

# EBRD strategy for Ukraine 1997-98: a summary

## Overview

The priorities in Ukraine for the European Bank for Reconstruction and Development (EBRD) are:

- to develop private enterprise through credit lines and equity funding for small and medium-sized enterprises, and through direct financing of both joint-venture and local private companies. The Bank will place special emphasis on working with Ukrainian companies and developing strong ties with the local business community;
- to strengthen the financial sector;
- to restructure the energy sector through promotion of energy efficiency, power and gas sector modernisation, financing of oil and gas projects, and if possible other fossil energy as well as renewable energy projects;
- to make improvements to nuclear safety in line with the Bank's Energy Policy;
- to promote private investment in agricultural sector development; and
- to reform key infrastructure sectors, including transport, telecommunications and municipal services sectors.

## Future commitments

The EBRD is determined to increase the level of its investments in Ukraine. It has already developed a significant project pipeline in Ukraine, but the level of future Bank commitments depends on:

- continued progress in the stabilisation of the Ukrainian economy;
- acceleration in the pace of structural reforms – for example, an increase in the privatisation of large and medium-sized enterprises;
- continuation of sectoral reform to allow the Bank to finance infrastructure on a private basis, to finance the development of the agriculture and power sectors and to increase foreign direct investment in the telecommunications sector; and
- strengthening of the banking sector, which will be key to the growth of the private sector.

Initially, most of the Bank's private sector operations are likely to be based on the extension of credit lines

to small and medium-sized enterprises (SMEs). The scale of direct private sector investment by the EBRD will depend on the pace of transition in Ukraine and on the operating environment for private companies.

The Bank's development of public infrastructure projects is likely to focus on environmental projects (both energy conservation and municipal) and projects with a significant impact on sector reform (for example, in the transport sector). The Bank will actively pursue the development of projects aimed at private infrastructure financing in the telecommunications and energy (power generation) sectors.

## Cooperation

The EBRD will focus in particular on:

- ensuring that a strong relationship is established with both national and local authorities;
- working with major Ukrainian companies and developing strong ties with the local business community; and
- providing national authorities with clear and regular information on the development of projects.

## Private enterprise

Private investment will play a key role in establishing sustainable growth in Ukraine.

### *SME development*

Most demand for private project financing in Ukraine has been for projects too small for direct EBRD financing. Accordingly, a central element of the Bank's strategy is to support SMEs through intermediaries using term credit and equity financing. At the same time, EBRD operations support the institutional development and growth of these intermediaries (banks and venture capital funds). Through these vehicles, over 50 SMEs are being financed for a total commitment of US\$ 43 million.

The Bank's strategy with regard to SME development will be to:

- closely monitor the implementation of the SME line of credit to ensure continuing high use;

- prepare a new SME line of credit, with a view to approval in 1997;
- continue the preparation of pilot regional venture capital funds; and
- develop a Small Business Fund to finance very small and micro projects (from US\$ 5,000 to US\$ 100,000) using the banks currently involved in the SME line in order to reach new private entrepreneurs.

#### *Post-privatisation support*

To support newly privatised enterprises, the EBRD is focusing on the creation of four post-privatisation funds (PPFs) in selected regions: (i) southern Ukraine – Odessa, Mykolaiv and Kherson regions; (ii) south-eastern Ukraine – Zaporizhya and Dnipropetrovsk regions (Ukraine's industrial heartland); (iii) western Ukraine – Lviv and all western regions; and (iv) north-eastern Ukraine – Kharkiv, Sumy and Poltava regions. As with earlier Bank-supported funds, the PPFs would be run by professional venture capital managers.

#### *Direct private enterprise financing*

The EBRD's direct private sector investments have focused on financing projects with foreign investors. The Bank will continue to be responsive to demand for project financing resulting from privatisation, economic recovery and greater foreign investment, and will actively target larger local private enterprises.

The EBRD will examine possibilities for supporting the restructuring of the most promising enterprises via direct loans and possible equity participation. The Bank has initially focused its attention on those enterprises that are already receiving technical support from bilateral agencies and especially EC Tacis.

### **Financial sector**

#### *Banking*

The EBRD's strategy entails:

- close monitoring of the US\$ 121 million SME credit line;
- preparation of a restructuring project for the recently privatised Bank Ukraine, the former State Agricultural Bank, including technical assistance and a twinning arrangement;
- possible direct credit lines as well as minority equity participation in leading private banks once their institutional strengthening has proceeded sufficiently;
- the establishment of Kiev International Bank (KIB), in which the EBRD is a shareholder together with foreign and Ukrainian private partners;
- the addition of more Ukrainian banks into the trade facilitation programme approved in December 1995; and
- the possible strengthening and restructuring of projects in the most promising private banks.

#### *Venture capital funds*

In addition to credit financing through banks and the PPFs, there is a growing demand for new equity financing through venture capital funds. The Bank is a leading shareholder in the Ukraine Fund, which has been operational since 1993. The Fund has built up a portfolio of 24 investee companies for total equity contributions of about US\$ 12 million.

The EBRD's strategy in this area will centre on:

- participation in the capital increase of the Ukraine Fund, to enable the Fund to expand its activities to newly privatised enterprises of a larger size than most investee companies to date, while also providing room for follow-on investments in the most successful existing investee companies; and
- participation in other venture capital funds with a foreign manager/co-investor for high-tech companies or energy conservation investments.

### **Energy**

#### *Energy efficiency*

Energy efficiency, on both the supply and the demand side, has become one of the Bank's priorities in Ukraine. This is also reflected in the Memorandum of Understanding agreed between Ukraine and the G-7 on the closure of Chernobyl, which includes energy efficiency improvements as a guiding principle. Close collaboration with the World Bank is being pursued in this area. The EBRD's strategy involves:

- strengthening gas metering capacity to improve cost recovery and lead to energy conservation and efficiency;
- district heating projects, including the refurbishment of the heat generation, distribution and control systems for end-users;
- creation of companies providing energy services to clients in the public and private sector (i.e. ESCOs - Energy Service Companies);

- financing for energy-saving programmes for a few financially viable large state-owned companies; and
- examining the feasibility of a demand-side management programme to improve energy efficiency at customers' facilities.

#### *Power sector*

The Bank's strategy is to support government in designing and implementing reforms in the power sector. The EBRD is working closely with the World Bank in this area. It will select investments that develop the sector in accordance with least-cost planning principles.

The EBRD's operations will focus on:

- renovation of thermal power generation capacity that supports the programme for closure of Chernobyl nuclear power plant agreed under the Memorandum of Understanding;
- improvements to efficiency and environmental performance by introducing new combustion technologies that can burn coal wastes and low-quality coal, by reconfiguring existing coal-fired boilers to eliminate the need for combustion support with oil or gas and by introducing co-generation systems in district heating plants;
- development of power generation schemes with private sponsorship that exploit local energy sources and markets for electricity;
- improvement of gas pipeline efficiency to increase Ukraine's benefits from providing international gas transit facilities;
- commercialisation of the sector and consolidation of the power market reforms, including improved tariffs and collection rates; and
- investments to improve energy efficiency.

#### *Oil and natural gas*

The EBRD has currently one project involving financing of oil and natural gas production in the Poltava region. As far as the supply side is concerned, selected improvements to energy supply infrastructure will be important to cut supply losses and to improve conversion efficiencies. The Bank will also consider projects involving other fossil and renewable energy.

#### **Nuclear safety**

As administrator of grant funds provided by the Nuclear Safety Account (NSA), the EBRD has concluded an agreement with Ukraine for the provision of ECU 118 million from the NSA for short-term safety upgrades to Chernobyl nuclear power

station and to assist with facilities required for decommissioning three units. The project is part of the Memorandum of Understanding, signed in 1995, which aims to secure the permanent closure of the Chernobyl plant by 2000 and to improve nuclear safety in Ukraine through an energy efficiency programme and supply-side investments. The project will be implemented by the Chernobyl plant and was declared effective in April 1997.

A project management unit is now in place, and implementation is under way. Assistance with decommissioning under the project will include financing for spent-fuel storage and a waste-treatment plant for liquid radioactive materials. Preparations for decommissioning under the NSA project are an important component of a comprehensive programme of activities for decommissioning of the plant supported by EC Tacis.

The EBRD is continuing its assessment of the projects to complete two units at the Rovno and Khmel'nitsky nuclear power stations.

The Bank is also preparing to assist in the establishment and management of a major new multilateral initiative on Chernobyl. This initiative aims to help Ukraine convert the sarcophagus of the destroyed Chernobyl Unit 4 into a secure and environmentally safe site, pending subsequent deconstruction and permanent disposal of the remains by Ukraine.

A programme (termed the Shelter Implementation Plan – SIP) has been prepared between a joint Western and Ukrainian expert group and agreed by the G7 and the Ukrainian Government. The US\$ 700-800 million programme will assist with measures to stabilise the existing sarcophagus, to provide additional shielding and to build a new shelter over the existing structure.

Ukraine and other countries are expected to assist with the initiative. The role of the Bank would be to administer the SIP fund on behalf of national contributors and to assist Ukraine with its management of the project.

#### **Agriculture and agribusiness**

Agriculture and agribusiness have a key role to play in the economic recovery and transition of Ukraine. The EBRD's strategy is to invest in market-oriented and private sector projects that:

- facilitate and support private sector initiatives;
- relieve critical bottlenecks by creating competition in marketing, generating exports and increasing the supply of inputs and machinery;

- add value through processing in Ukraine;
- are quick yielding and attract foreign investment and technology;
- can act as a model for other projects, both technologically and in highlighting the need to relax investment constraints and deregulate the sector; and
- support development of leasing operations specialising in agriculture.

To put this strategy into effect, the Bank will work in the more progressive regions with strong private entrepreneurs. The Bank will support projects that adopt an integrated approach and will develop distribution, marketing and processing programmes for crops.

## **Infrastructure**

### *Transport*

The transport sector is of great importance for the transition to a market economy and the development of diversified trade. The EBRD will focus on projects that:

- have revenue-earning potential,
- demonstrate a market-oriented approach to the provision of transport services; and
- are demonstrably cost-effective in alleviating particular bottlenecks.

Environmental aspects of projects will also have to be dealt with explicitly. The main focus will be on the removal of critical urban and inter-urban transport bottlenecks and on strengthening links with Ukraine's new European trading partners.

### *Telecommunications*

Ukraine needs major improvements in the telecommunications sector to underpin private-sector led economic recovery and integration with world markets. The strategy of the Bank will be to:

- support projects to upgrade network capacity and technology, with particular attention to projects and policies that expand local access;
- upgrade network capacity and quality, in particular for international communications;
- promote private market solutions for the above projects in order to mobilise private financing and technology transfer; and

- support government efforts to restructure the sector, and to increase domestic tariffs and private sector involvement. To this end, the Bank will also assist the Ministry of Telecommunications in drafting a new telecommunications law and licensing statutes, and in setting up a new regulatory body.

### *Municipal and environmental infrastructure*

The EBRD's strategy with respect to municipal and environmental infrastructure will rely mostly on sovereign-guaranteed public sector operations.

The EBRD will concentrate on:

- support to strengthen municipal finances and expand the range of municipal financing sources;
- pre-investment studies in major cities to prepare specific investment programmes for improving water supply and waste-water treatment;
- a pilot project with selected cities that would provide a blueprint for financing municipal infrastructure projects in Ukraine – the Bank has targeted two large industrial cities, Dnipropetrovsk and Zaporizhia, for a priority investment programme to finance critical investments in the water supply and waste-water sector; and
- assistance for local governments to find ways of increasing private sector involvement in municipal services, both for direct and indirect Bank financing.

### *Property and tourism*

The EBRD will focus on financing the development of modern hotel and office facilities to fulfil the needs of the business community. While the Bank's primary emphasis will be on Kiev, it will also consider hotel projects in leading regional cities and proposals for the development of warehouse and distribution facilities.

## **Cooperation with other international financial institutions**

The EBRD coordinates its activities with the International Monetary Fund, the World Bank and the European Commission in a broad range of areas, including the banking sector, post-privatisation funds, the energy sector, privatisation, municipal development and agriculture. It also maintains close relations with main bilateral donors active in Ukraine.

**This document is based on the EBRD's Strategy for Ukraine, approved by the Board of Directors at its meeting on 3/4 June 1997.**