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SOCIAL SECTOR PRACTICE

Lars H. Thunell on encouraging private-sector investing in emerging markets

The departing head of the International Finance Corporation discusses its mission to improve the lives of the world's poor.



Lars H. Thunell had no idea what awaited him when he left the Northern European banking world six years ago to lead the International Finance Corporation (IFC), the part of the World Bank that provides financing to the private sector in developing countries. As executive vice president and CEO, Thunell would be required to steer the IFC through the worst financial crisis since the 1930s while carrying out the organization's mission of helping people to escape poverty and improve their lives.

The 63-year-old Swede is stepping aside as head of the IFC at the end of June 2012. Amid the crisis, he presided over an organization that increased investment volumes to \$19 billion, from \$7 billion. Most important, Thunell says, lending was shifted to the world's poorer countries. "When I came, about 20 to 25 percent of IFC projects were in the low-income countries. Today, we're at about 50 percent."

In a recent wide-ranging interview with McKinsey's Tony Goland at the IFC's Washington, DC, headquarters, Thunell reflected on his tenure and how the organization responded to the events of this volatile period. Thunell also emphasized the increasing role of the private sector in development aid. "I think the private sector has now come into the middle of the whole development agenda," he said. In the interactive video (on mckinseyquarterly.com), Thunell discusses the IFC's responses to the financial crisis, investing and creating markets in emerging countries, and the building blocks of development. Read the following edited transcript for an expanded version of the interview.

McKinsey: *You have led the IFC during a tumultuous time. What comes to mind as one of your main accomplishments?*

Lars Thunell: One thing that I'm very proud of is our response to the financial crisis, where we developed a number of action steps: trade finance, capitalization of banks in poor countries, and distressed assets—just to take three of them.

The trade finance, I think, was particularly important because trade finance was drying up. And that affected, especially, the poorer countries that have to use letters of credit for their trade. In the London G-20 meeting, it was decided that \$300 billion should be provided over three years. And the IFC actually provided more than \$50 billion of that.

The other thing we did was to look at the capitalization of banks. In Europe and the United States, the governments provided the additional capital that was necessary. But in poorer countries, the governments didn't have the capital. So we, together with the Japanese, established a fund of \$3 billion through our asset-management company.

Another thing was the program we had for distressed assets, helping to take those off the balance sheets from the banks. Then pulling it all together was a major program we did

with the EBRD,¹ the IMF, the European Investment Bank, and the World Bank, where we provided 27 billion euros of financing for Eastern Europe.

McKinsey: *How did the role of the IFC evolve during your tenure?*

Lars Thunell: One of the things that we've done is that we have moved a lot of our people, and also the authority, to the field. We're probably the most decentralized multilateral organization, with more than 50 percent of our staff in the field and with 100 offices. And I think that is one of our key competitive advantages and also one of the reasons we can actually be successful in places like South Sudan or Burundi or other low-income countries.

Being there locally with the people, whether it's the government or the companies—that gets to totally different types of relationships, compared with the flying-in, flying-out type of relationship.

McKinsey: *What about the IFC's investment philosophy?*

Lars Thunell: If we look at the IFC investments in equity, we have had very, very good returns. We find that if you go in early and if you know what you're doing, you can actually earn more money. And we actually have had better returns in Africa than we have had in Brazil or India—mainly, I think, because there has been less competition there, and we're breaking new ground.

You obviously have to be careful in how you structure the deals. You have to focus on good governance. Very often, these are family companies, so you have to work with a family. And that's one of the things, I think, that private-equity funds also are now finding—that the idea they had, in the developed world, to take over a company 100 percent is not really working in emerging markets.

Very often, because you go in as a minority, you have to work clearly on your protection there so you don't get stuck. Obviously, since capital markets or equity markets aren't as developed in emerging markets, the listing or the exits become more complex and may take a little bit longer than you normally find in the developed world.

Our role is always to be in the frontier, whether it's in applying new concepts or moving to new regions. So when the private-equity firms move to India and China, we move to the next frontier.

¹European Bank for Reconstruction and Development.

McKinsey: *How does the IFC help create markets in lower-income countries?*

Lars Thunell: All countries are different. I was recently in South Sudan; there they have nothing. We have helped them with creating the first 19 laws—the corporate law, the bankruptcy law, and these types of basic things. That’s the investment climate. You need to have a government that provides some type of legal framework, a legal system. And very often, we know that the courts and the legal system in these countries don’t work that well.

The second important way is infrastructure. Take South Sudan again. There is no electrical utility there. One percent of the population has access to electricity. But it’s based on their own generators. You need to have electricity if you’re going to have manufacturing, if you’re going to have your children be able to do their homework, if you’re going to be able to cook food.

Transport is also very important because many countries in Africa are landlocked. Within a plant itself, you can reach very similar productivity numbers that you could reach in China. But getting things in and out is very, very expensive. So you become totally uncompetitive on a worldwide basis.

If you look at jobs and creating the environment for small- and medium-sized enterprises—because that’s where you have the most people employed—which is the investment climate, then access to finance.

And, finally, you need to train the entrepreneurs. And we have programs for that. One is called Business Edge, where we train the trainers. I had a chance to meet some of the young entrepreneurs, two women who had gone through that training, and hear them talk about the opportunities they’ve had and what they’ve done. One of them started a furniture factory two years ago and now has 30 employees. And she was looking at how to expand beyond—this was actually in Burundi—to expand from Burundi and out into the region.

And we’re seeing more and more of those—what I would call “regional champions”—where you have companies starting in one country and moving into other parts of the emerging market.

McKinsey: *That’s the so-called south–south trade. How is that developing, from your perspective?*

Lars Thunell: When it comes to south–south, what we see developing are these regional champions. For example, we have a mill company from Tanzania that we’ve now taken up to Mozambique and to Rwanda.

You’ve got a lot of Indian companies that are going into Africa. I was recently in Ethiopia, where there are now about 100 Chinese companies registered. And we had a chance to visit one of the shoe factories there, for example, driven by the fact that labor costs in

China have gone up tremendously. Chinese manufacturing is moving west in China—to Bangladesh or all the way to Africa. But you also have technology-driven companies. It's very interesting that some of the innovations from those companies are applied, especially, to emerging markets.

Those innovations can then be rolled out into other countries. We have one company—called Jain Irrigation, from India—that has developed some very, very good irrigation technologies. And we're now helping them to go into Africa and Latin America, and they're very, very competitive.

McKinsey: *Earlier, you mentioned the importance of infrastructure in emerging markets. How does the IFC promote its development?*

Lars Thunell: If you don't have infrastructure, development will not work effectively. On the other hand, governments don't really have enough money to invest.

So public–private partnerships have become a key concept, with the public sector very often giving the concessions or putting in place tariffs for buying electricity, for example, while the private sector can provide some of the money, and build and operate the infrastructure.

Not only does that offer the benefit of financing, but also, very often, the systems become more effective and better maintained and, therefore, have a longer life. It is easy to say. It's hard to do.

Experience shows that on the government side, capacity building is absolutely necessary. Very often, the governments don't have the capacity to negotiate the contracts. The IFC has advisory services in this area and can provide financing, working with the World Bank, which is more on the public side.

We are seeing some very interesting applications of public–private partnerships in electric utilities, water utilities, airports, ports, and, more and more, hospitals.

The G-20 has asked, “Why don't we see more of these?” One of the problems is that the project must be bankable. Very often, there's an idea but the project is not bankable yet. So we have also established a fund—we call it IFC InfraVentures—where we take the development risk of the first stage of a project so that you can actually bring it forward.

McKinsey: *The private sector seems to be taking a more active role in development issues. Can you offer an example?*

Lars Thunell: The food crisis of the past few years has been terrible for many people, especially in the developing world. But it has also opened up business opportunities; it's

now worth investing in agriculture, for example. So we've seen a resurgence of agricultural investments, whether in farmland or in the food-processing area or logistics. We have to remember that in Africa, for example, 40 percent of the food produced actually perishes on its way to the consumer. I think we have to work with the whole food supply chain—from farm to fork.

We have to remember that farmers are businesspeople. I met the head of a group of farmers in Malawi, with one million members, and the first thing he told me was, "We're not a labor union. We are basically an association of entrepreneurs or business people." And there, the IFC can do a lot with training and with getting them better credit or weather insurance or better seeds and irrigation.

McKinsey: *One of your highest priorities was resource-efficient development. How do you see the private sector pursuing this agenda?*

Lars Thunell: Resource efficiency is one of the key global challenges. There have been a number of drivers of this, and, of course, climate change has been one. But more importantly, I think, with prices of commodities now being so high, it has become an absolute economic necessity to address these issues.

Water is becoming a critical issue. For example, some people say that the constraint now for building new coal-fired power plants in China is actually water availability. Resource efficiency, especially after the financial crisis, has become a clear win-win issue: you use less resources and have less negative effects on the environment.

The Water Resources Group was an initiative within the World Economic Forum, and the IFC has been a part of that. We studied the various water basins around the world to see what the gap is between water supply and water demand. One of the important things that we realized was that we couldn't work only on the supply side, because there wasn't enough water in many of these basins. But if you also worked on the demand side, you could actually have a chance to get that gap down to zero and have it balanced.

But one very important thing there was the pricing, which is a political issue in the sense that water is a human right, and, therefore, some people were saying that you can't put a price on water. But, obviously, if you're going to have water efficiency, and since water has a cost, you need to price it. We're now doing diagnostics around the world on how to price water to maximize its efficient use. ○