# The World Bank: Buy, Sell, or Hold?

*by Mark Stoleson*

It seemed like a simple question, but the World Bank representative was visibly uncomfortable. Together with me was a delegation of investors visiting this small African country to see first-hand the micro-finance projects we had funded and to identify new development opportunities. We were visiting the World Bank's local offices to learn more about their activities and experience in the country. The Country Head was explaining how he planned to allocate his budget of over $100 million and highlighted one project to build cobble stone roads in the capital city. Knowing that the World Bank's mission is to reduce poverty, I assumed that building cobble stone roads would lead to a reduction in poverty. So, not being a development expert and almost thinking aloud, I asked our host: "How will these roads reduce the country's poverty?"

Surprisingly, he struggled to answer the question. After briefly discussing development theory, he finally stated that Bank staff on the ground do not have time to contemplate "ivory tower" notions such as the Bank's mission statement or overall goals but rather need to focus on the day to day business of managing their budgets and completing projects. But, I asked, if the projects do not reduce poverty, what is the point?

Only a few weeks before, World Bank President Paul Wolfowitz had emphasized the need to remedy the Bank's historically poor performance in Africa. He told Bank staff that "in the last 20 years, the number of people living in extreme poverty in Africa has doubled...in spite of roughly $200-300 billion in development assistance...[and] it's going to be hard to explain ourselves in 5 or 10 years if that picture remains the same. "In other words, results matter. Wolfowitz's comment seemed to imply the need for the Bank to focus not just on deploying capital and completing projects, but also on the overall "returns on

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investment," measured by the positive impact on the lives of people living in extreme poverty. In the office of the Country Head, however, concepts such as capital allocation and returns on investment seemed as far away as Washington DC.

## An investor's view of the world bank

Following our meeting, I couldn't help but wonder how the World Bank might look, were it an investment opportunity. If this were a public company, I wondered, would I buy its shares? Would the World Bank meet the standards of performance to which investors such as Sovereign Global ("Sovereign") holds its investments?

Given the scale of resources entrusted to the World Bank, and the importance of its agenda, shouldn't someone enquire as to whether that institution is itself a wise investment? We came to this question with a perspective shaped both by experience in capital markets and emerging economies.

Sovereign has been investing in the international capital markets for over 20 years. During this time, the firm has provided capital to companies and governments from Asia and Africa to Latin America and Eastern Europe. Our investments have spanned many industries ranging from banking and energy to telecoms, power, and steel.

In every case, we have found that a good investment has certain characteristics: Firstly, it has a competitive advantage relative to its market, i.e., it is providing a product or service more effectively than any alternative organization. Secondly, it operates under the scrutiny of independent auditors or evaluators. Finally, it is accountable to its shareholders who ensure that it follows a set of coherent strategic goals. In simple terms we endeavor to measure the organization's competitiveness, transparency, and accountability.

Given these core conditions (though not guarantees) for success, how does the World Bank measure up? We ran the Bank through a basic set of questions we would ask when evaluating any investment opportunity.

*Competitiveness: Is the Bank competitive at banking?* The Bank's core customers—developing countries—increasingly are able to obtain financing from international debt capital markets. Still, the Bank persists in pursuing these customers: Over the past five years, 99 percent of its funds were loaned to countries that have investment grade or high-yield bond ratings.[2] Yet this core customer base turns to the Bank for only 1 percent of its total debt financing needs.[3] Any company that has a 1% market share amongst its target customer base has a dubious commercial rationale and future prospects.

You would think that given this loss of competitive standing, the Bank would shift more resources to an underserved marketplace, such as poor countries whose prospects for repayment are less certain. In fact, the share of such loans has gone from 40 percent of available funds in 1993 to 1 percent more recently.[4] What that suggests to us is that the Bank is chasing customers who do not want or need Bank funding, while increasingly ignoring the needs of countries that do.

In addition, the Bank's lending operations are unprofitable. Over the last 12 years the Bank has accumulated net losses of over $3 billion from its lending operations[5]—which could have supplemented the Bank's own borrowing and investment returns and provided the Bank with funds to make grants and concessional loans to the world's poorest countries. If the Bank were a better "bank" it would have more funds available for those who need it the most, but the opposite appears to be the case.

*Is the Bank competitive at reducing poverty?* The Bank's mission is "to fight poverty with passion and professionalism for lasting results." Presumably the mission is not only to fight, but also to win. After 50 years and $570 billion spent or lent, however, there is no conclusive data that demonstrates that the World Bank has made a meaningful impact on its primary mission. Poverty has declined in East and South Asia—but that is where World Bank development ideas and lending have been relatively small. Meanwhile, as highlighted by Adam Lerrick in recent testimony to the United States Senate, "The living standards of the poorest nations have stagnated and even declined as much as 25%."[6] The Bank has tremendous human and intellectual capital in the form of its experienced and committed staff. Why then has the Bank seemingly failed to deliver on its core mission of reducing poverty?

*Transparency: Is the Bank a model of good governance?* The Bank granted or lent $20 billion in 2005—not a huge amount by international banking standards, but certainly more than your average regional commercial bank. Yet it does not have a truly independent audit committee or employ outside auditors to objectively evaluate project performance. In the post-Enron, Sarbanes-Oxley world, it is incredible that a multi-billion dollar institution backed by taxpayer money is operating without independent oversight. If it were publicly traded on a U.S. stock exchange, the Bank's lack of an audit committee alone would cause it to be de-listed. Largely because of this blind spot, it is impossible for those either inside or outside the Bank to know whether it is effective or not, simply because it lacks any credible or objective metrics related to performance. Without measurable results there can be no accountability.

*Accountability: Are the Bank's shareholders aligned in pursuing a sensible reform agenda?* Shareholders with a common purpose can bring about governance reforms at under-performing companies. Reform will fail, however, if certain interests divide shareholders and conquer their common resolve. Or worse yet, if shareholders simply do not care about the returns on their investment, management will never improve performance. The World Bank does not lack its share of critics, both internal and external; many of those critics are the Bank's largest funders. Yet many of the Bank's financial backers either do not agree on a common agenda for reforming the Bank, or do not care to reform it in the first place. Either way, this flaw represents an abrogation of fiduciary responsibility by the Bank's shareholders to the Bank, to the taxpayers whose funds support the Bank's functions, and most of all, to the poor.

## A solution from the private sector

These weaknesses would represent significant reasons not to invest in the World Bank. Its management and staff have an impressive and undeniable record of service and commitment to the cause of development, but the multiple and conflicting objectives of the Bank and its shareholders, combined with a total failure at self-governance and minimal involvement by shareholders, have made it impossible for positive "fundamentals" to emerge.

Any efforts to improve the Bank's competitive advantage must start with the creation of independent governance mechanisms and objective measures of success and failure. Without these measures, how would

Bank management and its shareholders discern what impact, if any, the Bank is really making?[7]

To make serious efforts toward upgrading its transparency and accountability, the World Bank, would benefit from adopting certain measures commonly used by public companies. Specifically, the World Bank could consider the merits of:

1. *Establishing an Independent Audit Committee.* Any effective audit committee is comprised of members that are truly independent. That means committee members could not accept any consulting, advisory, or other compensatory fee from the Bank, or be affiliated with the Bank or any of its entities other than as a member of the Board.

2. *Giving the Audit Committee Authority.* Independent audit committees generally report directly to the Board and have the authority and budget to hire their own counsel and consultants if necessary.

3. *Engaging Top Outside Auditors.* Audit committees are responsible for engaging and managing outside auditors. A World Bank audit committee could start by putting out for bid a multi-year, multi-million dollar auditing engagement that would draw in a qualified firm to audit the Bank's financial performance and projects while establishing proper internal controls so that the Bank's management team is equipped with the information they need to make sound decisions. The costs of a rigorous audit would be far outweighed by the benefits of transparency and accountability in addition to the valuable information the Bank would be able to provide to its management and the development industry as a whole about what works and what does not.

This proposal would offer many benefits. First, it would harness the inherent power of free market principles in fashioning new ways to evaluate development projects. Second, it would transform the World Bank from a laggard to a leader in accountability and transparency in the development community. And finally and most importantly, as the Bank responds to objective and accurate data about its performance, it will be able to make adjustments in its business model and operations so that it can more effectively deliver capital to the world's poorest communities.

For example, if the Bank were to recognize that larger and more focused grants have a greater likelihood of creating transformative change in a region, it would be able to restructure its grant-making to focus on such projects. If the Bank saw that its efforts must be combined within a larger coalition of NGO-led stakeholders on the ground, then that would be adopted as a preferred model. If the Bank saw that loans are still a credible instrument of development aid in certain cases, it could focus on that mechanism where appropriate and use grants elsewhere.

Moreover, by establishing credible accountability and governance measures, the Bank would finally address the weaknesses that have led to multi-billion dollar losses in loans. That would assure the Bank's shareholders—taxpayers from productive and wealthy nations—that the cause of development is "worth it" and would finally give the Bank the unified support and involvement of its shareholders. Performance, accountability and transparency are no longer optional in either the public or private spheres.

We know from experience that the most successful organizations constantly hold their performance up for analysis and criticism, and correct those problems as they emerge. Although there may be some resistance to an external audit of the World Bank, at the end of the day full transparency and accountability regarding its performance will free the Bank from its past, restore its credibility and relevance, and set it on a new course to more effectively change the lives of the world's poor. The Bank's mission is too important and its budget too large to accept anything less.

## Notes

1. World Bank Town Hall Meeting Transcript, February 6, 2006.
2. See Adam Lerrick, "Has the World Bank Lost Control?" in this volume.
3. Id.
4. Id.
5. Id.
6. Adam Lerrick, "Is the World Bank's Word Good Enough?" Statement Presented to the Committee on Foreign Relations of the United States Senate, March 28, 2006.
7. See Ruth Levine and William D. Savedoff, "The Evaluation Agenda," in this volume.