**SUMMARY OF THE OPERATION PERFORMANCE EVALUATION REVIEW**

## 1. The project

This evaluation considers the EBRD's relationship with a leading privately owned commercial bank (the client) in an early transition country. The EBRD disbursed its first loan to the client after admitting the client as a participant in a multi-bank framework financing facility (MBF). The client itself was the result of a merger of two smaller institutions. The EBRD had helped to initiate discussions that led to the merger of the two banks. Prior to the merger, the banks had been considered too small to benefit from participation in the MBF.

Subsequently, the EBRD became a shareholder in the client, acquiring a stake of 20 per cent. This was diluted to just over 15 per cent when another international financial institution (IFI) became a shareholder. To date the EBRD has committed three small and medium-sized enterprise (SME) credit lines to the client under the MBF. The Bank has also raised three syndicated loans with an A/B structure for the client.[1] All have been disbursed in full. The client has also made active use of the Bank's Trade Facilitation Programme.

## 2. Project rationale

The Bank's equity participation and the proceeds of the later loan facilities are intended to provide funds for general banking purposes, including lending to micro, small and medium-sized enterprises (MSMEs), trade finance and retail lending. A particular aim is to allow the client to compete more effectively with state-owned banks. Improving the governance structure standards and supporting capacity building are further principal goals of the equity investment. The rationale for the Bank's interventions with the client is premised on the need to encourage sound private sector institutions in the financial sector.

## 3. Achievement of objectives

The principal objectives of the MBF were to strengthen the institutional capacity of participating banks in relation to SME lending and to provide SME finance. The present evaluation has found that the client's senior management fully supported the facility. It also internalised the SME lending procedures of the facility through appropriate staff training, management supervision and systems development. The equity investment and A/B loans had three principal objectives, described as follows.

- **Support the process of restructuring and consolidation of the banking sector:** Since the merger of the two institutions, the client has developed into the leading private commercial bank in the country. Industry participants and others interviewed by the evaluation team commented that the EBRD's proactive role in the merger provided the sector with a strong example of an IFI working in partnership with local owners to achieve successful consolidation. There have since been several other merger initiatives in the market.

- **Provide effective support for institution building and setting standards for corporate governance and business conduct:** The Bank has further strengthened the outcomes of the

[1] In the A/B loan syndication structure, the EBRD provides financing (A loan) and syndicates the remainder among commercial lenders (B loan).

technical assistance initiatives under the MBF, particularly through participation in the supervisory board. Appropriate amendments have been made to the client's internal regulations, organisation structure and procedures to make the improvements in governance and business conduct sustainable. Clear roles and responsibilities have been defined for all staff and functions, including independent internal audit and risk management.

- **Provide medium-term funds for on-lending to SMEs and to support the growth of other banking activities:** The first two syndicated loans together have been fully disbursed by the client to around 40 privately owned SMEs for terms of between two and five years. The quality of the portfolio is good with no reported arrears.

The achievement of objectives is rated "Good" overall.

## 4. Overall assessment

On the basis of its independent assessment, the OPER team assigns an overall performance rating of **"**Successful" to the Bank's operations with the client. The bank responded well to the institution building programme and the credit advisory services provided. Although three local shareholders together hold around 75 per cent of the bank's shares, they appear not to interfere in day-to-day operations of the bank. These are handled by a strong management team.

Management has been strengthened further by the appointment of Western-trained experts in risk management and retail banking development with executive authority. Through its representation on the supervisory board, the EBRD has promoted the introduction of internal policies and organisational restructuring, reflecting best governance practice. Transition impact is rated "Excellent", with "Excellent" transition potential but "High" risk.

The EBRD operations have increased the client's capacity to offer strong and effective competition in the sector, which is still dominated by state-owned banks. The syndicated loans have attracted new Western sources of finance and the syndicated portions of the first two such loans have already been successfully extended. The operations have sent a strong signal to the market, in need of further consolidation, that the merger of private banks can succeed.

The transition risks stem from the bank's rapid growth rate and the refinancing needs in an increasingly volatile environment. Additionality is "Verified in all respects". With the exception of IFI credit lines, most available finance continues to be short-term in nature. The EBRD funding has allowed the client to make medium-term funding available to the real sector.

## 5. Transition impact and the Bank's additionality

The client benefited from SME and micro-lending technical assistance under the MBF. Strong management support for the development of MSME lending facilitated the rapid assimilation by staff of sound MSME lending principles. The consultants assisted in building credit appraisal and portfolio management procedures through on-the-job and classroom training of loan officers.

TC-funded consultants also worked with the client over an 18-month period to streamline the organisational structure and introduce new internal policies across many areas of the bank's operations. However, as a result of rapid expansion, the bank is likely to face pressure on capital and mounting liquidity constraints as the loan book grows and borrowings become due for repayment. Transition impact is rated "Excellent", with "Excellent" remaining transition potential that has “High” risks attached, which stem from the client’s rapid growth and the liquidity pressures of refinancing.

Privately owned commercial banks continue to suffer from a lack of medium and long-term funding with which to satisfy corporate demand for other than short-term loans. The syndications were highly additional in introducing new foreign sources of finance to the domestic market.

## 6. Bank handling

Bank handling is rated “Good”. The EBRD representative on the supervisory board appears to play a key role in managing shareholder relationships. After the merger the EBRD crucially contributed to governance by encouraging the clear separation of management board from supervisory board. This has assisted the formation of a strong management team.

## 7. Main OPER issues and lessons learned

***Mergers***

There is potential for strong transition gains through promoting the merger of well-managed banks in difficult and volatile markets. Merging banks worthy of EBRD support should possess a number of key attributes that can be identified from the present case:

- reform-oriented management and shareholders
- robust and diversified operations and balance sheet
- evidence of an understanding of good corporate governance practices and willingness to improve on these
- independence from third parties, such as government or state authorities, who might seek to exert influence over the utilisation of funds.

***Stepped syndications***

Stepped syndications of increasing loan amounts can attract new international lenders and help increase confidence in markets in the Bank’s countries of operations, including early transition countries. In the present case, using the A/B loan structure, the Bank has succeeded in raising the total loan amount of successive syndications by more than six times. Through this structure the Bank is effectively subordinating its claim in favour of other participants, which may be seen as giving additional comfort to new market entrants.

***Sound banking***

It is important to balance the transition objectives of loan book growth and extended sub-loan tenor with sound banking principles. Very rapid growth may lead to overtrading and liquidity problems. Difficulties with liquidity may be exacerbated by maturity mismatches and may result in failure to meet liabilities as they fall due, leading potentially to bank insolvency. While, as in this case, the inclusion of liquidity and other covenants in loan agreements can help impose discipline on partner banks, it is important for the EBRD to ensure that partner banks have sufficiently robust cashflow management and rolling liquidity planning procedures.