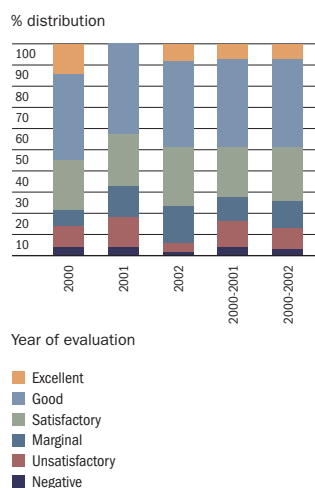


## Evaluating EBRD projects



EBRD projects are normally evaluated one to two years after full disbursement has taken place. The EBRD's Project Evaluation Department (PED) seeks to establish whether the Bank's operations have met their objectives and to assess whether the EBRD is complying with the Bank's mandate. Through this process, the Bank is able to improve the selection and design of future operations. In 2002, 77 per cent of the 66 projects evaluated received an *Excellent-Satisfactory* transition impact rating.

### Transition impact ratings of EBRD projects 2000-02

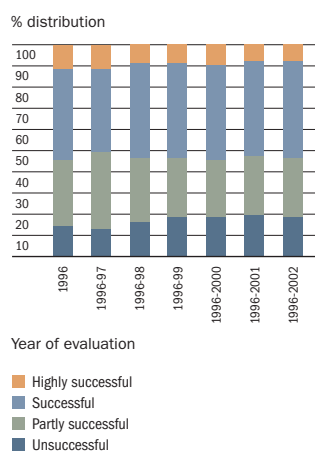


### Impact on the transition process

To evaluate the impact of EBRD projects on the transition process, PED looks in particular at their wider impact in the economy as a whole. At the time of project evaluation, PED assesses transition impact using the same criteria applied by the EBRD during the selection and approval of projects. This involves, for example, assessing to what extent the project has promoted privatisation, developed skills, encouraged competition and supported market expansion. It might also look at how the project has improved the functioning of markets, acted as a model for other projects and set new standards in business conduct and governance.

The new six-point rating scale on transition introduced in 1999 allows the EBRD to compare the transition ratings assigned to projects at Final Review (prior to Board approval) with the ratings achieved following project completion, when an evaluation is carried out. So far, of the 142 projects evaluated during 2000-02, 33 have also been rated on transition impact prior to Board approval. A total of 61 per cent of these were rated *Excellent* or *Good*, but following project completion the percentage in these rating categories drops to 48 per cent, demonstrating that part of the risk identified at appraisal has materialised during project implementation.

### Overall performance rating of evaluated EBRD projects 1996-2002



The chart top left shows the transition impact ratings of projects evaluated in 2000-02. Of the 142 operations evaluated, 49 per cent achieved a transition impact rating of *Good* or *Excellent* and a further 25 per cent were assessed as *Satisfactory*.

In 2002 a total of 24 per cent of evaluated projects were given transition impact ratings in the *Marginal-Negative* range, which is similar to previous years. This apparent lack of progress can be explained by the fact that the Bank operates in areas where risks are high. This affects the sustainability of some private sector operations and prevents them from realising their full potential. The share of projects with an *Excellent-Satisfactory* transition impact rating in 2002 was 77 per cent.

The risk factor for these projects prior to Board approval was rated as *Medium* in 73 per cent of cases and *Low* in 15 per cent. However, following project completion the risk was rated as *Medium* for 30 per cent and *Low* for 48 per cent. This difference might reflect the fact that during the implementation of the project the risk factor becomes easier to assess as information is available on how the risk is evolving. The number of projects available for comparison is still too small to reach general conclusions and further analysis will therefore be conducted as more data becomes available.

## The EBRD's overall performance

The overall success of the EBRD's operations is illustrated in the second chart on page 70, which presents the Bank's overall performance ratings. This rating gives a high weighting to transition impact but also includes other performance ratings, such as the fulfilment of project objectives, financial performance, environmental performance and additionality (the Bank's ability to complement rather than replace private sources of finance). In 1996-2002, 53 per cent of evaluated projects achieved a rating of *Successful* or *Highly Successful*. This is much lower than the percentage of projects (74 per cent) that received positive ratings for transition impact alone.

The difference between the scores on transition impact and the overall performance rating is primarily due to the impact of lower financial performance ratings, which were caused by a high-risk investment climate in the Bank's countries of operations. As in previous years, it was concluded that the Bank could have mitigated the industry-specific risk more effectively and that specialist knowledge of the industry must be better used in the appraisal and structuring of projects. During 2002 three projects scored an overall rating of *Highly Successful*. The conclusion of PED is that the Bank has been relatively successful in operating according to the Bank's mandate, especially in view of the difficult operating environment.

## Importance of learning from past experience

The EBRD is careful to ensure that past experience is applied to new projects. This begins with intensive consultation with the EBRD's banking teams on the lessons learned from previous projects. Regular feedback is also offered at every stage of the approval process to provide bankers with relevant past experience. Case-based workshops are held and tailored to the specific needs of banking teams. PED also makes presentations to management and maintains a lessons-learned database for internal use. A database for external use is also being developed.

## Special studies

### Mid-term review of the Bank's equity funds

PED carried out a mid-term review of the EBRD's investments in private equity funds (PEFs), focusing on transition impact and sustainability. The review evaluated over 70 funds run by 55 managers with a total capital of €5.2 billion, including €1.5 billion from the Bank.

Close to 50 per cent of the Bank's finance has been invested in "expansion/buy-out" funds, which take an average stake of above €6 million in medium to large private enterprises. Donor-supported (DS) funds account for about 33 per cent of EBRD financing and focus on smaller holdings in countries at less advanced stages of transition. Venture capital (VC) funds, which also focus on small to medium-sized enterprises (SMEs), have an average stake of below €2 million and represent 17 per cent of the Bank's commitments. Increasingly, the EBRD has focused on the sustainability of funds and has provided finance to support the establishment of second-generation funds.

The review found that the impact of the funds on the transition process depended on achieving sustainability. Funds that took bigger stakes in medium to large enterprises in the advanced transition countries were found to have the best prospects in terms of returns for investors and the enterprises. Conversely, investments in SME funds and in countries at the early stages of transition suffered from a lack of sustainability. The nature of the fund – whether donor-supported or not – was found to affect the nature of the fund's investments.

The amount invested by equity funds remains minute compared with the needs of the region. The review found that fostering an equity fund infrastructure can attract international and domestic investors. If fund managers are able to raise additional funds, this can provide vital capital within the region's financial systems. Some promising signs were observed in central Europe and Russia, where strong managers have raised second and third-generation funds. The fund investments were clearly seen to complement rather than replace other sources of finance. Investors need firmer proof, however, of the likely returns on their investment. Currently these range from 15 per cent for expansion/buyout funds to a negative return in others. VC and DS funds have poor to fair returns due to their low exit rates.

The evidence is clear that most stakes under €1.9 million are difficult to sell at a profit, but recent bigger investments should help to improve returns over time. The region lacks valuation benchmarks, making for uncertain returns until a bigger portfolio is realised. There are positive signs, however, for the long-term future of the portfolio. In the short-term there is a more uncertain outlook for early returns due to high commitments in certain sectors, the volatility of the region, the sensitivity to global cycles, and the impact of the reform process and EU enlargement progress.

The Bank's handling of equity funds is increasingly state of the art, matching the highest standards and establishing tailored systems. Trouble-shooting and workout cases are efficiently undertaken. The DS and SME funds in the early transition countries suffer, however, from the lack of good examples of sustainability. Further specialisation should help to further improve the Bank's management of equity funds. It could also help to attract long-term investors.

The review recommends that the EBRD should set a clear strategy, focusing on long-term institution-building, sustainability and standard-setting. The Bank should continue to invest in mainstream PEFs to support medium to large private enterprises. It should also continue investing selectively in VC, SME and DS funds but only after a rigorous examination of their prospects of sustainability. The scope of the fund and the needs of the professional fund management should be taken into account. A strategy for DS funds should emphasise the need for sufficient grants.

In addition, it is essential that no new SME investments are channelled via PEFs aimed at early and intermediate transition countries, where the constraints are too great for the fund to meet its sustainability and institutional aims. Instead, the Bank should continue to channel loans through local banks and institutions, where the risks can be better mitigated and more acceptable returns achieved.

### Trade Facilitation Programme

The EBRD's Trade Facilitation Programme (TFP) is a network of 250 banks that uses EBRD guarantees to reduce payment risk in international trade with the Bank's region of operations. The network creates over 12,000 pairs of banks that can cooperate to produce a confirmed letter of credit (LC). Since 1998 the EBRD has guaranteed over 900 LCs worth €650 million. The TFP fosters transition by reducing risk and by providing a "safety net" for trade transactions based on LCs (see page 21).

A study undertaken by PED confirms that TFP complements transition tools such as privatisation and regulatory reform across the region. TFP has been a sound way for the EBRD to foster transition in countries that offer few viable projects or that demonstrate a slow pace of reform. By acting as a safety net for trade payments, TFP can reduce risk, such as during the political crises in FYR Macedonia in 2000.

TFP has been *Successful* overall, but needs to take bigger steps to meet the Bank's intra-regional objective. Most of the trade has been with the West. Only 8 per cent of LCs linked exporters and importers within the Bank's region of operations. Most LCs confirmed by a TFP bank in the Bank's countries of operations would be in support of intra-regional trade. To date, however, a small number of Western confirming banks have dominated TFP's activities. For example, EU-based banks confirmed 78 per cent of TFP deals. By contrast, only 24 of the 93 confirming banks in the EBRD's region of operations have confirmed a LC, and those LCs accounted for only 4 per cent of all LCs. The Bank should develop, with the help of technical cooperation funding, more local confirming banks that can facilitate trade between the many importers and exporters based in the region.

## Examples of evaluated EBRD projects

### Successful projects

#### Russian telecommunications

In 1999 the EBRD made an equity investment of €33 million in a telecommunications company in Russia. Through this investment, the Bank supported the initial public offering (IPO) and sent a strong signal of confidence in the telecommunications market. The investment promoted network expansion and competition through the introduction of innovative and advanced services.

The Bank's evaluation of the project confirmed that the company's performance is excellent considering the difficulties experienced by the global telecommunications market. Since the EBRD joined the IPO at a fairly late stage, it was not possible for the Bank to introduce structural elements that could enhance the project's impact on the transition process. However, the Bank clearly provided much-needed support.

Through the EBRD's nominee on the board of the company, the Bank contributed to discussions about bringing in a strong domestic shareholder. The evaluation also reviewed the Bank's selection process for board nominees and the range of their responsibilities. It concluded there is a need for the Bank to monitor the performance and effectiveness of board nominees.

#### Sunflower seed crushing plant

The EBRD contributed to the financing of this country's first 100 per cent foreign-owned agribusiness "greenfield" project through a combination of equity and working capital financing. The foreign sponsor brought in state-of-the-art technology and built the plant within the allocated budget. The plant produces sunflower oil, which is mostly exported.

The EBRD's evaluation confirmed that the project has demonstrated resilience to the chronically depressed world price of sunflower oil. This was partly achieved through extensive training of local staff. The project complies with local and Western environmental standards. As part of the Bank's conditions, the company constructed a waste-water

treatment plant, which had not been required by the local authorities. The project has created approximately 100 new skilled jobs and has been a major boost to sunflower farmers, who have improved the quality of seeds as well as crop yield.

One of the lessons learned was that the strength, both financial and technical, of the foreign sponsor is crucial to the success of such a new venture. In addition, the support provided by the Bank made it possible for the sponsor to invest in a country where foreign direct investment has been in short supply. The Bank's in-depth knowledge of the sector was extremely beneficial in putting together such a successful partnership.

### Projects with a less successful outcome

#### Port reconstruction

In 1996 the EBRD provided a sovereign loan of €42.5 million for the reconstruction of a port, which would cost about €72 million. The loan was used to finance improvements to dry cargo berths, cargo-handling equipment and environmental practices and to support the commercialisation of activities at this important port in Central Asia. A total of €2.4 million was provided in grant funding to assist in project preparation, implementation and institution-building. Despite a short delay, the main construction work was completed in September 1999, and the overall project completed in March 2001.

The EBRD's evaluation of the project confirmed that the work on the general cargo berths was of a high standard. Also, the installation of modern equipment on the general cargo berths was carried out satisfactorily. The commercialisation of the port had been achieved, and the impact of the institution-building initiatives was positive.

The project became tarnished when the government announced in September 2001 that the port's main assets would be leased out to another state enterprise without adequate compensation to the port and without the Bank's consent. As a result, the port's ability to service the Bank's loan was jeopardised. Moreover, the government's interference in tariff setting and other areas hampered the impact of the project on the transition process. Overall, the project was rated as *Partly Successful*.

In situations of external interference, the EBRD must react quickly to avoid the potential damage gaining momentum and to make clear that the Bank is not in agreement with the action taken. Although the Bank is protected under the sovereign loan obligations, the interference changes the nature of the project and undermines its objectives. Preserving the financial viability of public sector clients is regarded as essential to the transition process.

To enhance the impact of infrastructure reforms, the Bank may need to introduce clear and verifiable transition impact milestones. The effectiveness of these would be enhanced if they are linked to loan disbursements whenever possible. In this respect, it is essential that conditions are included in the loan documentation.

#### Investment company for agribusiness SMEs

In 1994 the EBRD invested in a recently established investment company together with Western fund managers and a government agency in south-eastern Europe. The aim was to support agribusiness and SMEs and to promote the development of the financial sector. Both equity and loan finance was provided. Training, advisory services and financing was provided through an institution that would establish a strong local presence.

Following the first capital contributions from the EBRD and other sponsors, the investment company began disbursing to selected businesses. The local sponsor was unable, however, to make additional capital contributions as planned or to participate in the management of the company. As the company was unable to function satisfactorily in these circumstances, the EBRD was obliged to suspend participation in the project. The Bank lifted this suspension after the local sponsor had transferred its shares in the company to the Western fund managers.

The EBRD's evaluation found that the project provided much-needed finance to entrepreneurs in a number of sectors and provided management and technical support to investee companies. Progress was hampered by a number of political and economic factors, which made it impossible for the project to build a sufficient portfolio of successful investments to achieve a viable critical mass. After discussions with the fund managers, the decision was taken to wind down the investment company.

Evaluation by PED identified differences in the objectives of the EBRD and the fund managers. In addition, the selection of sub-projects showed a lack of understanding of the suitability of candidates for equity funding. The evaluation emphasised the importance of agreeing common commercial objectives with equity partners and of assessing the effect of local conditions on the suitability of various forms of financing. If the conditions of the banking sector are not conducive to lending, the authorities should be encouraged to improve conditions for intermediation.

## Evaluating technical cooperation operations

PED has evaluated over 300 consultant assignments funded through technical cooperation (TC), involving almost €100 million of funding from over 30 donors under the Bank's Technical Cooperation Funds Programme. Including TC assignments evaluated during PED's special studies, the number rises to over 900 assignments involving over €250 million of funding.

## Examples of evaluated technical cooperation operations

### Preparation for a port development project in Central Asia

The project involved six TC operations totalling about €2.9 million, funded by three donors. The funding was used to assist the preparation and implementation of a Bank investment of €27.5 million for a port in Central Asia.

PED's evaluation rated the TC operations as *Successful*. This was supported by a satisfactory rating for transition impact. The TC operations were instrumental in bringing about the follow-on investment, which is presently under implementation.

PED's evaluation noted that the TC resources did not fully take into account the difficult operational environment. As a result, some shortcuts were undertaken, which can lead to problems for follow-on TC work or the subsequent EBRD investment. More realistic costing is required. In addition, the feasibility work was too narrowly focused on the follow-on investment. Finally, the political and strategic reasons for undertaking a project need to be separated from the economic rationale. Both aspects should be discussed separately.

### Project development in Central Asia

An investment company in Central Asia supported by EBRD financing was intended to provide finance to three locally owned enterprises, making use of €1.6 million in TC funding for management services. The aim of the project was to maximise the commercial potential in ailing privatised enterprises through active management involvement and to assist the enterprises in becoming competitive and profitable market-oriented companies. The project was also intended to demonstrate to local enterprises and prospective investors the value of modern management, financial control procedures and outside investment. Unfortunately, the project did not encourage other parties to invest in similar opportunities, and saving businesses from collapse also failed.

In spite of considerable TC funding, only one relatively small investment materialised and even that one appears to be no longer financially viable. The overall assessment of the TC operations for this project is *Unsuccessful*. The TC funding was not able to help in establishing a viable private sector enterprise. The only project developed with the help of TC funds did not succeed in transforming the factory into a market-driven enterprise.

Through this project, the EBRD has learned that we must not rely too much on consultants to find investment opportunities for the Bank. Instead, providing funds to encourage the promotion of investment is sometimes a more viable approach. Investment opportunities can be identified through existing SME facilities in the region or through other donors' work with local companies. TC funding is not a substitute for unambitious management. It is vital that the recipient of TC funding is committed to the project. In future, the Bank must make sure that TC operations aimed at improving the business conduct of local management must allow consultants to adopt a long-term approach financed by sufficient TC funding.