Agricultural Commodity Programme

Summary of the Operation Performance Evaluation Review (OPER)

February 2004

THE PROJECT

This project was designed to provide secured financing to buyers of agricultural commodities in the absence of Warehouse Receipt (WHR) legislation enforceable in the Country. The Client, an ad hoc subsidiary of a major international financial institution, takes actual ownership of the financed commodity, warehouses it under strictly defined terms and conditions until it is sold to traders or food processors referred to as the "Borrowers". Funding of such inventory holdings was initially obtained by the Client exclusively from its parent bank. EBRD agreed to participate to such a financing initially as guarantor only (in 2000 and 2001 for USD 50 million), but subsequently, when the facility was first increased to USD 100 million in 2002, on a flexible (i.e. funded or unfunded) basis, at the Client's option.

PROJECT RATIONALE

Because of a legislative vacuum in the Country to implement WHR financing, the project was intended to fill the need for secured working capital lending to the agribusiness sector immediately downstream of the primary sector. It is made of companies involved in the initial processing of agricultural commodities, ranging from flour milling to seed crushing or sugar refining. A number of them are SMEs which would find it difficult to raise the required financing to purchase and store their raw material at reasonable conditions. The project was also meant to pave the way for a new legislative initiative which would see the implementation of a proper WHR framework to be eventually substituted for this programme. Finally, the project, as it was presented in May 2002, was to broaden the scope of beneficiaries and activities through the introduction of sugar quotas financing as well as supplementing the Bank's risk sharing with an actual funding opportunity.

ACHIEVEMENT OF OBJECTIVES

Most objectives have been met. Of particular significance is the fact that the Bank contributed meaningfully to the increase and diversification of agricultural commodity financing in the Country in the absence of an economically sounder alternative. The success of this project did not breed, as anticipated, the successful implementation of a new WHR legislation. This is however more of a setback for the Bank's policy dialogue than for the project itself. Through the demonstration effect of warehouse licensing it brought indeed a positive contribution to the exercise. Fulfilment of Objectives is rated as ***Good*** based on the excellent performance achieved quantitatively in a background of over ambitious goals set with respect to the implementation of WHR financing.

OVERALL ASSESSMENT

The Bank's operation overall ***Successful*** **rating** acknowledges the ***Excellent*** ratings of both Company and Project Performances but takes into account the ***Satisfactory*** rating of the anticipated Transition Impact, which relied on presently stalled institutional changes. Fulfilment of objectives is also negatively impacted by the lack of success in promoting WHR legislation but is rated ***Good*,** in view of outstanding achievements otherwise realised. The ***Satisfactory*** rating of Environmental Performance and ***None*** in Extent of Environmental Change reflect the very limited direct impact that the Bank can exercise through the programme on its beneficiaries' environmental behaviour. The absence of significant progress in institutional changes impacts at least three ratings and distorts the overall picture of a financially successful project that sets standards for the introduction of WHR legislation. This highlights the excessive weight given to the institutional changes objective in relation to the project itself.

TRANSITION IMPACT AND THE BANK'S ADDITIONALITY

The main risk to Transition Impact derived from continuing delays affecting the necessary institutional developments. The materialisation of this risk is the main reason overall Transition Impact is rated as ***Satisfactory*** in spite of the programme's economical and financial successes and of its achievements with respect to setting precedents in the licensing of warehouses. A number of positive features with respect to business standards know-how and skill transfers have been developed through the programme, however, the Bank's contribution was limited to allowing the programme to increase in size.
The Bank's additionality is clearly demonstrated by the tripling of the Client's loan portfolio since the risk sharing and optional funding programme was implemented with EBRD. The significant expansion of this programme is entirely attributable to the professional support and political comfort provided by the Bank. The Sponsor's recognition of the Bank's additionality is best evidenced by the relatively modest management fee withheld from the Bank's share in the profit margin. The evaluator therefore regards the Bank's additionality as ***Verified at Large.***

BANK HANDLING

The Banking Team developed a professional and commercially rewarding relationship with the Client which was based on shared skills in agricultural commodity financing risk analysis and transaction structuring. The quality of this relationship made it possible to increase the Bank's commitment from an initial USD 50 million to the present USD 140 million level while the Client's total portfolio increased proportionately. The Banking Team has dedicated a considerable amount of time to legal and institutional framework improvements. The dedication of the team to lobbying the different ministries and industry representatives has not yet produced the anticipated outcome from a legislative standpoint. The project's sound earnings provide a financial justification for the time and efforts spent on lobbying. The Team has no contacts with the ultimate Borrowers and relies on the Client to insist on improved financial reporting, compliance with minimum corporate governance and health and safety standards as well as EBRD Exclusion List regarding commodities financed. This absence of direct influence on transition impact features may explain the emphasis given to WHR legislation which proved disappointing although its apparent failure cannot be blamed on the project itself. The Banking Team should not have raised expectations beyond what the programme could deliver. It was however handled in a most professional manner and achieved a very rewarding risk return ratio. PED therefore assigns a ***Good*** rating to Bank Handling.

LESSONS LEARNED

Focus on demonstration effect of project at approval. It may be preferable to focus on demonstration effect at project appraisal stage since fulfilment of such an objective is strongly correlated to the project itself while the impact on institutional changes is a function of the outcome of policy dialogue, more remotely related to the project. In this case, the disappointing scoring on legal and institutional framework cast an undeserved shadow on the successful overall performance of the project.

Good demonstration effect can enhance policy dialogue. Policy dialogue can be significantly enhanced through the demonstration effect of successful projects which also better justifies the cost involved in time spent on carrying it out. This is however a one-way proposition and the outcome of policy dialogue results from many other factors, often independent from the project itself.

Sectoral expertise can sometimes rival Preferred Creditor Status as a driver of the Bank's additionality. In this project, the Sponsor was less interested in the incremental legal protection that the Bank may bring about, if structured appropriately, than in the overall comfort of its reputation combined with sector expertise. Such proven additionality may be equally conducive to specific conditionality in the loan agreement.

Reliance on a foreign sponsor is enhanced by the relative size of its equity stake in a project. In this project, the Bank went ahead with a subsidiary of a very strong financial institution which had a track record of successful implementation of similar programmes in other countries. In addition to such demonstrated professional expertise, the Bank obtained that the Sponsor retained a minimum 40% equity share. This was documented through a requirement that its own share of risk may not be brought down to less than 40% of each individual transaction through syndication or equivalent risk sharing arrangement.

Commitment fees should in principle not be waived. Waiving commitment fees should occur exceptionally and only where the Bank has reasonable grounds to expect full utilisation of a facility. In this project, the high remuneration of the Bank's exposure combined with a specific front end fee, albeit modest, on any funded portion led the team to give in on the commitment fee. Since the funded option is unlikely to be selected in the future and seasonality does impact the utilisation of the guarantee, low utilisation of the guarantee would translate in a lesser optimisation of the use of the Bank's capital than is facially apparent from the average margins collected.