

Management Comments
Evaluation Department: Special Study - EBRD-Italy Western Balkans Local Enterprise Facility (LEF) (Western Balkans)

Management agrees with the overall assessment of LEF by EvD in terms of its key features (e.g. dedication of resources, staff, focus on small deals and an intensified portfolio management are part of such features) and impact on the ground especially in terms of transition.

Management agrees with the main conclusions and recommendations of the Report, especially those related on the challenges ahead and on the need of the Facility to make a step forward in terms of its geographical expansion (e.g. in SEMED) and expanded product definition (e.g. via the new fund for the Western Balkans, ENEF). On the specific recommendations, Management has the following comments:

Management agrees with the comment that LEF is not a "mass market" facility. The intensity of the work for each of the prospective investee companies is difficult to scale up and this requires a gradual and parallel development of portfolio size and resources. In a pre-investment stage, the resources (both human and financial) dedicated to due diligence activities are already above average in the Bank context, and the objective to focus more on equity cases will further increase this need. There are areas where the LEF team has been gradually approaching best practices in the private equity industry and this, inevitably, will require an even higher use of resources on a limited number of prospective deals. This is expected to enhance the quality of the Banks equity/quasi equity transactions with small companies. This will be coupled with an intensified post investment management through the work of the respective project monitoring team and LEF Monitoring Team's regular review of the portfolio (monthly). This is an effective way of dealing with difficult cases in a timely fashion and the interdisciplinary cooperation (with Small Business Services, Corporate Equity, Credit Portfolio Review Unit and Sector Teams) is very constructive.

Management also believes that most of LEF deals (due to a careful selection of clients) can have important demonstration impact on local business environments, especially if successful cases of corporate governance improvements and business restructuring are visible to peers on the ground. In this respect, Management believes that the impact of LEF can go beyond and be greater than the number of transactions actually financed.

Management agrees that the equity component of the portfolio is lower than originally expected and on the stated reasons for this. However, it should be noted that for small deals with small and unsophisticated local client, even secured senior debt could be de facto considered an equity risk. The capability to enforce rights under legal agreements is in fact impacted by the legal regimes on the ground and the lack of effective legal procedures in most of the targeted countries. Therefore, even in the debt cases, most of the portfolio management and post-investment actions are close to the one adopted for equity, including a very heavy engagement in supporting the companies' management for strategic decisions and business planning.

Management also agrees on the reliance on donor funding, as this has proven to be a critical feature to allow affordability of small deals. Long-term availability of donor funding therefore becomes a critical potential bottleneck for future developments. In this

context, Banking has already planned actions ahead, which will allow a balanced growth of portfolio across the LEF region: (i) new substantial resources will be contributed by the WBIF to the Bank as the Investment Advisor to ENEF, which will also result in support to LEF operations in the Western Balkans which are co-financing ENEF deals; (ii) the SSF and the SEMED MDF have already deliberated on resources to support the expansion in SEMED; (iii) Italy has reconfirmed its commitment to the LEF by adding additional amounts to available TC resources and agreeing on the expansion in the use of its Special Fund resources for SEMED and ENEF; and (iv) a systemic expansion plan for Turkey is envisaged, with the involvement of both the EU and the Turkish authorities to provide grant resources for the expansion towards Eastern Turkey.

On LEF being at a critical junction, Management agrees with the following comments:

The creation of a new platform for SMEs in the Western Balkans is an opportunity to leverage on LEF to create a European vehicle which sits firmly within the developing European financial architecture. This is obviously a big challenge for the Bank, which will need to demonstrate that it can step up its actions vis-à-vis SMEs in the Western Balkans, also by "sourcing in other investors money. Although the process is just at the beginning, its successful implementation would likely guarantee funding for the Banks SME business from the EU and other players in the years to come. As such, this is as a unique opportunity for the Bank to be part of the growth of a new financial vehicle able to become one of the most important equity providers in the Western Balkans.

The expansion to new territories beyond the Western Balkans and the need for a specific approach is fully acknowledged. The LEF replenishment document to be discussed by the Board in October 2012, already identified specific challenges and actions in the four different areas where LEF is/will work: the Western Balkans and Croatia, Bulgaria and Romania, Turkey and SEMED. For Turkey and SEMED, specific directions are indicated for the work over the next 12-18 months, which will render LEF more capable to meet the specific needs of these two areas. Potentially, both Eastern Turkey and SEMED can have a big role in future developments of LEF and can grow their significance in LEF overall portfolio.

Management agrees that LEF should be targeting higher policy objectives. This is the reason why, under the Enterprise Development and Innovation Facility (the new SME platform created within the Western Balkans Investment Framework - WBIF) , a comprehensive regional TC programme has been introduced to support legislative changes to allow a proper 'ecosystem' for private equity and venture capital. The WBIF will represent the ideal platform to gather all IFIs, the EU and beneficiary countries around the same table and discuss reform priorities and actions.

On the potential overlaps externally and internally, Management agrees that this needs to be carefully managed. However, externally, the WBIF already provides a strong coordination platform to avoid overlaps and promote co-operation; internally, overlaps are avoided, especially with FI products, by a careful dialogue within Banking on the best financing options for deals. Whenever LEF financed deals which could alternatively be financed by other facilities (or conversely), this has been managed in full agreement among teams and taking into consideration the specific needs of the transactions and the specific features that could be offered under each facility.