SUMMARY OF THE OPERATION PERFORMANCE EVALUATION REVIEW

1. The Project

1.1. Background

In October 2003 the EBRD Board approved a sizable equity investment in the voting shares of a state-controlled bank (the client) in an EBRD country of operations. A second international finance institution (IFI) made a similar investment. The transaction supported the implementation of the revised privatisation strategy for the client and initiated a process of reviewing and upgrading its operational policies and capacity as well as corporate governance to prepare the way for full privatisation.

The revised strategy called for the sale of the client bank to a strategic investor by. A fully transparent tender was organised which resulted in the sale of the shares held by the IFIs and the state privatisation agency to a reputable strategic investor within the agreed timeframe.

1.2. Scope of the OPER: joint evaluation

The EBRD's Evaluation Department (EvD) and the IFI's independent evaluation department agreed to cooperate in the ex-post evaluation of the joint pre-privatisation equity investment. They also agreed to share information and resources to maximise the benefits of cooperation in the evaluation process. To achieve complementarity, the two evaluation departments agreed that each could use the shared information in the preparation of their final evaluation reports, which would be prepared in accordance with the requirements of their respective institutions.

2. Project rationale

There was a clear rationale for the operation in light of the EBRD mandate. The operation reduced the government's stake to below 50 per cent for the first time and contributed significantly to banking sector transition in the region.

3. Achievement of objectives

The operation had two principal objectives, both of which were achieved:

- facilitate the transfer of ownership to the private sector through IFI involvement and appropriate conditionalities:
- prepare the client for privatisation by reviewing and upgrading key business and control functions, as well as corporate governance.

4. Overall assessment

Based on its independent assessment, the OPER team assigns a rating of "Highly Successful" to the operation. The Bank clearly identified the steps needed to devise and implement a privatisation strategy after two earlier attempts by the government had failed. Comprehensive due diligence enabled the Bank to diagnose the improvements and changes required in corporate governance, operations and systems to prepare the client for the privatisation tender.

Well-structured legal agreements helped to underpin the commitment to privatisation of the parties involved. An institutional reform programme tailored to address areas of weakness identified by the due diligence review helped to reform governance, management practices, operations and systems and added economic value to the client bank in advance of the privatisation itself.

Clearly defined rules of tender lent transparency to the process and helped to attract reputable bidders. Several commentators observed to the evaluation team that the close involvement of the EBRD and the second IFI helped to increase the level of confidence in the client among potential strategic investors.

5. Transition impact and additionality

Transition impact is rated "Excellent". The initial pre-privatisation investment was undertaken at a time when economic conditions were unfavourable and full political backing for privatisation was not certain. The privatisation itself, which was achieved within the targeted timeframe, had a pronounced positive impact on the client as well as on the financial sector and the economy more broadly through promotion of competition and sound governance structures and practices.

The institutional -reform programme succeeded in introducing new managerial practices, operations and systems. There is strong potential for further transition impact both within the client bank and more widely. The strategic investor intends the client bank to become a focus of competitive strength within the banking group as well as in the national market. Additionality is "Verified in all respects" and is clearly demonstrated against the background of failure of the two previous privatisation attempts.

6. Bank handling: risks, cooperation and public perception

Bank handling overall is rated "Excellent". Extensive risk protection was negotiated in legal agreements. The EBRD's knowledge of the client, supplemented by extensive due diligence, enabled the Bank to take steps to mitigate commercial and banking risks. There were, however, political risks that had to be specifically addressed. To avoid the risk of directed lending or directed trading activities, the Bank included a provision in the legal agreements that all transactions by the client would be conducted on an arms-length basis.

The parties committed themselves to the timely completion of the privatisation exercise. In interviews with the evaluation team, representatives of various parties directly involved and other industry participants praised the dedication and hard work of the EBRD and IFI teams involved at all stages of the operation. During the mission the evaluation team questioned a number of interviewees about the current public perception of the operation. All responded positively, remarking that the voices raised against the privatisation at the time were politically inspired and had not influenced the public perception of the operation which remained good, especially in the light of changes effected at the client bank.

7. Key issues and lessons learned

Generic lessons: key factors influencing the success of pre-privatisation equity investment

- A comprehensive due diligence review should identify areas requiring improvement in governance, operations and systems.
- Government commitment is essential. A review should be made of the capacity and commitment of government organs and senior officials.
- The government organ that is responsible for implementing the privatisation should be different from the policy-making organ to reduce the potential for undue political influence.
- Using a comprehensive institutional -reform programme helps achieve essential restructuring

prior to privatisation, attract reputable bidders and add transparency to the process.

- Political winds may change rapidly. Legal agreements should have conditionalities that reinforce the commitment of all parties including government with sanctions and remedies if undertakings are not fulfilled.
- Supervisory board representation and a strong shareholders agreement help maintain control mechanisms and the chain of command during the privatisation process. This may be important in order to control and limit the potential for self-dealing by some participants.
- The rules and conditions of the tender should be drafted to ensure full transparency of the process. If non-price considerations are to be taken into account in selecting the winning bidder, they should be weighted in the calculation. In the case of very good quality bidders, the price criterion should have the greatest weight, say 70-90 per cent, to reduce the influence of subjective criteria.

A well-designed and implemented institutional -reform programme creates value. An institutional -reform programme that is tailored to the needs of the recipient can create added economic value as well as improving technical and managerial skills and capacity.

IFI cooperation in a privatisation has potential to increase the scope of transition impact. In the present case, the achievement of the desired objective was assisted by combining the financial and professional resources of the IFIs resulting in a highly significant outcome in terms of transition impact.

IFI cooperation can enhance the influence and authority of representations made to national and supranational bodies. In the present case careful and informed interaction was required with the government and national authorities, and with international bodies. The combined representations of the IFIs helped to provide clarity of focus among key policy makers and actors.