

SUMMARY OF THE OPERATION PERFORMANCE EVALUATION REVIEW (MAY 2008)

1. The project

This project formed part of the overall restructuring of the electricity sector in this country. The Bank had been maintaining an active policy dialogue with the government over privatisation of the distribution sector. It was invited by the Ministry of Economy to participate in the privatisation and enhance the bidding process.

In November 2001 the government tendered 49 per cent of its shares in the three regional electricity distribution companies through the National Property Fund (NPF). It was the intention of the government to complete privatisation at an unspecified time in the future by divesting of the remaining 51 per cent of the company's share capital by selling an additional 41 per cent stake to one organisation and listing the remaining 10 per cent via an initial public offering (IPO). Enabling legislation was prepared for further divestment.

However, the government refrained from effecting further privatisation pending parliamentary elections held in mid-2006. The successor government, which was formed with the support of parties opposing power sector privatisation, made it clear that it had no intention to relinquish the state's control of the distribution companies through the sale of additional shares. The further privatisation of all three regional distribution companies has therefore stalled and is unlikely to be resumed without a change of political direction in this country.

Under the financing arrangements with the Bank, the company committed to follow the strategic plan agreed. All monitoring to date confirms that business is being conducted in accordance with the strategic plan and operative agreements. In particular, investments in plant and equipment undertaken by the company from 2003 to 2006 have exceeded projections and resulted in reduced network losses, more reliable supply, new connections and better customer service management.

2. Project rationale

The rationale behind the Bank's participation in the project was to:

- facilitate and support the market liberalisation and privatisation process in the country?
- help advance ongoing or unfinished reforms
- foster energy trade and competition.

The restructuring and unbundling of the power sector, the creation of a transparent and non-discriminatory regulatory framework conducive to competition, and the opening of electricity markets to outside investors and third parties, were policy objectives pursued by the government to meet the obligations of European Union (EU) accession and EU membership (for example, implementation of EU electricity directives). Privatisation was not imperative for EU integration.

However, private sector participation in the electricity supply industry was seen as a vehicle for achieving performance improvements through:

- good corporate governance
- access to capital and know-how

- the build-up of competitive pressures.

Moreover, the Bank's involvement in the privatisation of this company was intended to enhance the transparency and credibility of the transaction, shield the investor from political and regulatory risks, and provide positive demonstration effect, although the intended nature of the demonstration effect was not discussed in the Board Document.

3. Achievement of objectives

The project had the following objectives:

- facilitate and enhance the first part of the privatisation (and prepare the way for majority privatisation)
- provide comfort to the investor and the government
- support market liberalisation and competition in the electricity sector
- increase confidence in the regulatory process
- help improve utility performance, notably through efficiency gains and better service quality.

Overall, the achievement of objectives is rated "Good".

4. Overall assessment

Based on the findings and the assessment of the OPER team, the overall performance of the project is rated "Successful".

5. Transition impact and the Bank's additionality

Short-term verified transition impact of the project is rated "Good". The longer-term impact potential is also "Good", contingent on the eventual privatisation of a majority of the equity. A "Medium" risk is assessed, based on the risk of political interference, either directly or via the regulatory mechanisms.

The Bank's additionality is "Verified in all Respects". The Bank complemented private sector funding in the build-up to privatisation by endorsing the process (for example, through specific reference in the offer documents and issuing letters of support to bidders). The offer of equity to selected bidders also fulfilled additionality criteria by being based on the political risk comfort provided by the Bank. This was precisely the basis on which the offer was accepted as bidders had no obvious financial need for the Bank's participation. Cooperating with an international financial institution (IFI) with considerable experience in the project region was perceived as a safeguard against political and regulatory risks in the country.

6. Bank handling

Bank handling is rated "Good". Project appraisal was good and valuation, based on standard financial indicators, verified that the bid fell within the expected price range pertaining to the region. The Board Document gave appropriate consideration to key risks and proposed relevant mitigation strategies, although the consequences and mitigation for government not proceeding with a subsequent majority privatisation were not explicitly considered in the risk analysis. This was, however, considered under past experience. Moreover, the need for continuing policy dialogue in achieving further privatisation was made clear.

The transaction was suitably structured and provides a balance between the Bank's risks and shareholder interests. The Bank has maintained working relationships with the main stakeholders even through fraught periods, especially during secondary unbundling. The Bank mobilised an effective policy dialogue through the Resident Office (RO) and the EBRD's Vice President of Banking, which was well supported by the banking team and the Bank's Office of the Chief Economist (OCE). The Bank had to mediate a number of times on regulatory and legislative issues.

More specifically, the Bank played an important role in bringing secondary unbundling to a satisfactory conclusion across the sector, not just within this company. This intervention was certainly influential (but probably not singularly decisive), allowing secondary unbundling to proceed while preserving the rights legitimately purchased by the sponsor.

7. Main OPER issues and lessons learned

Planning privatisation

Where government is committed to eventual majority privatisation but only willing (or able) to initially commit to a minority privatisation, a clear path towards further privatisation may reduce the risk of subsequent disruption resulting from a political change. While the risks of changing political direction cannot be avoided, preparation for future rounds of privatisation (such as timetabling, enabling legislation, valuation formulae for further share sales or agreeing trigger criteria for further privatisation) should be at an advanced stage of preparation prior to the launch of the first round. This will minimise the time delay between first and subsequent rounds and establish transparency over a future path of action.

Government interventions

While it is very difficult to prevent a government from interfering in nominally independent regulatory structures if it so wishes, there are possible approaches that can help reduce the ease with which government can intervene in the sector via the regulator. These include establishing, as part of the sector reform process, arm's length and transparent procedures, possibly protected by legislation, for appointing senior officials to the regulatory institutions. Similarly, ongoing support with implementation assistance technical cooperation (TC) may help strengthen regulatory institutions and better equip them to withstand external political pressure.

Agreeing a policy basis

There should be clear agreement between the strategic investors and government over investment and dividend policy prior to privatisation. Agreeing a policy basis for areas of potential conflict between stakeholders should be completed before privatisation. Also, an agreement should be established that stipulates the frequency and method of review.

Partial privatisation

Successful transition outcomes in a partial privatisation situation are possible but require several key elements to be in place. These include:

- a well defined and independent regulatory structure at outset
- political will to respect the new structure and institutions for the sector
- strong sponsors experienced in similar market and committed to clear business and investment plans
- appropriate corporate governance arrangements between the supervisory and management boards.

Establishing these elements before the initial privatisation enhances prospects of meeting key stakeholder expectations and establishing a foundation for future majority privatisation.