased to hear that I was prepared to continue with a primary division.

IFC came at a very good time, just after I started the 10th, 11th, and 12th grades. The children were doing extremely well, topping the whole country, in fact, with the highest aggregate averages in both grades 9 and 12. Then people started saying the school was very good, but didn’t have any laboratories. I was using The Gambia High School’s lab, but they wanted me to have my own. Fortunately, IFC made the new facilities possible, and the laboratories will start operating in September.

IFC: From the very beginning your emphasis was on educating girls. Why?

Ndow: When I took over the Serrekunda Primary School as headmistress, I noticed that girls were neglect-
ed. Even when their papers were marked, some teachers would take marks off the girls' papers because they thought girls were weaker. I said no. According to psychology, primary school girls should do better than boys. So I decided that I would give the girls equal treatment.

**IFC:** How?

**Ndow:** I am a very active person by nature: I played tennis, hockey, and net ball; I also ran and took part in bicycle racing. I just rejected the idea that boys were stronger and encouraged the girls to compete. Last year, the grades of two of my girls were the highest in the whole country. We've had two graduating classes now, and most of the students have gone on to higher education, either in The Gambia, where we are just beginning to have a university, or out of the country to Ghana, the United States, or England. They're studying engineering, law, aviation, computer technology, and else, although my decision was also partly based on necessity. When I worked at the bank, I was very busy. My daughter was only three, and it was becoming very difficult managing. So while I maintained a very busy professional schedule, at the same time I had to make sure that my daughter was not neglected. So we started a school in my house, partly to be able to help her and other children as well.

**IFC:** Why did you call the school "Makini"?

**Okelo:** It's a Swahili word that more or less translates to "work with diligence, keenness, and integrity." It reflects one of our philosophies, which is to encourage our students to do their very best at whatever they choose to do. We focus on setting goals, and they do us proud. One of our students became the first woman pilot at Kenya Airways, and because of her example, many others are now pursuing aviation. Another had the best score in the country in the 1997 Kenya Certificate of Primary Education, and we believe he will go far. He is focused, disciplined, and self-motivated.

**IFC:** Africa certainly has its leadership problems, but it sounds as if you are trying to build its leaders of tomorrow. How do you do it?

**Okelo:** We remind them of what US President John F. Kennedy said: "Ask not what your country can do for you, but what you can do for your country." The school instills discipline and a profound

"**All agree that the single most important key to development and poverty alleviation is education.**"

— James D. Wolfensohn
President, World Bank and IFC

Other things. I'm sure that many of them will come back to work at home once they have completed their studies. But for some, of course, there will be better opportunities outside the country.

**IFC:** Mrs. Okelo, what made you decide to start a school?

**Okelo:** I came into education more out of the love of children than everything other things. I'm sure that many of them will come back to work at home once they have completed their studies. But for some, of course, there will be better opportunities outside the country.

**IFC:** We remind them of what US President John F. Kennedy said: "Ask not what your country can do for you, but what you can do for your country." The school instills discipline and a profound

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sense of responsibility in each student so they can internalize it. We tell our students that they can accomplish nothing without self-discipline, because their teachers will not follow them everywhere. We also teach them to be self-reliant because we can no longer rely on government, which has its own problems.

Ndow: I'm from the old school as well. I believe in discipline. When it's time to work, we work; when it's time to play, we play. But we don't do anything halfway. We pay attention to how the children dress, how they speak to people, and so on — we give them close attention, unlike the public schools.

The only problem is our leadership in Africa is not an example for young people. And the children know this, you see, because they have television, radio, newspapers — you can't hide anything from them. They know when someone has been fired for corruption, when somebody has stolen, when someone who did not have a car one day is seen driving an expensive vehicle the next.

IFC: Tell us about the courses your schools offer.

Okelo: The curriculum we use is essentially the same as the public schools' but matched with better facilities and more motivated teachers — the public schools in Kenya can have classes with up to 60 students per teacher.

Ndow: The public schools in our country also have a problem with low remuneration of teachers and a low-quality education, with a student-teacher ratio of about 40 to 1. We offer well-trained and motivated teachers good remuneration and a higher quality of education, with classes of about 25 students. We use the national curriculum with core subjects and both prevocational (such as metalworking and carpentry) and vocational electives. Then we have specific requirements for computer studies, skills training courses, and extracurricular activities, with all taught with commitment in an atmosphere of the highest tranquility.

IFC: Extracurriculars can be a big part of education. Tell us what you do there.

Okelo: We encourage and involve our students in many extracurricular activities such as athletics, drama, and music. But in particular we emphasize social responsibility — for example working with AIDS orphans, street children and the aged.

IFC: What are other examples of your emphasis on social responsibility?

Okelo: We've set up a small rural school for poor children in my home area of Nyanza Province, using old Makini materials. It's just a single-building school. But until now the children who live there had had to walk four to six kilometers each way, which is hard for five-year-olds in the hot weather and means many of them just don't go to school at all. We felt obliged to do something, because we knew they needed to be in school. Otherwise they will grow up to be nothing but laborers like their parents.

IFC: Was IFC the only source of financing available to you?

Ndow: No. Standard Chartered Bank, our country's leading private financial institution, lobbied to loan me the money, but I told them their interest rates were too high and that I preferred to deal with IFC. But the main point is that I don't like debt. I am afraid of debt. Even the IFC loan, when it was offered, I wanted to refuse, but a parent convinced me that I should take it at least for the new science complex, so our children would not have to go somewhere else.

IFC: Will the expansion you are undertaking with IFC financing cause you to raise your tuition?

Ndow: No, it will not.

IFC: Why?

Ndow: For the simple reason that I started this school to help my people. I did not do it for the money. That's being completely honest, even though obviously I am getting something out of it.

If I could do it without charging a fee, I would. But the fact of the matter is that there are costs involved in building the buildings and paying high enough salaries to attract the best-qualified teachers. Even the government schools in our country charge a fee of $180 a year. But I get no support or subsidies from anyone else, and never want to have to charge so much that the average or poor person cannot afford to come to our school. I see this as a long-term investment in my country, and what I am doing for others through it is far more important to me than what I am getting out of it.

— Interview by Ken Best
In business, the best deals — the only ones that last, it might be argued — are those that benefit all sides.

In that spirit, our two institutions have come together with other partners on a for-profit approach to preserving a portion of one of the planet’s great natural beauties: the endangered rain forests of Papua New Guinea (PNG).

Remote and rarely visited, PNG is a country whose assets are truly irreplaceable. It is a group of islands like none other on earth, home to a kaleidoscope of 700 different ethnic groups, many living in isolation with their traditional cultures intact. Collectively, they speak a quarter of all the known spoken languages, by some estimates. Equally dazzling is the array of local plants and animals, including the world’s largest butterflies, its smallest parrots, and a vast number of other species found nowhere else.

This cultural and biological treasure chest survives within PNG’s enormous virgin rain forest — one of the largest, in fact, that remains anywhere today, comparable in many ways to the Amazon or Congo basins. It has been there for thousands of years. But if current trends continue, much of it could be gone in just a few decades.

That might seem inconceivable, considering the inaccessibility of PNG’s rugged interior and the fact that the country still has an unusually high degree (about 75%) of its original forest cover. But consider the Philippines. It was in a comparable situation as recently as about 1960, when it decided to become one of the world’s biggest timber producers and began a development push that would see it lose roughly 95% of its original forest cover. Today the Philippines is a net importer of wood products.

At a time when the world loses an acre of original forest every second, there are serious concerns over what could happen in PNG. It too encourages large-scale commercial logging. Protesting won’t solve the problem. Nor will creating new national parks. The only solution must be one that fully considers the local people’s legitimate development needs and gives them a better deal than the ones the timber industry offers them today.

To understand the complex dynamics involved, go back to 1989. That year the country was experiencing a significant economic downturn and loss of foreign exchange from the closure of its Bougainville copper mine, the world’s largest. The government was in sore need of a replacement source of tax revenues. It turned to timber, which soon became PNG’s third-largest export.

The development model used essentially involved the government’s marketing the traditional landholdings of various PNG ethnic groups as concessions to foreign logging companies, which then pay both operating fees to the groups and taxes to the government. The authorities, though, have often found it difficult to enforce conservation policy and proved largely unable to stop private concessionaires from using bulldozers to clear far more of the forests than is necessary for timber extraction.

Since the foreign logging companies first arrived in numbers earlier this decade, more than 1% of PNG’s forests have been lost each year. Raw logs are shipped to export markets across Asia, creating no added value and few jobs in the local

The clearing of ancient forests is a process with powerful momentum in PNG. Unless a new, more sustainable model emerges that takes into account the needs of all parties, the heavy habitat losses in other countries may be repeated, sending many irreplaceable species and cultures into extinction.

In 1994, the oil joint venture began funding a $7 million, six-year WWF effort to integrate the project area's needs for conservation and development. The work was done with extensive participation from the government and local indigenous peoples and produced many innovative ideas for collaboration.

Consciousness-raising exercises were clearly not enough — something had to be done that could protect the region for the long term by appealing directly to its residents' self-interest. Although a non-profit itself, WWF was keenly aware of the fast pace of private logging development in the country and saw that anything run on a charitable basis could well fall apart once the grant funds stopped flowing. It decided to try a for-profit approach, introducing instead a new way for people to earn money for needs such as food, clothing, and children's school fees. Ideas such as eco-tourism lodges and butterfly farms were considered, but in the end it only made sense to work with the area's dominant natural resource, trees.

From an economic development perspective, forestry was the only game in town, covering a far wider area and employing far more people than could any "non-core business." It was time to try a different approach to commercial logging.
WWF has since helped design a new community-based sawmill company called Kikori Pacific Ltd., based in one part of the large area surrounding the oil project. Its location in the town of Kikori lies at the confluence of several river systems that form a natural transportation hub for many traditional communities in this sparsely populated area. That leaves it well positioned to train local people in environmentally sound “ecoforestry” and then purchase logs from them for processing, thus adding value in the local economy.

Managed by a New Zealander with 15 years’ experience in PNG, the sawmill company approaches local landowners in an entirely different way than do the large foreign logging companies. It starts by helping the local people map a 150,000-hectare forest zone and choose individual trees that can be responsibly cut. These trees are then cut and carried out, not by machine, but by hand. The ratio is only five per square mile, leaving the fragile basis of forest life intact.

Kikori Pacific buys logs from more than 1,000 local landowners. Since the company does not need to invest in heavy earth-moving equipment, it can afford to pay the landowners higher prices than the big foreign buyers. As these suppliers establish their reliability, they will also obtain shares that will eventually enable them to become Kikori Pacific’s majority owners.

Working through the Small and Medium Scale Enterprise (SME) Program (see box, page 29) that it manages with funding from the Global Environment Facility (GEF), IFC has provided a $250,000, 10-year low-interest loan to WWF that will enable Kikori Pacific to buy new equipment and scale up its activities. The SME Program supports this initiative because it addresses one of the GEF’s basic objectives: developing sustainable strategies for preserving biodiversity while providing an equitable distribution of benefits to local stakeholders. WWF shows its commitment by taking full commercial risk, being fully responsible for repaying IFC, even if Kikori Pacific fails.

Projects of this kind enable local people both to preserve ecosystems and to make a living from them. But they cannot attract commercial funding in their early, high-risk stages. Without the long-term financing the SME Program provided, Kikori Pacific might never have left the drawing board. But by the end of 1999, its first full year of operations, the company expects to generate about $150,000 in revenues, supplying sawn timber not only to the Kutubu oil joint venture and other local buyers, but also to the international market interested in high-quality species such as Papuan mahogany. This summer, Kikori Pacific exported its first shipment, bought by an Australian company marketing environmentally sound lumber to the 2000 Olympics in Sydney.

The people of the Kikori region are under heavy pressure to sell the rights to their forests to concessionaires whose aggressive cutting would cause serious loss of biodiversity. Kikori Pacific, however, offers many of them an alternative path to economic development that permits community-based involvement, keeps them as the true stewards of their own land, and preserves the riches of the forest. Given the unique system in PNG, where the people (not the government) own almost all the land, we believe this approach, based on mutually reinforcing incentives, is the best way to achieve long-term conservation of the forests and their inhabitants.
As word spreads from village to village, and more local communities see that they can earn more money by selling safely harvested logs to Kikori Pacific than by concessioning away their entire forests to foreign interests, a basis for enduring long-term conservation will emerge. Nevertheless, anyone who knows PNG knows the many difficulties involved in working there. This project has no guarantee of success. It is essentially an experiment to see if the power of the profit motive can help avert widespread environmental tragedy, rather than cause it. The model it offers may not stop those that currently earn more than $250 million a year from controversial industrial logging in PNG. But it may help attract other, more responsible timber companies who want to make a profit without destroying the very resource on which their industry and the country depend, and which the world cannot afford to lose. And it may show the people and government of Papua New Guinea that there is a better deal to be obtained for themselves and their forests.

Jamie Resor is conservation finance director of WWF, based in Washington, DC. Douglas Salloum manages the IFC/GEF SME Program.

The Small and Medium Scale Enterprise (SME) Program is an initiative of the Global Environment Facility and IFC. GEF grant resources fund up to $16 million in IFC-administered loans used to stimulate greater involvement by private sector SMEs in addressing climate change and the sustainable use and conservation of biodiversity. These long-term, low-interest loans of up to $1 million to each intermediary are sparking several innovative SME projects (see below). Almost $10 million of the GEF funds have been lent out so far, with a follow-on program already under consideration.

<table>
<thead>
<tr>
<th>NAME</th>
<th>DESCRIPTION</th>
<th>LOCATION</th>
<th>LOAN AMOUNT</th>
<th>GEF OBJECTIVE</th>
<th>PROJECTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Environmental Enterprises Assistance Fund</td>
<td>US non-profit environmental investment fund</td>
<td>Central America, Dominican Republic, Mexico</td>
<td>$400,000</td>
<td>Biodiversity, Climate change</td>
<td>Energy efficiency, Renewable energy (photovoltaic solar home systems)</td>
</tr>
<tr>
<td>2. CARESBAC-POLSKA</td>
<td>Local for-profit small business investment fund</td>
<td>Poland</td>
<td>$600,000</td>
<td>Biodiversity, Climate change</td>
<td>Energy efficiency, Organic farming</td>
</tr>
<tr>
<td>3. FUNDECOR</td>
<td>Local non-profit foundation</td>
<td>Costa Rica</td>
<td>$500,000</td>
<td>Biodiversity</td>
<td>Reforestation, Sustainable forestry</td>
</tr>
<tr>
<td>4. El Sewedy</td>
<td>For-profit electrical supply company</td>
<td>Egypt</td>
<td>$500,000</td>
<td>Climate change</td>
<td>Energy efficiency (compact fluorescent lamps)</td>
</tr>
<tr>
<td>5. World Wildlife Fund</td>
<td>Global NGO</td>
<td>Papua New Guinea</td>
<td>$250,000</td>
<td>Biodiversity</td>
<td>Sustainable forestry</td>
</tr>
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<td>6. Grameen Shakti</td>
<td>Local non-profit company</td>
<td>Bangladesh</td>
<td>$750,000</td>
<td>Climate change</td>
<td>Renewable energy (photovoltaic solar home systems)</td>
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<tr>
<td>7. Dessau-Soprin</td>
<td>Canadian for-profit engineering company</td>
<td>Tunisia, Morocco, Algeria</td>
<td>$800,000</td>
<td>Climate change</td>
<td>Energy efficiency (energy service companies)</td>
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<td>8. Conservation International</td>
<td>Global NGO</td>
<td>Global</td>
<td>$1,000,000</td>
<td>Biodiversity</td>
<td>Organic farming, Ecotourism</td>
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<td>9. FCG</td>
<td>Local foundation</td>
<td>Guatemala</td>
<td>$500,000</td>
<td>Biodiversity, Climate change</td>
<td>Ecotourism, Renewable energy</td>
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<tr>
<td>10. Selco Vietnam</td>
<td>Local for-profit company</td>
<td>Vietnam</td>
<td>$750,000</td>
<td>Climate change</td>
<td>Renewable energy (photovoltaic solar home systems)</td>
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<td>11. Savé Valley Wildlife</td>
<td>Local for-profit company</td>
<td>Zimbabwe</td>
<td>$1,000,000</td>
<td>Biodiversity</td>
<td>Re-stocking of wildlife on private conservancy land</td>
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<tr>
<td>12. International Expeditions</td>
<td>US for-profit company</td>
<td>Central and South America</td>
<td>$750,000</td>
<td>Biodiversity</td>
<td>Ecotourism</td>
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<td>13. Barclays Bank of Botswana</td>
<td>For-profit bank</td>
<td>Botswana</td>
<td>$1,000,000</td>
<td>Biodiversity, Climate change</td>
<td>Ecotourism, Non-timber forest uses, Renewable energy</td>
</tr>
<tr>
<td>14. Peer Consultants</td>
<td>US for-profit engineering company</td>
<td>South Africa</td>
<td>$1,000,000</td>
<td>Climate change</td>
<td>Energy efficiency (passive solar heating and cooling designs)</td>
</tr>
</tbody>
</table>

**Total** $9.8 million
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