Special Study

Facility for Medium-Sized Projects

October 2012

Evaluation Department (EvD)

European Bank
for Reconstruction and Development

Special Study

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EvD produces thematic or sectoral level evaluation reports in the form of Special Studies. These provide valuable insights to strengthen operational outcomes and institutional performance; they focus on larger issues for which a transactions lens is unsuitable and generate more widely applicable findings for a wider audience. The larger scope of these studies facilitates the use of innovative and robust evaluation methods. This study forms one of eight such studies scheduled for EvD's 2012 Work Programme.

Report prepared by:
William Keenan
Senior Evaluation Manager

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Abbreviations

DIF	Direct Investment Facility
DLF	Direct Lending Facility
ESD	Environment and Sustainability Department
EvD	Evaluation Department
FMSP	Facility for Medium-Sized Projects
LEF	Local Enterprise Facility
OCCO	Office of the Chief Compliance Officer
OCE	Office of the Chief Economist
OGC	Office of the General Counsel
OpsCom	Operations Committee
SBIC	Small Business Investment Committee
TC	Technical cooperation

Defined terms

"the Facility"	Facility for Medium-Sized Projects

Executive summary

This Study presents the first full evaluation by EvD of the Facility for Medium-Sized Projects (the Facility) which received Board approval in March 2008. The initial funding of €50 million was increased to €70 million in 2010 and €140 million in 2011. The Facility is a regional framework providing equity and debt to corporate enterprises in countries not covered by other EBRD initiatives. The Facility targets subsidiaries of international sponsors new to the region, regional cross-border investors and locally owned companies. At the request of the Board, EvD carried out an interim evaluation of the Facility in 2009. The Board requested a full evaluation in 2012.

The Study begins with an explanation of the background to the Facility, a summary of the interim evaluation findings, and a description of the Facility profile in mid-2012. In assessing the results after four years of operation, the Study applies the OECD-DAC criteria of *Impact and Sustainability, Relevance*, and overall *Effectiveness* and *Efficiency*.

It was anticipated that the Facility would use a streamlined approval process to enable small projects to be handled efficiently without compromising the Bank's standards for project appraisal and preparation. The model assumed utilisation of €50 million in about 15 investments in the first two years.

The crisis affected initial demand. The Facility signed only eight transactions totalling €44.5 million in the three years to March 2011. Two transactions were prepaid. In the 15 months to June 2012, however, utilisation picked up with a further eight transactions representing €55 million signed. This resulted in a portfolio of 14 operations amounting to €92 million, making use of a second replenishment that had brought the Facility from €70 million to €140 million. Signed operations cover five countries. Seven operations involve equity investments, one accompanied by a senior loan. Seven operations involve debt only including one subordinated loan. The average deal size is €6.8 million. In June 2012 the reported pipeline amounted to €168 million in 22 operations.

The principal findings of the evaluation are that:

- affected by the crisis, initial demand for the Facility fell short of forecast; demonstration effects from initial operations have been slow to emerge. However, utilisation has increased significantly since
- overall savings through efficiencies in project preparation have not been observed except for the saving achieved by the delegation of approval authority
- the EBRD's requirements for the preparation of banking operations have been followed and have not been compromised
- instances of synergy with other Bank initiatives have been observed.

The evaluation identifies a number of factors which are not conducive to efficient execution and cost effectiveness, among them the presence of offshore entities in the client's corporate structure, the limited experience of the region of some sponsors and legal complexities.

These observations notwithstanding, the evaluation finds that the Small Business Investment Committee (SBIC) functions efficiently. Noting that SBIC is empowered to approve eligible transactions under 18 facilities and frameworks, the Study recommends that it would be timely to review the various channels used to deliver investment products to small and medium-sized enterprises (SMEs). A review could lead to rationalisation with potential to increase the depth of outreach in the business segment, streamline procedures and improve cost effectiveness.

1. Background

1.1. The Facility approvals

1.1.1. The March 2008 approval[1]

The Facility for Medium-Sized Projects ("the Facility") received Board approval in March 2008 with €50 million funding, which increased to €70 million in June 2010 and to €140 million in March 2011. The Facility was designed as a regional framework providing investment capital from €1 million to €10 million in countries not covered by other EBRD initiatives targeting medium-sized enterprises, namely Kazakhstan, Russia, Ukraine, the new EU member states and Croatia. The financial instruments offered initially were equity capital and mezzanine finance/subordinated debt. The Facility design envisaged a streamlined approval process under which the approval of investment proposals would be handled by the Operations Committee under the authority delegated by the Board of Directors. The intention was that the streamlined process would enable smaller projects to be handled efficiently thereby reaching a new clientele of medium-sized enterprises. The Facility would use more simple procedures, standardised products, more local content in origination and monitoring and a portfolio approach.

The Facility targeted subsidiaries of international sponsors, regional cross-border investors from the Bank's countries of operations and locally owned companies. Beneficiaries had to meet the following eligibility criteria:

- be a new client of the EBRD in the country concerned
- privately owned and not under the control of a dominant player in the market
- with transparent ownership and owners/managers acceptable to the Bank in terms of integrity
- if a foreign sponsor, be a new entrant in the country concerned, with no more than €20 million already invested in the country
- international sponsors were only to be eligible for projects in Kazakhstan, Russia and Ukraine.

1.1.2. The June 2010 approval of amendments to the Facility[2]

Approximately two years after its launch, the operation team proposed a number of amendments to the Facility based on experience to date. The proposals also drew on the findings of the Interim Evaluation completed by EvD in 2009. In approving the €20 million increase in the size of the Facility and amended terms in June 2010, Directors noted that EvD would carry out a full review of the Facility in 2012.

Progress in the first two years was slow. EvD's interim evaluation completed in June 2009 had identified a number of reasons for this, principal among them:

i. the abandonment of projects by sponsors as a result of the crisis
ii. the complexity of some proposals which made them unsuitable for the simplified procedures contemplated for the Facility
iii. the weaknesses of the projects themselves in a number of cases.

[1] BDS08-026 Regional: Facility for Medium-Sized Projects.
[2] BDS08-026 (Addendum 2) Regional: Facility for Medium-Sized Projects.

It is fair to observe that bankers had been ascending a learning curve, especially bankers located in Resident Offices, in a crisis period which was not conducive to stimulating entrepreneurial activity. Their experience led them to identify further issues that were preventing the origination of more operations, in particular the absence of senior debt as a product under the Facility either alongside equity or on its own.

The following key structural and procedural amendments were approved in June 2010:

- allowance of clients to use up to two products per project
- adding senior debt as a product
- allocation of €500,000 of TC funds to cover due diligence and legal costs.[3]

The geographic scope of the Facility was amended by removing Croatia from the definition of the FMSP region since it had been admitted to the Local Enterprise Facility (LEF) in January 2009. A reply by the banking team to Directors' Advisers' Questions clarified the rationale for this by stating: "The objective through (i) the Facility; (ii) the DIF/DLF in the ETC countries and (iii) the LEF in the Western Balkans is to cover all countries of operations."

The Board paper also noted the formation of the Small Business Investment Committee (SBIC) and proposed the sub-delegation of approval by OpsCom to SBIC to harmonise approval procedures for medium-sized projects under various frameworks.

1.1.3. The March 2011 approval of amendments to the Facility[4]

Some three years after inception the Board approved the team's proposal to increase the Facility from €70 million to €140 million in view of increased usage in recent months and strong demand. Also approved was the increase of the single country limit to 40 per cent of the Facility to accommodate demand especially from Ukrainian enterprises that were suffering from very limited access to equity and loans following the crisis.

All other terms, including eligibility criteria, remained unchanged with one point of clarification. The existing criteria included the requirement that foreign sponsors be new entrants in the country concerned with no more than €20 million invested in the country so far. The definition of "international or foreign sponsor" was clarified in the March 2011 Board document such that the Facility could include enterprises controlled by private equity funds without applying the €20 million limit, provided that such private equity funds are dedicated to one or more of the countries targeted by the Facility.

The March 2011 Board document noted in the President's Recommendation that the Facility operated in countries not covered by other EBRD initiatives *except for Romania and Bulgaria, recently added to the Local Enterprise Facility* (EvD emphasis). Romania and Bulgaria continued to be eligible, unlike Croatia which was removed as an FMSP country following its admission to LEF.

1.2. The 2009 Interim Evaluation

At approval in 2008 the Board acknowledged that the Facility was innovative and experimental in nature. Accordingly it requested an early interim evaluation to be carried out after around 12 months of operation. EvD completed its interim evaluation in June 2009, by which time the Facility team had logged 94 potential transactions, leads and enquiries, and signed three operations. Two of these were subsequently cancelled. One operation signed in March 2009 remains in the portfolio.

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[3] The TC provision aligned the level of support to Facility clients with that available under other EBRD frameworks such as DIF, DLF and LEF.
[4] BDS08-026 (Addendum 3) (Rev 1) Regional: Facility for Medium-Sized Projects.

The Interim Evaluation was a preliminary assessment of Facility implementation and of the balance being struck between the mandated requirements of banking operations (including due diligence and integrity checks) and the desire for cost reductions. The evaluation reviewed in detail the documentation relating to the three signed projects and seven projects in the active pipeline at the time. The "active pipeline" comprised projects approved but not signed and/or disbursed. It is noted in passing that none of the seven projects then in the pipeline followed through to disbursement. One operation was subsequently presented to the full Board and approved in January 2010, but did not proceed.[5]

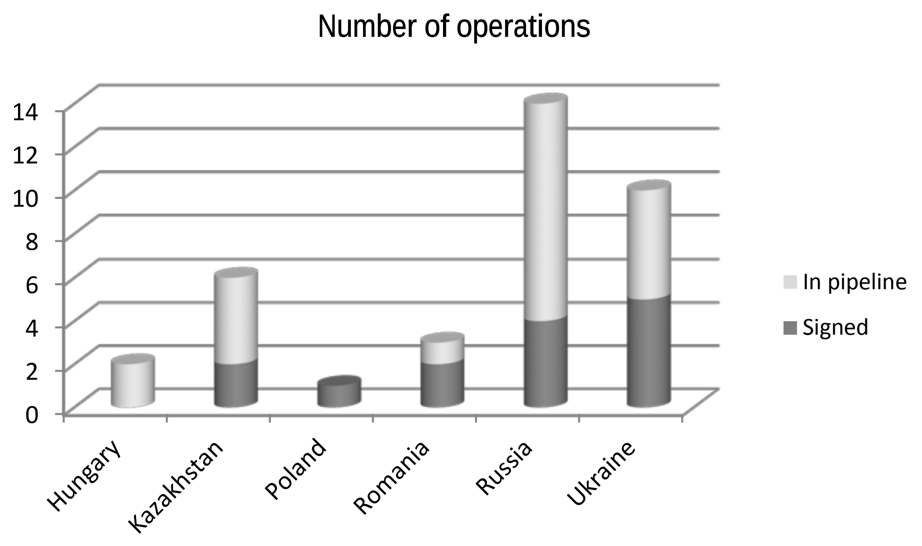
The Interim Evaluation confirmed that proper Bank procedures were followed in respect of the projects examined. Another finding was that credit risk ratings at the project level were at the higher end of the credit risk scale (between 6 and 8) compared with a range of 5 to 6W assigned to the Facility as a whole. Resources expended on project preparation, in particular bankers' time and legal costs, were higher than anticipated.

2. Facility profile in mid-2012

2.1. Projects signed and in the pipeline

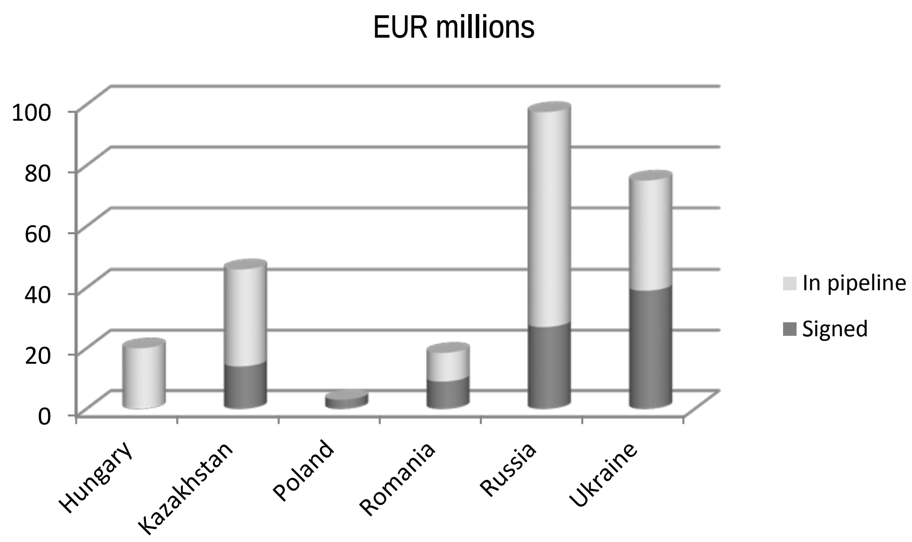
The tables in Annex 1 show the numbers and volumes of projects by country, both signed and in preparation as of 3 July 2012. In total 14 projects were signed worth €92 million; four others passed final review (€10 million); 12 passed concept review (€94 million); and 8 were exploratory (€64 million).

The charts below show the numbers and volumes of projects signed and in the pipeline by country.



Operations signed – 14; in pipeline – 22; total - 36

[5] BDS09-242 Poland: EMC Hospital Facility, Board approved 12 January 2010.



The value of signed operations amounted to €92 million; in pipeline €168 million; total €260 million.

There were no signed or pipeline operations in Bulgaria, Latvia or Lithuania.

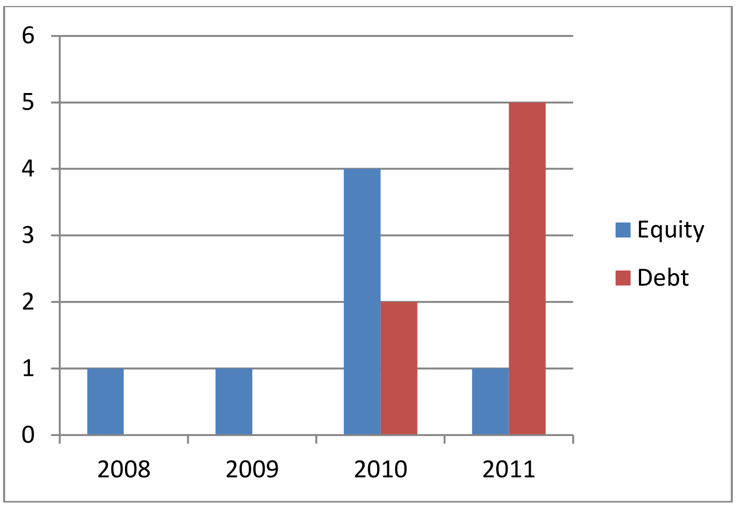
2.2 Facility utilisation and characteristics of the portfolio

2.2.1. Expected and actual utilisation

At appraisal in 2008 it was expected that the first €50 million tranche of the Facility would target about 15 companies belonging to the corporate sector offering projects that were smaller than those usually executed by the Bank directly. The initial modelling of the Facility assumed seven investments in the first year and eight in the second year with the first exits taking place in year four.

Initial demand for the Facility was affected by the crisis. Eight transactions totalling €44.5 million were signed in the three years to March 2011. The conversion rate then improved significantly and another eight transactions were signed in the 15 months to June 2012. Two transactions were prepaid, resulting in a portfolio of 14 operations amounting to €92 million. The operation team reported in June 2012 that the active pipeline contained 22 projects totalling €168 million, as illustrated in the above charts.

The following chart shows the number of operations by type and by year of approval in the current portfolio.



2.2.2. Country and sector distribution of projects

The following table shows the country distribution of signed operations by banking team.

Banking team	Number of signed operations	Countries
Manufacturing and Services	10	Ukraine – 4 Romania – 2 Russia – 2 Kazakhstan – 1 Poland – 1
Agribusiness	2	Russia - 2
Natural Resources	2	Kazakhstan -1 Ukraine - 1

2.2.3. Equity and debt

Seven operations involved equity investments by EBRD. The planned exit is by put to the sponsor in three cases, and in three cases by sale to a strategic or portfolio investor. In one case exit will be made through the local stock exchange. One of the equity investments was accompanied by a senior loan.

Seven operations involved debt only – senior debt in six cases and subordinated debt in one instance.

2.2.4. Country of investment and country of sponsor

Of the seven companies receiving equity investments, four have unlisted, locally owned sponsors, while two have foreign sponsors (India and Japan). In one case the sponsor is a locally owned listed company.

Among the debt-only operations, five recipients have locally owned sponsors and two have foreign sponsors (US and Spain).

As regards domiciliation, three of the equity investee companies with local sponsors are owned through Cyprus holding companies. One loan recipient is 94 per cent owned by a Cyprus incorporated private equity fund which is itself owned by a grouping of Emerging Europe Growth Fund (USA), Western NIS Enterprise Fund (USA) and FMO (Netherlands).

3. Impact and sustainability[6]

3.1 Transition impact expected at appraisal

3.1.1 Framework level

The March 2011 appraisal documents identified four areas in which the Facility was expected to have the strongest transition impact, as follows:

- demonstration effects of new products and processes – through supporting the entry of new investors into the region and the expansion of existing companies into new products and business activities; leading in turn to replication by other companies already active in the sector
- competition – by leading to increased competitive pressure, the development of markets and innovation, and improvements in the availability of goods and prices for final consumers
- transfer of skills – by way of staff training and know-how transfers through both business contacts and rotation of trained staff to other companies

[6] The changes produced by operations and the extent to which the changes are likely to continue.

– standards for business conduct – through adopting sound disclosure and transparency standards, accounting and governance practices.

3.1.2 Individual operations

It was anticipated in the Facility design that each sub-project would include benchmarks that would reflect its contribution to meeting the transition objectives of the Facility and would be "easy to monitor on the basis of information regularly supplied by the clients for monitoring purposes".[7] There is evidence from inspection of the project files that OCE worked with banking to develop monitoring benchmarks for transition impact objectives on a case-by-case basis. OpsCom and latterly SBIC notes and minutes record instructions to banking teams to work with OCE on the transition impact rationale and develop monitorable benchmarks.

3.2 Evidence of realised transition impact

The project fiches note for each signed project the key components of transition impact potential identified *ex ante* and observations from transition impact monitoring to date. It should be kept in mind that 11 of the 14 operations were disbursed in 2011 or 2012. In respect of these, it is arguably too soon to seek evidence of realised transition impact except to the extent that indicators and benchmarks relate to achievements required to be evidenced pre-signing (for example, adoption of IFRS reporting) or improvements in behaviour or performance expected to emerge in the very early stage of the project.

The first three operations disbursed in 2009 and 2010. Improved corporate governance and/or business conduct was a transition objective in each case. Other components of transition impact were market expansion via the development of forward and backward linkages, the demonstration effect of an expansion programme through energy efficient investments and the stimulation of competition through investment in distribution logistics.

The TIMS records of a project disbursed in June 2009 note that OCE later downgraded the TI rating from Good with High risk to Satisfactory with High risk because of delays resulting from poor operational performance, although the banking team reported an improvement in business performance in mid-2012 (Pehart Tec). In the case of an operation disbursed in August 2009, the creation of a new governance structure is noted. However, there has been little progress in the development of market linkages because of delays in the restructuring of operations in the midst of competitive pressures and squeezed margins (Tata-Grand). In the third project, disbursed in November 2010, the achievement of transition benchmarks is reported to be on track (FRA-M).

Eight operations disbursed in 2011. In most cases the transition benchmarks are reported to be on track with the proviso that it is too early to assess the outcome of such components as skills transfer or demonstration effect. Some knock-on delay is noted in two cases where management focus has been on dealing with problems that have arisen in the underlying investment project (Khask; Industrial Mecano).

3.3 Sustainability – remaining transition potential

The estimates of remaining transition potential and of transition risks are together a measure of the extent to which the impact of the Bank's intervention is likely to be sustainable. At appraisal in 2008 a matrix was adopted within which the TI potential of operations in Kazakhstan, Russia and Ukraine was rated Good, while the potential of operations in EU-9 and Croatia was rated Satisfactory, but could be upgraded to

[7] BDS 08-026, section 4.1.

Good if the project addressed "a significant and explicitly identified sectoral transition gap".[8] The main transition risks were linked to the possibility of commercial failure.

Three operations are in EU-9 countries, two in Romania and one in Poland. Of these, two received *ex ante* TI ratings of "*Good*" rather than "*Satisfactory*" because of enhanced transition expectations. One of the two was subsequently reclassified as "*Satisfactory*" (Pehart Tec – see 3.2 above). The second disbursed in 2012 and its assessment has not yet been updated, although it has been recorded that the investee has put in place an environmental and social action plan (Tea Project). Delays have been recorded in the third project and sustainability is called into question by the credit downgrade from 6W to 7 in April 2012 resulting from poor operational performance (Industrial Mecano).

In the case of 6 of the 11 operations disbursed between 2009 and 2011, credit reviews comment on performance or financial problems which could question sustainability if not addressed and rectified.

3.4 Overall impact of the Facility

The assistance given even to one of the players in a specific sector can make a difference in terms of demonstration effect of new products and processes or enhanced competition. The impact is not necessarily proportional to the money invested. Projects in the areas of packaging, specialty chemicals, oil and gas and brick production can all contribute to the demonstration effect of new products and processes in their respective sectors while other projects provide examples of market expansion in the food sector.

As of the time of this evaluation, in view of the early stage of most of the signed projects, it is difficult to identify evidence of strong transition impact. Given the smaller size of the operations, expectations for impact through the demonstration effect of new products and processes or enhanced competition depend importantly on building a sizeable portfolio of sound projects with critical mass. Whether the recent accelerated uptake, after a slow, crisis-related start, will deliver more evidence remains to be seen.

4. Relevance[9] (rationale and additionality)

4.1 Rationale

In 2008 the main rationale for the Facility was the desire to find new approaches and procedures capable of handling smaller projects to address a market gap in financing available to the corporate sector. The 2008 appraisal documents described the need for a more client-friendly approach in dealing with medium-sized clients who at their best were able to move swiftly to adapt to their markets, but lacked large administrative structures. There was also a need to address the negative economies of scale that the EBRD had experienced when dealing with small projects. The 2008 Board document recognised that the Facility should be seen as a work in progress. The Board discussion of the operation noted that the Facility sought to introduce an innovative approach, moving the Bank towards riskier investments in a segment where availability of capital was still limited.

4.2 Additionality

Additionality at appraisal was posited principally on the lack of financial instruments in the Russian regions, Ukraine and Kazakhstan. The experience of the Bank in the region and its role in political risk mitigation were advanced as further elements of additionality that could be attractive to new foreign sponsors. With regard to the EU-9 countries and Croatia, the appraisal documents recognised that equity

[8] BDS08-026 section 4.1.

[9] The extent to which operations are suited to the policies and priorities of the Bank and the recipient.

capital, though still limited, was more readily available. Subsidiaries of international investors in these countries were therefore excluded from the Facility.

Reviewing the 14 operations signed to date, the financial additionality of the Bank's involvement appears clear in the projects with local sponsors. Foreign sponsors until now have been large corporates where financial additionality is perhaps more tenuous. In these projects the case for the Bank's additionality rests more soundly on the non-financial EBRD attributes that stem from political risk mitigation and the Bank's knowledge of the region.

4.3 Overall relevance of the Facility

The Bank's periodic analyses of transition gaps suggest that availability of equity and debt finance for mid-sized corporates continues to be an issue in the countries covered by the Facility. From that perspective, the relevance of the concept behind the Facility remains valid.

5. Effectiveness[10] – achievement of objectives

5.1 At Facility level

The overarching objective of the Facility is to address a market gap. This was spelled out clearly in the 2008 Board document and reiterated in the 2010 and 2011 amendments. The President's Recommendation in the March 2011 Board document stated in terms that sound aspirational: "The operation enables the Bank to handle efficiently smaller projects and to reach a new clientele of local entrepreneurs or foreign direct investment, typically from Western *Mittelstand*."

It remains the case that medium-sized corporates have difficulty raising external equity in the countries served by the Facility. However, it is not possible to conclude on the basis of results to date that the Facility has made significant inroads.

As regards mezzanine debt, experience suggests that this is a poorly understood concept in the market and that considerable effort would be needed to educate the *Mittelstand*. Only one subordinated loan has been signed to date.

The June 2010 amendments admitted senior debt as a Facility product. It may be significant that the operations approved since then have been predominantly senior loans.

5.2 At project level

The operation objectives at the individual project level are set out in each case in the description of business purpose in the investment memorandum. The objectives are generally expressed in concrete physical terms such as capital expenditure to construct, expand or modernise production facilities.

The status of projects' current achievement of physical objectives suggests that in the majority of cases goals either have been achieved or are on track to be achieved. Ongoing delays have been recorded in four cases. Each of these is an equity investment rather than a loan.

5.3 Overall effectiveness of the Facility

The results to date suggest that the Facility has been reasonably effective at an individual project level in assisting clients to implement their investment programmes. The effectiveness of the Facility overall in meeting the objective of addressing the market gap has been modest.

[10] The extent to which operations attain their objectives.

6. Efficiency[11]

6.1 Modelling the Facility

The 2008 Board document sets out the key assumptions used in modelling the Facility. This and the following section 6.2 compare the key assumptions with what happened based on the 14 signed projects in the portfolio.

Key assumption	What happened
Average deal size of €3 million	Average deal size €6.8 million
Transactions equally split between equity capital and mezzanine debt	6 equity; 1 equity + senior loan; 1 subordinated loan; 6 senior loans[12]
Maturities of 5 and 4 years, respectively	Too early to say, especially with respect to the equity portfolio
Average margins of 3% (put to sponsors) and 10% (local companies)	Margin of 6%-6.5% on senior loans to companies with local sponsors
The Facility is fully disbursed 3 years into operation	49% of original €50 mm approval disbursed within 3 years; 100% of original approval within 3.5 years

6.2 Projected profitability

The expected contribution to the Bank's profitability was estimated at 5.1% IRR before risk adjustment and 3.5 per cent after risk adjustment. There were two further key assumptions underlying the profitability model – discounted preparation costs and project risk rating.

6.2.1 Assumption 1: Pre-signing costs discounted by 50 per cent

What happened

The evaluation team asked operation leaders and portfolio managers to estimate the savings in time and resources with operations approved under the Facility compared with the usual approval procedures. One OL estimated that processing the operation under the Facility saved around 30 per cent of pre-signing time, largely because no Board approval was required. Others responded that there were no significant savings in time or resources (apart from Board approval time) because of the need to follow the Bank's full appraisal and pre-Board procedures involving banking and other departments – Credit, OCE, ESD, OGC and where relevant OCCO, Procurement and others. Portfolio managers responded that there was no difference compared with larger projects in respect of post-approval / pre-disbursement procedures and monitoring.

In 2008 the Board expressed concern that the intended streamlining of procedures could lead to inadequate preparation with insufficient due diligence and monitoring. Comfort should be taken from the fact that the Bank's normal procedures have been followed with regard to transition impact assessment, credit appraisal, consideration of environmental and legal issues and integrity due diligence with the appropriate involvement of, and documented contributions from, non-banking departments.[13] However, the corollary appears to be that no significant savings in time, resource or cost have been made other

[11] The extent to which operations are cost-effective and completed on time.
[12] The eligibility criteria were amended in 2010 to permit senior loans.
[13] This confirms a finding of the interim evaluation in 2009.

than the time and resource that would be spent on the process of full Board approval. The presentation of a project for discussion by the Board is estimated to add at least six weeks to the approval process.

6.2.2 Assumption 2: Half of sub-projects assumed at risk rating 6 and half at 6W.

What happened

The credit risk ratings at appraisal are summarised as follows for the 14 signed projects:

Risk rating	7	Two projects, both in Ukraine with local sponsors
	6W	Nine projects – Russia, Romania, Kazakhstan, Ukraine, Poland – of which eight with local sponsors, one with an Indian sponsor
	6	One project in Russia with Spanish sponsor
	5	One project in Kazakhstan with US sponsor
	4	One project in Russia with Japanese sponsor.

6.3 The use of TC funds in connection with FMSP operations

Following the June 2010 amendments to the Facility, the Board approved the allocation of €500,000 under the Shareholder Special Fund to be used for pre-investment consultancy assignments, legal due diligence, documentation and support for monitoring.[14] The TC was approved for use in Russia, Ukraine, Kazakhstan, Bulgaria and Romania with cost-sharing to be sought where appropriate.

Scrutiny of the files suggests that TC has been used selectively. To date approximately €234,000 has been disbursed or committed in support of six projects of which two have been signed.[15] It seems appropriate that the TC funds are allocated from the Shareholder Special Fund since they are employed to defray preparation costs and are for the benefit of the Bank. Depending on the status of each project, due diligence costs have been either shared or agreed to be shared for the six projects.

6.4 Overall efficiency of the Facility

Comparing outcomes with the key assumptions used in modelling the Facility:

- the average deal size is double the size envisaged
- one subordinated loan has been signed, suggesting little appetite for mezzanine finance
- margins are below the level assumed in the model
- the crisis affected Facility utilisation during the first years; however, utilisation increased significantly over the 15 months to June 2012.

A higher-than-expected average deal size does not necessarily call into question the efficiency of the Facility. Cost effectiveness is affected also by the higher-than-expected risk profile and by the pre-signing resources required which are reported to be close to those for normal banking operations excluding the process of full Board approval.

[14] No-objection approval was given on 31 August 2010 – BDS10-193.
[15] The total of €300,000 includes €70,000 approved for one project separately outside the Facility umbrella.

7. Key findings and recommendations

7.1 Comparing results to date with expectations at appraisal – key findings

The 2008 Board document observed that the success of the Facility would hinge on its ability to be efficient from the Bank's perspective and that of its clients. The Facility would be deemed a success if it could deliver the forecast number and volume of sub-projects and incur a lower level of preparation costs without compromising on the quality of the sub-projects. This was reiterated in 2010 when the approval document for TC funds defined the success indicators as follows:

"The success of the Facility and the related TC Funds will be assessed based on the ability to (i) deliver the forecast number of sub-projects while (ii) incurring comparatively lower preparation costs, (iii) without compromising on the Bank's requirements for banking operations (including due diligence and integrity checks)."

7.1.1 Findings as regards performance of the Facility

The evaluation identifies the following findings:

- The economic crisis resulted in the Facility initially falling short of meeting its forecast number of operations; however, the situation has improved over the 15 months to June 2012.
- As a result of the slow start, the Facility has not yet been able to deliver demonstration effects through critical mass.
- Overall savings through efficiencies in project preparation have not been observed, except for the saving achieved as a result of delegated authority from full Board to OpsCom/SBIC.
- The configuration of SBIC, with representatives of support departments who are knowledgeable concerning transactions with small businesses and medium-sized corporates, enables proposals to be considered efficiently without compromising the Bank's standards for the approval of investment operations.
- Some operation leaders reported that the time saving from avoiding Board presentation (estimated to be at least six weeks) was a deciding factor in making the Bank's proposition acceptable to the client.
- The original modelling underestimated the level of preparation costs and the risk profile of projects.
- The Facility's core instruments – equity and mezzanine finance – are inherently more costly in time and other resources including legal costs compared with senior debt.

Some instances of individual success and possible broader impact should be noted:

In one case the client (recipient of debt finance) is working with BAS to improve financial and HR management and systems.

In one case the client (recipient of debt finance) is enrolled in a TAM programme with the aim of improving business planning and strategic skills.

In one case the Bank's loan signals potential for working with equity funds to provide term finance not available from local banks.

The first two instances indicate potential scope to work with other Bank mechanisms to enhance the impact of investment operations. In the third instance the absence of available term finance locally confirms the Bank's additionality and potentially raises the profile of the Bank's intervention through cooperation with an existing equity fund.

7.1.2 Factors influencing the performance of individual operations

Experience to date suggests that some factors, where present, are not conducive to efficient execution and cost effectiveness. The following is a summary of the principal such factors identified by the evaluation:

- presence of offshore entities in the corporate structure
- need to reorganise corporate ownership or management structure
- requirement to obtain regulatory approvals for aspects of a client's operations
- where completion has to await the legal reorganisation of the client or the approval of an official body, for example to obtain anti-monopoly clearance, this can result in higher pre-signing costs as well as additional post-signing/pre-disbursement expenditure of time and resource and more legal costs
- sponsor has limited experience.

Foreign sponsors who are new to the country or region are likely to need additional guidance and advice from EBRD staff in negotiating the business and legislative environment during the various stages of project preparation. While this may help satisfy the additionality requirement for the Bank's involvement, it increases the depth and extent of Bank staff involvement and therefore pre-signing costs. Similar considerations apply where a local sponsor lacks experience in private equity financing and has a poor understanding of the concept, in particular the notion of sacrificing a share of control and future rewards in return for medium-term finance.

Other examples of complexity militating against efficiencies in project preparation include:

- introduction of price adjustment formula to afford the Bank additional protection
- introduction of warrants to give the Bank a share of potential upside
- negotiation of complex put and default put options.

7.2 Rationalising the delivery of EBRD products to medium-sized corporates – Recommendation

It would be timely for the Bank to reconsider the organisation of the various frameworks, facilities and initiatives that it has put in place over two decades to address equity and debt funding for small and medium-sized corporate enterprises. As well as the Facility for Medium-Sized Projects (FMSP) these include the Direct Investment Facility (DIF) and Direct Lending Facility (DLF) which target early transition countries, and the Local Enterprise Facility (LEF) which began by targeting the Western Balkans and has been extended to cover Bulgaria, Romania and Turkey. Other vehicles include the Medium-Sized Co-Financing Facility (MCFF), credit lines to local banks designed to improve access to finance for corporate enterprises and private equity funds supported by the Bank.

The role of the Small Business Investment Committee (SBIC) is relevant here. The Terms of Reference approved for SBIC by OpsCom empower SBIC to approve eligible transactions under 18 facilities, among them the FMSP, LEF, MCFF, DLF, DIF and a range of other framework facilities. Most of the facilities cover a defined region or group of related countries. Six facilities are country specific – Turkey, Ukraine, Russia, Kazakhstan (one each) and Moldova (two). There is geographical overlap in a number of cases.

Each of the above facilities is designed to handle one or more of three basic products: equity, mezzanine finance and senior debt. The set of questions asked at appraisal – with regard to due diligence, credit, integrity, legal issues, environmental and other matters – is fundamentally similar in each case with such adjustment as is necessary to elaborate the set of enquiries to fit local conditions.

Recommendation

The Bank should undertake a review of the various channels currently used to deliver investment products to medium-sized corporate enterprises. The critical challenge appears to remain that of achieving critical mass and demonstrable results through a portfolio approach and within cost constraints. Based on this and other evaluations of similar facilities, a review of the different delivery channels could lead to rationalisation and the development of an integrated cross-country and cross-regional approach with potential to deepen outreach in the business segment and improve cost effectiveness.

Annex 1: Statistics as of 3 July 2012

Number of projects	Signed	Passed Final Review	Passed Concept Review	Exploratory	Total	
					No.	%
Bulgaria						
Croatia						
Hungary			2		2	5.5%
Kazakhstan	2			4	6	16.7%
Latvia						
Lithuania						
Poland	1				1	2.8%
Romania	2		1		3	8.3%
Russia	4	1	7	2	14	38.9%
Ukraine	5	1	2	2	10	27.8%
Total	14	2	12	8	36	100%

EUR financing € millions	Signed	Passed Final review	Passed Concept review	Exploratory	Total	
					€m	%
Bulgaria						
Croatia						
Hungary			20.0		20.0	7.7%
Kazakhstan	14.0			32.0	46.0	17.7%
Latvia						
Lithuania						
Poland	3.0				3.0	1.1%
Romania	9.0		9.5		18.5	7.1%
Russia	27.0	5.0	50.5	15.0	97.5	37.5%
Ukraine	39.0	5.0	14.0	17.0	75.0	28.9%
Total	92.0	10.0	94.0	64.0	260.0	100%