SYNTHESIS PAPER

Financial Sector Operations - Insights and Findings

March 2012

EBRD EVALUATION DEPARTMENT

European Bank
for Reconstruction and Development

Synthesis Papers bring together the findings of prior evaluation studies on a related group of operations. Syntheses do not gather new evidence or carry out additional analysis. Instead, they identify and explore reoccurring themes and issues and identify priority areas for future work. Such themes and issues include areas such as project design, monitoring and self-assessment, policy dialogue and client buy-in among others. This presentation of commonly occurring findings is followed by a series of actionable recommendations to help enhance future operations.

Contents

Abbreviations

ABV	Annual business volume
BEEPS	Business Environment and Enterprise Performance
CIS	Commonwealth of Independent States
CRR	Capital Resources Review
ECA	Eastern Europe and Central Asia
ETC	Early transition country
EvD	Evaluation department
FI	Financial institution
IBP	Institution Building Plan
IFI	International financial institution
IMF	International Monetary Fund
MSME	Micro, small and medium-sized enterprise
OPER	Operation Performance Evaluation Review
SME	Small to medium-size enterprise
TC	Technical cooperation

1. Setting the scene

EBRD transactions in the financial institutions (FI) sector have grown significantly in recent years, not least because the sector is a key medium through which the Bank can effect transition impact and institutional change. A substantial amount of evaluation work has been completed on these FI sector operations, providing a body of experience-based analysis that can contribute to the design and performance of future operations and achievement of the Bank's mandate goals. This report distils and presents specific evaluation findings that may be especially useful in this respect.

1.1 Introduction

Between 2007 and 2010 EvD completed over 30 evaluation reports (OPERs and Special Studies) relating to FI sector operations, for the most part handled by the Bank's Financial Institutions sector team. Together they represent a large body of analytical work from which it is possible to extract higher level findings, insights and lessons of potential relevance to operations and policy, especially in the context of:

- challenges resulting from substantial FI portfolio growth in recent years
- implementing Capital Resources Review 4 (CRR4)
- the Bank's move into the southern and eastern Mediterranean area.

This report draws out some patterns of themes, insights and pragmatic responses from EvD financial sector evaluations of recent years, as well as from other relevant sources. The material is organised into four subject areas that seem most closely to reflect recurring topical issues of relevance to the Bank's interventions in the financial sector going forward:

- governance
- due diligence
- monitoring and evaluation
- SME sector and microfinance issues.

Given the close interconnection among them, there is inevitably some overlap in the discussion, although an attempt has been made to avoid repetition.[1]

The report also highlights a number of issues pertinent to the SME and microfinance sector, drawing on recent papers from the IFC, World Bank and IMF. It concludes by identifying two key areas through which increased focus by the Bank could improve operational effectiveness going forward, namely:

- closer integration of approaches to financial sector intervention
- adding value through monitoring, evaluation and continuous learning.

1.2 Looking back– portfolio growth before and during the crisis

Looking forward – CRR4 and the new Mediterranean region

FI portfolio growth during the CRR3 period was substantially in excess of the transaction numbers and volumes originally projected. This presents the Bank with particular challenges in respect of transition effectiveness, the establishment of *ex ante* performance benchmarks, and the adequacy of monitoring and reporting. The challenges are especially strong by virtue of the fact that a large part of transition impact is achieved indirectly at sectoral level through interventions with partner institutions, and at the level of the economy through the business activities of partner institutions' customers.

CRR4, covering the years 2011 to 2015, was approved by the Board in March 2010.[2] The sections relating to transition challenges and opportunities, and proposed EBRD activities in the financial sector, take account of the rapid credit expansion in most of the Bank's countries of operations up to mid-2008, the ensuing crisis and the systemic weaknesses exposed (particularly in banks' risk management and central bank supervision). The CRR4 document highlights a number of key issues that the EBRD will seek to address across its existing sub-regions:

[1] The present report, synthesising insights and lessons from recent evaluations, does not address sector-level performance by analysing the ratings given in evaluation reports to transition impact, fulfilment of objectives, overall performance and other evaluation indicators. This level of analysis was carried out in the Evaluation Special Study of the Financial Sector Operations Policy, September 2007 (PE06-338S) and the Evaluation Special Study of the Bank's Small Business Finance Operations Policy, February 2010 (PE08-430S).

[2] BDS10-020 (Final).

- eastern Europe and Caucasus
- south-eastern Europe
- Central Asia
- Russia
- central Europe and the Baltic states
- Turkey.

CRR4 was drawn up and approved before the events in 2011 that led the EBRD to make plans for operations in the southern and eastern Mediterranean, commencing in Egypt. The following sections discuss a number of insights garnered from the experience of the EBRD and others, together with related findings that could be considered apposite to the planning of financial sector interventions in the new territory.

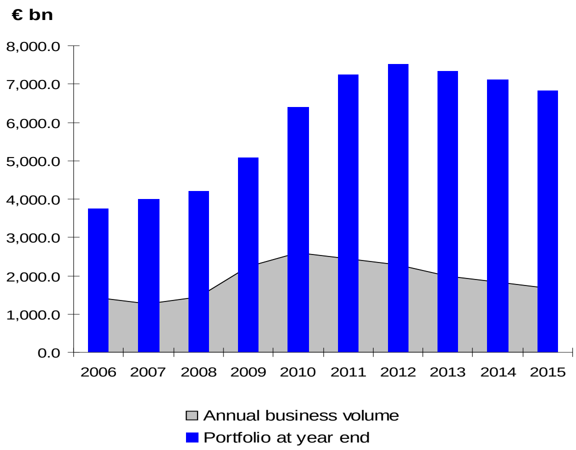
1.3 The shape of the FI team debt portfolio

Annual business volume (ABV) and year-end portfolio for FI team debt transactions between 2006 and 2015 (actual to 2010; CRR4 projections to 2015) are shown in Figure 1 below.

The following points are worthy of note:

- The portfolio stood at €3.2 billion at year end 2006 and rose to €5.1 billion at year end 2010.
- A portfolio in excess of €6.8 billion is expected by the end of the CRR4 period in 2015, falling back from a peak of €7.5 billion expected in 2012.
- Annual business volume (ABV) of €1.4 billion in 2006 nearly doubled to €2.6 billion in 2010 and is expected to fall to around €1.7 billion in 2015.
- Operations signed in 2009 and 2010 included a large volume of high-value crisis response transactions with existing clients, including major international groups with systemically important subsidiaries in the EBRD region.
- These projections do not include prospective new countries of operations.

Figure 1: FI team debt portfolio 2006-15



Several factors suggest that there will be increasing pressure on FI team resources to meet the new business targets and manage the portfolio:

- High-volume crisis response transactions will probably be replaced with a larger number of lower volume transactions, still in a stressed environment.
- Preliminary, somewhat tentative estimates suggest that FI team business in the new region could amount to an additional €1.0-€1.5 billion for 2012-15.

With these developments in prospect there is a strong case to leverage the lessons of experience in order to maximise the effective use of resources and the performance of future operations.

2. Governance – issues and insights

2.1 Good governance standards for robust institutions – the value of TC-funded institution building

Evaluation consistently shows strong connectivity between the application of sound governance standards and the success of an institution-building programme (IBP).

In the case of one systemically important bank in a south-eastern European country, the EBRD's pre-privatisation equity investment was accompanied by an institution-building programme that emphasised an immediate focus on improvements in corporate governance. The client responded positively to the IBP, which was seen from the results of the subsequent privatisation tender to have added economic value to the enterprise, as well as improving technical and managerial skills and capacity. In another case, in the Western Balkans, the client's governance structure displayed some weaknesses and there were skills gaps in key functional areas. The client's senior management team was slow to respond constructively to the IBP, leading to delay in implementation and the privatisation timetable.

The experience demonstrates that it is always necessary to understand, and frequently necessary to change, client management attitudes if restructuring and institution-building are to succeed. In retrospect a more proactive approach by the EBRD at commencement of the consulting assignment might have yielded fuller buy-in by the client and improved results.

2.2 Governance and management performance

Strong governance structures tend to be correlated with management willingness and ability to take and execute key business decisions needed to respond to crisis.

At a large Central Asian bank, delays in implementing agreed governance and risk management improvements were attributed by owners and managers in large part to the time commitment required to manage the very rapid growth that preceded the onset of the crisis. When the crisis hit, the bank's loan book contracted sharply and portfolio quality suffered. By contrast, a large privately owned Russian bank with a sound governance structure had the foresight to limit its exposure to US dollar financing risk as well as to construction and real estate lending, thus providing some protection from the worst effects of the crisis. The management team in the latter case was guided by an experienced supervisory board including seasoned independent directors, a mechanism that was lacking in the former case.

In difficult cases the Bank should be prepared to use all the appropriate levers available – for example, through loan covenants, Board representation, shareholders' agreements and interaction with other IFIs – to exert influence on the incumbent management team.

2.3 The linkage between governance and EBRD Board representation

When the EBRD takes an equity stake in a bank, it frequently secures and exercises the right to appoint a nominee to the supervisory board. The positive influence of such appointments may be seen in some cases, but not in others. For example, in one early transition country (ETC) bank, the EBRD's board nominee was able to strengthen the outcomes of the accompanying technical assistance initiative through promoting amendments to internal company regulations, organisational structure and procedures that helped to make the governance improvements sustainable. But in another case, an EBRD minority representative on a supervisory board was unable to catalyse institutional change in the presence of hesitant majority shareholders and management. In such circumstances it is important to ensure prompt feedback of useful information to the Operation team so that appropriate action can be taken, bringing into play such other levers of influence as may be available.

2.4 Material from other sources – governance and state-owned banks

A recent International Finance Corporation (IFC) study of small to medium-sized enterprise (SME) access to financial services argues that preconditions for sustained positive outcomes in the provision of credit to SMEs by state-owned banks include establishing sound governance structures with independent boards and imposing clear performance criteria. Such criteria might include a requirement to fill market gaps and target underserved segments while avoiding direct competition with privately owned banks. On a similar tack, a 2011 report by Fitch Ratings on banks in the Commonwealth of Independent States (CIS) and Georgia draws attention to the failure in July 2011 of Bank of Moscow, the fifth-largest bank in Russia. According to Fitch, the acquisition of Bank of Moscow by VTB with minimal prior due diligence "called into question the quality of governance at state-owned banks".[3] The same report describes the state-dominated banking system in Azerbaijan as remaining "underdeveloped and non-transparent, characterised by generally weak governance and management, considerable relationship lending, limited deposit funding and volatile performance".

These observations are of relevance to the EBRD's future operations given the continuing preponderance of state-owned commercial banks in

[3] Moody's called attention to the poor quality of governance at Bank of Moscow itself, in particular the prevalence of related party lending [Moody's Investors Service, Survey of Russian and CIS Banks, September 2011: "Survey Shows Related-Party Lending Remains a Structural Weakness"].

a number of the Bank's existing countries of operations, and in the new region. In some cases the profile and influence of state-owned banks have increased as a result of measures to counter the effects of the global crisis.[4]

2.5 Findings

– A well designed and implemented IBP has the potential to create economic value over and above the improvement of technical and managerial skills.
– It is essential to secure client ownership of the IBP, regardless of whether the client is privately or state-owned. The client should be involved as fully as possible in the IBP design, including consultants' terms of reference, and in the planning of implementation.
– Measures to achieve best international corporate governance practices should include the appointment of experienced non-executive directors to an active and independent supervisory board.
– Supervisory board nominees appointed by the EBRD may have limited influence on dominant shareholders and an incumbent management team resistant to change. It may be possible to increase the Bank's influence by linking follow-on investment (equity or debt) to progress with implementing the institution-building programme.

3. Due diligence – issues and insights

3.1 Company ownership – "know your customer"

Evaluations have highlighted the importance of transparent shareholding structures and of management structures that provide for adequate checks and balances. In countries where the environment is being reformed only slowly, it is essential for the Bank to work with the

[4] The EBRD's current Financial Sector Strategy, approved in October 2010, states that there can be circumstances where the EBRD can use commercially run state-banks as conduits to clients that cannot effectively be served by privately owned banks. These situations "would be reviewed periodically to ensure that the Bank's engagement with the state-owned banks achieves the Bank's goals to provide financing to priority areas without stifling private sector competition or crowding out privately owned banks..." BDS10-219 (final).

authorities to improve the legal, regulatory and supervisory framework of the financial sector. In individual cases, continuing due diligence is necessary to monitor the beneficial ownership of financial institutions and the possible involvement of politically exposed persons. In these cases, timeliness and clarity in the Bank's own reporting is particularly important.

3.2 Corporate structure – how effective and efficient is the client's internal organisation?

An evaluation of the ETC Non-Bank MFI Framework concluded that microfinance institutions (MFIs) need transparent and efficient internal organisation to be sustainable in the long term. A clear policy on fraud prevention is needed with appropriate organisation and procedures to facilitate detection of fraudulent activity. Whatever the size of the business, effective due diligence must determine the location of decision-making powers within the organisation and the processes by which decisions are implemented. For its part, the Bank might usefully ensure the assessment covers monitoring procedures, measures for the prevention and detection of fraudulent activity, and the competence of the internal audit function.

3.3 Client education

Experience has shown that when Bank staff with the requisite skills direct the due diligence process, the results can be used constructively in project design to heighten the transition impact of the project by encouraging the client to adopt best practice. The process can also be an effective learning tool for clients' management teams, helping them to understand the principles of sound banking as well as elevating them to international standards of disclosure.

3.4 New transactions with existing clients

Evaluation findings have highlighted that a partner bank's long-standing relationship with the Bank does not remove the need for in-depth due diligence when considering new transactions. Rapidly developing sub-sectors such as consumer finance may present sensitive issues, especially in the absence of sound regulation. Operation teams need to refresh their knowledge and understanding of a client's business model through continued, deep engagement to help identify issues for corrective action.

3.5 Using expert assistance

The Bank may employ industry experts to perform specialised aspects of due diligence such as integrity checks, diagnostic studies and audits of client IT systems. Inputs of this kind must be critically assessed and evaluated by the operation team. The careful use of inputs from expert consultants can give the EBRD additional credit comfort and contribute to project design and functioning. An adequate *ex post* assessment of consultant performance is important to provide timely feedback to improve the planning and implementation of future assignments.

3.6 Environmental due diligence by partner banks

Partner bank recipients of EBRD equity funding are required to implement EBRD environmental due diligence procedures in loan appraisal across the full range of their lending operations. Actual experience with partner banks has been varied. Some have responded well and include in their credit assessment procedures the identification of environmental risks and evidence of compliance with environmental regulations. Others only apply environmental due diligence systematically in the case of loans financed by the EBRD and other international financial institution (IFI) credit lines. Evaluations have observed that pressure on client bank management and staff resulting from rapid growth contributed to delays in adopting sound environmental practices widely in a number of cases.

3.7 Findings

– Adequate due diligence of partner institutions requires careful assessment of the strengths and weaknesses of the system of governance and of internal controls. Board documents should identify clearly any outstanding risk issues and explain how they will be addressed.

– The Bank has developed procedures, guidelines and criteria for integrity due diligence that take into account the business environment and the Bank's objectives. To protect the Bank, procedures must be implemented consistently with close attention and vigilance on a continuing basis.

– A locally owned bank with uncertain support from sponsors may be particularly vulnerable in times of financial or economic stress. A critical assessment of shareholders' capacity and motivation to support the bank in distress should be made at the due diligence stage.

– It is appropriate to use expert consultants to perform specialised aspects of due diligence. It is an important responsibility of the operation team to appraise the findings of consultants and auditors critically.

– Where necessary, operation teams should stress the partners' obligation to apply EBRD environmental procedures and guidelines across their operations. Environmental due diligence is a practical tool in credit appraisal that can mitigate the potential for credit losses and claims against a bank resulting from loans to borrowers engaged in environmentally sensitive activities.

4. Monitoring and evaluation – issues and insights

[Note: The discussion in this section applies in particular to the evaluation of technical cooperation (TC) interventions and to banking operations that are programmatic in nature, for example small business financing facilities, energy efficiency and certain other kinds of framework. Many of the following insights are relevant to operations for which development outcomes are identified as aspects of expected transition impact. They are also relevant where an issue is the comparability of a large number of operations of a particular type, for example leasing.]

4.1 The importance of baseline data, benchmarks and indicators, and monitoring

Several evaluations emphasise the potential for improved monitoring and evaluation systems to strengthen the robustness of evaluation findings and enhance the practical application of lessons. The 2007 Mid-Term Review of the ETC Fund noted concern within the Donor Assembly that the cases for claiming poverty reduction impact was not sufficiently articulated in the EBRD's monitoring and evaluation system given the absence of baseline data, benchmarks and indicators.

An evaluation of successive private equity funds run by the same fund management team in an advanced transition country noted that the *ex post* evaluation could not assess such social effects as employment impact since monitoring and reporting procedures had not been built into the operation at the design stage despite being identified at appraisal as expected beneficial outcomes.

The Mid-Term Review of the Japan-Europe Cooperation Fund commented on the need to be more explicit in setting objectives and benchmarks to assess the achievements of TC interventions. Project documentation lacked definitions of primary and secondary objectives, milestones, success indicators and benchmarks.

A study of leasing operations noted the absence of consistent indicators to measure the outcomes of EBRD inputs in a meaningful way. There was inconsistency in the setting of indicators with some lessors in some countries being measured against 15 or more indicators while others were measured against four or five. Measurable indicators of expected outcomes are necessary in order to provide actionable feedback on the efficacy of operations and programmes. Consistency in the use of indicators is necessary to permit comparison of the performance of programmes within one country, or across a number of countries, or over time. This in turn is critical for wider and deeper institutional learning, and superior institutional performance.

The evaluation of TC interventions associated with the EU/EBRD SME Facility also drew attention to the lack of objectively verifiable indicators of achievement. The documentation for the umbrella programme in 2006 contained a table listing 21 "benchmarks" under four "transition impact (TI) objectives".[5] But information was not systematically available in individual cases or in aggregate across the facility, with the result that robust findings could not be demonstrated on the basis of the given benchmarks. The same evaluation observed that the EBRD reporting focus was output-led, addressing such things as disbursement of loans and completion of consulting activities, rather than focusing on outcomes. The report noted the absence of solid baseline data, carefully chosen indicators and defined means of verifying the achievement of stated TC objectives.

The first evaluation of the EBRD Shareholder Special Fund concluded that, while governance and management arrangements were well established, the quality of reporting and monitoring needed to be strengthened. Reporting would be improved by rigorous monitoring of the contribution to transition impact of non-TC grants made from the fund. In addition, similar to other TC interventions managed by the Bank, the fund would benefit from a rigorous system of monitoring and reporting transition impacts and development outcomes.

An evaluation of the Bank's Small Business Finance Operations Policy noted that the EBRD's existing monitoring and reporting systems do not at present adequately capture, record or systematically report development outcomes, even though such outcomes are often closely

[5] The four TI objectives were institution-building, financial intermediation, operating efficiency and sustainability.

associated with aspects of transition. The study commented that this has contributed to an expectations gap on the part of donors and stakeholders – the gap between donor expectations of supported Bank interventions and the reported results of the interventions.

4.2 Material from other sources

A 2007 Evaluation of IFC's Development Results summarised lessons and implications from 10 years of experience and concluded that better metrics would allow for deeper performance evaluation and further learning from operations.

The 2009 Evaluation of IFC's Development Results focused in particular on Advisory Services (roughly analogous to EBRD TC interventions) and included a comparison of advisory services to the private sector provided by Multilateral Development Banks. The evaluation found that performance indicators were mainly output-oriented from the design stage, resulting in a lack of focus on outcomes. At best most indicators measured outputs (that is, deliverables), not outcomes (short- or medium-term changes resulting from the advisory project), and baseline data were rarely collected. The same report identified monitoring and evaluation quality as a key driver of performance.

4.3 Findings

- By applying a more consistent approach to the use of baseline data, benchmarks and indicators, the Bank could identify opportunities for improved operational effectiveness and impact. The information obtained could be a valuable link in the feedback chain through which the Bank builds its own capacity and performance.
- The Bank needs to develop and apply more effective mechanisms to monitor and report development outcomes in the context of the assessment of realised and potential transition impact.
- When development outcomes such as employment creation are stated at appraisal to be operation objectives, baseline data (together with measurable indicators) should be established *ex ante*.
- The objectives of TC operations should be formulated at the outset that are monitorable and evaluable. Objectives, milestones, success indicators, outputs and outcomes should be clearly stated alongside expectations in respect of transition impact.

- The Bank should improve consistency in setting measurable indicators in order to make project results comparable and to reduce the transaction costs of customised approaches.
- Taking the existing Transition Impact Monitoring System (TIMS) framework as the starting point, the Bank could develop a more systematic approach to setting performance benchmarks for those development outcomes with conceptually strong linkages to aspects of transition impact,[6] for monitoring implementation, and for *ex post* evaluation of performance and impact.

5. SME sector and microfinance issues

Recent papers from the IFC, World Bank and IMF contain valuable insights of relevance to present and prospective EBRD operations. This section of the synthesis report summarises salient points from each paper.[7]

5.1 More work needed to create an enabling environment for SME access to finance (IFC)

SMEs have been particularly affected by the slowing of business lending caused by the financial crisis. Many have suffered a hardening of credit terms due to low profitability, a decline in creditworthiness and weakened financial markets. Export finance has become more difficult to obtain as banks become increasingly risk averse. Banks have imposed tighter credit conditions, shortened maturities and increased collateral requirements on SME borrowers. Particular obstacles to SME success were observed in the Middle East and North Africa (MENA) countries where surveys conducted with banks identified a lack of SME transparency and the weak financial infrastructure (for example, poor credit information and weak creditor rights) as the main obstacles for further engagement in SME finance.

In commenting on the creation of an enabling environment for SME finance, the 2010 IFC report notes that partial credit guarantee schemes are considered one of the most market-friendly types of intervention. They may prove an effective way to reach underserved groups such as

[6] Conceptual linkages were demonstrated in the Evaluation Special Study of the Bank's Small Business Finance Operations Policy.
[7] "Scaling-Up Access to Financial Services in the Developing World", IFC, 2010.
"Challenges to Enterprise Performance in the Face of the Financial Crisis – Eastern Europe and Central Asia", World Bank, 2011.
"The Impact of the Global Financial Crisis on Microfinance and Policy Implications", IMF, 2011.

start-ups and small firms. They may also generate positive externalities by encouraging banks to enter the SME market, and improve their lending technologies and risk management systems. The report observes that historically such schemes have been used for countercyclical purposes.

The report describes equity as a necessary complement to debt for high-growth, innovative SMEs with potential for job creation, yet the outreach of equity funds is limited since they target firms with high-growth potential. A key design feature of SME lending facilities is to complement funding interventions with tailored capacity-building programmes, a factor that is closely related to ensuring the quality of private financial institutions. This is confirmed by EBRD evaluation findings.

More broadly, the IFC report reaffirms the value of developing country-specific diagnostics and strategies on which to base the planning of EBRD interventions in existing and prospective countries of operations. It will remain important periodically to identify and redefine specific sectoral transition gaps in order to develop integrated policies and provide the basis of monitoring progress.[8]

5.2 Retaining access to finance important to firm survival during the crisis (World Bank)

The 2011 World Bank study draws on the Business Environment and Enterprise Performance Survey (BEEPS),[9] according to which firms reported that access to finance was, on average, easiest in 2005. The study attributes the significant change in financial market conditions that took place in the early 2000s in large part to the restructuring of banking sectors throughout the region in the 1990s and broadened access to credit made possible over time by increasing foreign bank participation. The report identifies over-borrowing in foreign currency as a particular problem, noting that direct cross-border lending and local lending in foreign currency had a destabilising effect. This echoes the findings of EBRD reports.

Of particular relevance to the EBRD is the observation that the ample supply of financing previously available to countries in eastern Europe and Central Asia (ECA) may not reappear as banks attempt to recover and central banks strengthen prudential requirements. As a result, ECA countries will have to compete for foreign investment with countries in other regions. Interestingly, the study finds that countries with a well-

[8] See, for example, Country Strategy Updates 2011, BDS11-077 (Final).
[9] The Business Environment and Enterprise Performance Survey (BEEPS) is conducted jointly by the World Bank and the EBRD.

established foreign bank presence experienced some easing of financial constraints during the crisis. Firms were less likely to report that access to financing was a serious problem in countries with high foreign participation in the banking sector.

The study finds that some firms did not survive because of the drop in demand for products and services, which it describes as the most worrisome effect of the financial crisis. Where market demand has survived, small enterprises have suffered disproportionately since lenders find it easier and cheaper to extend credit to larger, older firms.

There appear to be three implications in particular for the EBRD:

– There is likely to be growing demand from local banks and, possibly, subsidiaries of international banks in the region for EBRD credit lines to on-lend to micro, small and medium-sized enterprises (MSMEs).
– As has been noted over the years in several evaluations, the Bank should insist on appropriate covenants in loan agreements with partner institutions to ensure that funds reach the targeted borrowers.
– The Bank should monitor the use of proceeds closely and seriously consider expanding its monitoring and reporting to capture broader effects of lending operations, such as enterprise and employment growth to record development-related outcomes of potential relevance to transition progress.

5.3 Increased systemic risks call for more focus on market structures (IMF)

The 2011 IMF paper analyses the impact of the global financial crisis on microfinance and identifies some policy implications. The paper finds that, from a macroeconomic perspective, the boom in microfinance over the last two decades resulted in microcredit coming to represent a significant proportion of both gross domestic product and total credit to the private sector for some countries including Armenia, Bosnia and Herzegovina, Kyrgyz Republic, Mongolia and Tajikistan. Rapid development increased the systemic risk of the microfinance industry as links between MFIs and the general economic environment became stronger. Eastern Europe, the Middle East and Central Asia are regions where MFIs appear most sensitive to changes in the economic environment. The paper suggests that the increasing attention given by MFIs to “sustainability”, by diversifying funding structure and increasing scale, has made them more similar to financial institutions with more traditional lending portfolios.[10] In addition to declining asset quality and profitability in the wake of the global crisis, MFI performance deteriorated further in some markets in response to credit oversupply.

On the policy side, regulation should aim at creating an enabling environment – a market structure conducive to innovations allowing increases in productivity and efficiency, and in which MFIs can exert competitive pressure on each other. Developments in regulation should choose appropriately between prudential and non-prudential principles depending on the industry's local characteristics. Strengthening of legal frameworks should embrace such issues as the use of credit bureaux and the promulgation of better corporate governance principles.

A policy implication for the EBRD is that the Bank should continue to work with sound, experienced MFIs and with younger MFIs that are capable of assimilating technology transfers in a properly regulated environment. A corollary of this is that the Bank must work actively through policy dialogue to encourage a better enabling environment with an approach tailored to local specifics country by country.

6. Conclusion

Over two decades the EBRD has achieved considerable success in a good number of countries, while transition challenges remain large in the financial sector in some existing countries of operations and in the southern and eastern Mediterranean region. In many countries that have been slow to reform, and in the new region, there are challenges on the development front, without progress in which lasting transition results may be unattainable. Looking forward, this brief synthesis of evaluation insights suggests that increased focus on two main issues could improve operational effectiveness in an increasingly challenging and demanding environment.

6.1 Integrate the Bank's approaches to financial sector intervention to sharpen focus on market structures

Effective market structures and market-supporting institutions require committed political buy-in, which in turn requires a strong legal and regulatory framework. At the same time, where state-owned banks

[10] It should be noted that non-bank MFIs in most jurisdictions are not permitted to take deposits so that diversification of funding has mostly entailed tapping commercial sources, which increased instability with the onset of the crisis [EvD note].

predominate and privately owned financial institutions are weak, the form of ownership may be less immediately important than competent regulation within a strong legal framework and the application of sound governance principles. The IFC study suggests the creation of sound regulatory and institutional structures should be prioritised over privatisation in the interests of effective transition.

The development of an effective financial sector strategy for an individual country should be based on a comprehensive diagnostic of financing needs and the quality of existing infrastructure. An integrated approach that brings together policy dialogue, technical assistance and banking operations is likely to result in a higher level of success of individual operations, especially where smaller scale individual operations are grouped within programmes, frameworks or facilities such as MSME programmes or energy efficiency facilities. Coordinated policy dialogue and technical assistance can target weaknesses and gaps in infrastructure to improve the chances of success for individual operations.

6.2 Add value through monitoring and evaluation

The business projections summarised in Section 1.3 above suggest that there is likely to be an increasing need for effective and efficient monitoring because of:

– a larger number of smaller transactions
– a portfolio volume of almost double the size in 2006
– transaction growth in the new region.

Reconciling the demand to do deals with adequate monitoring and effective feedback is an issue that requires greater attention since the quality of new deals may suffer as well as the quality of the portfolio if monitoring is incomplete or its findings unutilised. The Bank has an opportunity to anticipate this challenge by upgrading and streamlining its monitoring and evaluation policies and procedures. The monitoring and evaluation system should:

– provide timely information for credit review purposes
– create value through information flow to banking teams
– produce compelling evidence of the impact of EBRD investments and TC operations.

A recent joint report of 31 multilateral and bilateral development institutions, including the EBRD, emphasised that “[M]onitoring and evaluation will be critical to further guide investment prioritisations and improve operation design through continuous leaning."[11] A number of EvD reports have identified the need to improve design, monitoring and evaluation in order to enhance the comparability of operations and programmes. By incorporating development outcomes in the assessment of transition impact, the Bank could report consistently over time on these outcomes to strengthen transparency with the Board, TC donors and other stakeholders. Complex multiyear programmes particularly need to incorporate in their design solid baseline data, definition of the monitoring and evaluation system and metrics, specification of quantifiable indicators and means of verification. There is scope for the Bank to build on the existing TIMS mechanism to develop a more effective approach, commencing with improved clarity of benchmarks *ex ante*.

[11] "International Finance Institutions and Development through the Private Sector, September 2011" - a report by the Private Sector Development Institutions Roundtable, an annual forum of the heads of IFIs with private sector focus. The report was coordinated by the IFC and contains contributions from the EBRD as well as from other IFIs.

Sources

Scaling-Up Access to Financial Services in the Developing World	IFC, 2010.
Challenges to Enterprise Performance in the Face of the Financial Crisis – Eastern Europe and Central Asia	World Bank, 2011.
The Impact of the Global Financial Crisis on Microfinance and Policy Implications	IMF, 2011.
CIS/Georgian Banks: Semi-Annual Review and Outlook	Fitch Ratings, July 2011.
Survey of Russian and CIS Banks	Moody's Investors Service, September 2011.
International Finance Institutions and Development through the Private Sector	Private Sector Development Institutions Roundtable coordinated by the IFC, September 2011.

European Bank for Reconstruction and Development
One Exchange Square
London EC2A 2JN
United Kingdom

Switchboard/central contact
Tel: +44 20 7338 6000
Fax: +44 20 7338 6100

Information requests
For information requests and general enquiries, please use the information request form at www.ebrd.com/inforequest

Evaluation department
Tel: +44 20 7338 6467
Fax: +44 20 7338 6726
Email: askevd@ebrd.com

Web site
www.ebrd.com