



## **SPECIAL STUDY**

# **EBRD's Nominee Director Programme Management Comments**



**European Bank**  
for Reconstruction and Development

EvD ID: SS19-143

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EBRD EVALUATION DEPARTMENT

## Executive Summary

- Management would like to thank EvD for this study, which it views as generally balanced and comprehensive. Management believes the study's general diagnosis of the issues is sound and the proposed recommendations are directionally sensible.
- Management acknowledges that the EBRD Nominated Directors ("NDs") are critical for the success of our equity investments, including the achievement of transition and value creation plan ("VCP") objectives. Management recognizes that the Bank's relations with its NDs could be managed centrally more efficiently and effectively with an appropriately staffed and resourced function. This would allow us to better use the ND resource, learn from the experience and recruit NDs from a more relevant, diverse set of candidates.
- Management appreciates the recommendation that our approach to using NDs can be better fleshed out and communicated. Management believes that the efforts to strengthen the EBRD's strategic approach does not warrant the preparation of a new strategy but can be better defined in the Enhanced Equity Approach update.
- Management finds the recommendations of the study to be relevant, valuable, and reflective of the direction it has been moving in. However, these recommendations should be viewed with a clear understanding of the scope of the ND role and the duties of NDs to the EBRD. The best practice in corporate governance is for NDs to primarily have a responsibility to act in the best interests of the company. Supporting implementation of VCPs, managing the EBRD relations or any other duties should not be in contradiction with or have priority over this.
- In March 2021, Management has tasked a Senior Banker from the Equity Team to lead the establishment of a centralized ND management function, in line with the study's recommendations. The function is planned to combine deep industry and functional knowledge of the ND search, assessment, appointment and evaluation processes to find experts and NDs who best fit unique needs of each EBRD equity investment and have a positive impact on the investment performance.
- The ND management function will also be responsible for developing and maintaining the ND network of professionals who share and promote the EBRD's values and contribute to developing the EBRD's equity business.
- The initial tasks assigned to the Senior Banker leading the establishment of the ND management function include (i) the preparation of a virtual Annual ND conference, (ii) the review and optimisation of the EBRD's ND procedures and rules to address the key areas, including the selection of ND candidates, ND performance evaluation systems with clearly defined objectives and process, etc., (iii) the audit of the existing database of ND experts, (iv) the selection of a software to improve the ND database functionality, (v) the identification and implementation of tools for better engagement with the ND network.
- This work will serve as the basis for the build out of all of the capabilities identified for the function in the areas of recruitment, performance assessment, learning, and a database. Management notes that implementation of the improvements in the ND

management function identified by the study as per the work plan above will be dependent on allocation of upfront capital expenditures and ongoing recurring costs not identified in the study.

Management's response to EvD's recommendations is provided below, followed by comments on the study analysis and related findings. Other comments provided in the draft stage are already reflected by EvD in this final version of the study.

## 1. Study Recommendations

**Recommendation 1:** *Develop an Equity Policy or Strategy or Approach covering use of NDs, including key priorities for various equity scenarios in different company types. Present a 3-5 year vision for the programme, making clear how NDs will be used, and how their input will be tracked, reported and assessed against specific indicators to ensure the programme has a basis on which to develop. Define operational guidance, duties and principles, and rules and procedures. Provide details on how to ensure a diverse and high-capability pool of candidates, use of board network/s information systems to support records and data management.*

Management partially agrees with this recommendation. Management recognises the importance of improved centralized management of the ND management function and in better using NDs as an asset for transition. Management also appreciates the recommendation to better flesh out and communicate our approach to using NDs. Management believes that this would be an integral part of further improvements and strengthening the Bank's strategic approach in the upcoming update of the Enhanced Equity Approach rather than through a separate new strategy.

To address insufficiencies and areas for improvement in managing EBRD's NDs, a Senior Banker has been assigned to work full time to diagnose and put together a plan for improvement in process and policies of ND use. The general direction Management proposes will be presented in the Enhanced Equity Approach update due for June 2021. The operational guidance documents exist on the OCCO website.

It is important to note that certain other MDBs have central functions to manage NDs with full time staff, as do PE investment firms with comparable scale to the EBRD's equity business. This is a direction Management is looking to go in to ensuring a better management of the function. This expanded scope requires dedication of considerable amount of time and resources, both at the design and set-up stage, as well as on a permanent basis. The extent of the implementation of the EvD study recommendations and establishment of an ND management function in line with best practice will be dependent on the availability of resources.

**Recommendation 2:** *Update and standardise objective setting, monitoring, reporting and assessing ND inputs and defining incentives. Provide briefing packs for NDs upon appointment, recordkeeping and tracking of ND objectives. Require Operation Leaders ("OLs") to regularly report on ND contributions to VCPs and CGAPs through annual ND assessments, a final assessment and de-brief on conclusion of the assignments. Use this as input for the wider project self-assessment.*

Management agrees with this recommendation about the need for enhanced monitoring and reporting on ND performance and support to companies. While done capably by many individual OLs, these tasks are not performed consistently across the portfolio. Our failure to do centralized reporting and monitoring makes it harder for us to apply principles

consistently, compare performance across the board, deduct, and apply lessons learned across the portfolio.

Management notes that OLs interact frequently with NDs, engage meaningfully with them on key developments and discuss solutions to issues the companies face. The feedback from many of our NDs also suggests they find the level of interactions and the use we get from the NDs to be good and better than their experience with peer MDBs that they work as NDs for as well. However, better documenting the work done is needed and will be a key priority for the ND management function.

Management notes that EPMU currently requires annual feedback from OLs on ND contributions to VCPs and CGAPs and upon each contract renewal. As part of contract re-issuance, EPMU not only checks that the OL recommends the ND should continue in their role for a further 12 months but also reaches out to the EL/VCL for them to provide a brief performance review. Management acknowledges the value of a more comprehensive performance review process in improving the ND management function's effectiveness.

In connection to the above, Management would like to clarify the ND role and the duties of NDs to the EBRD. Best corporate governance practice suggests that duties of NDs are primarily to the company and not to the shareholders that proposed or appointed them. The EvD study refers to the duties of NDs to manage EBRD's relations with the companies or their duties to implement VCPs and CGAPs or otherwise further our transition objectives. Such undertakings should not contradict or be prioritized above the duties of the NDs to the companies whose boards they sit on.

The report also comments on the EBRD's practices around development of VCPs, sharing these with our NDs and what is expected in their implementation. Management uses the term VCP to mean all of the actions or other drivers needed to create value and effect transition in our equity investments. Our practice is to discuss and be aligned with all of the relevant actors in the implementation of particular actions listed in the VCP. However, this is different from sharing all the contents of the entire VCP with all of the relevant parties (shareholders, management, board members). This is unnecessary and can often be detrimental. With the establishment of an ND management function, Management expects to be able to better monitor and ensure the discussion with NDs of key VCP objectives.

**Recommendation 3:** *Mine the ND experience as a valuable and distinctive corporate asset for insights to inform new projects, and to share as orientation material with new NDs. A new Strategy/Approach should pay particular attention to these issues. Develop specific training modules for OLs managing NDs that are based on experiences sourced through activities such as a formal "After Service" interview/de-brief/survey and shared through systematic use of case studies in equity workshops.*

Management agrees with the importance of self-assessment and learning from experience with NDs. The ND management function will also include a robust process of collecting insights from NDs and the companies they sit on the boards of through a number of channels including interviews and surveys and aggregating the lessons learned to be shared within the Bank and to inform our ND programme going forward. However, Management believes the study underestimates the value of the current training provided for the new NDs, for instance in reference to the 2 day compulsory training through which the EBRD NDs acquire knowledge of the guidance and rules.

Management welcomes the recommendation to develop additional training modules for NDs and sees the increase use of virtual meetings as an opportunity to provide this. Management sees the value of training to NDs to develop more knowledgeable and capable

advocates at the board level for our transition qualities and specific EBRD focus areas of GET, inclusion and digitalisation.

**Recommendation 4:** *Recruitment/retention of NDs, particularly from outside the EBRD orbit, merits a more systematic and ambitious approach. This could tap into and establish board networks across the COOs, along the lines of IFC's approach. A formal mentoring programme for suitable internal mid-level staff could be considered. Review current incentive levels for both internal and external NDs.*

Management agrees with this recommendation on the need for a more systematic and ambitious approach to recruit and retain NDs. There are many good practices of sourcing ND candidates in the EBRD and long standing relations with various networks that allows us to have access to a more diverse and relevant pool of candidates. Nevertheless, Management acknowledges that the efforts are largely ad-hoc, with limited central coordination and with results relying heavily on the judgement and experience of individual OLs and VCLs.

Management intends to add to its existing set of relations with such networks like Professional Boards Forum, Institute of Directors, as well as expert networks such as GLG.

The evolution of our approach to selection of NDs reflects our recognition of the potential for wider ND contribution. The Bank is increasingly looking for ND candidates who bring more than generic corporate governance skills. We look for common challenges faced by our portfolio companies that are impediments to reaching our transition and VCP objectives and look for NDs who can help with those. We look for NDs who are experienced in the markets our companies operate, have expertise in their industries or in critical functions for their operations. We are looking for external candidates, women candidates and candidates from more diverse backgrounds to enrich the quality of boards. The contribution of NDs selected with these objectives in mind naturally goes beyond the Well-Governed objective to the other qualities as well and to other areas of importance for the companies. We will also continue to aim to align the compensation and incentives for external NDs with market practices to secure the interest of high quality candidates for our ND roles.

Management also looks to provide NDs with opportunities to learn from each other and from other experts on areas such as green transition, diversity and inclusion, digital transformation of businesses to allow them to be advocates and catalysts for change in our companies.

Management would also note the resource implications of establishing board networks across COOs and believes that the Bank's limited needs for its own portfolio can readily be addressed through collaboration with existing networks.

Management agrees with the report's suggestion that recognition of internal NDs is important. However, Management believes EBRD bankers already value the career development and growth impact of an ND experience and are adequately motivated to seek opportunities without the need for further motivation by financial rewards for those taking on ND roles. Requesting ND roles as a way to supplement income could reduce the average quality of the internal applicants even if it increases the number interested, reducing the opportunities for candidates that are interested in the roles for their inherent value and importance. As Management currently observes adequate internal interest and are in any case looking to attract more external candidates than we currently have, we think financial motivation/compensation for internal NDs is not appropriate or needed. Management notes the interest of motivated internal candidates, directs them towards EBRD's Board Training and actively pursues opportunities to put them on boards where they can gain experience and add value.

## **2. Comments on the study analysis and related findings**

### ***Recognition of ND contribution to transition objectives***

Management agrees with the report's suggestion that the existing transition approach references NDs mostly in relation to the Well-Governed objective and that the role of ND in achievement of transition objectives across transition qualities could be potentially better specified ex-ante and monitored ex-post, subject to the extent of possible attribution. While the board is an instrument of governance, its contribution to a company is not limited to ensuring better governance. NDs come with various valuable skills and experiences and interact with the company in various ways to support the achievement of its business and financial objectives, as well as improve the business in a variety of ways.

Management welcomes the suggestion to further explore ways to track NDs invaluable contribution to transition at the company level. Management thinks the needs of companies are evolving beyond generic corporate governance support from the board towards more functional/sectoral/country expertise, better understanding of and experience with areas that can advance transition in companies. Therefore, Management believes NDs can contribute over a wider set of topics than originally assumed. Management agrees that training NDs (or finding NDs with such backgrounds) can provide more knowledgeable and capable advocates at the board level for our transition qualities and focus areas of GET, inclusion and digitalisation as well. While corporate governance support by NDs remains a key need for many companies, for more sophisticated investee companies this is less critical than before. In these cases, NDs can contribute to transition qualities beyond Well-Governed with the expertise they bring.

### ***Relationship of investment performance and CGAP, VCP and transition objectives***

Management sees CGAP, VCP and clearly devised transition objectives as very important components of a successful equity investment. The study asserts that the factors above also seem to be associated with investment success in the cases reviewed. A small sample set considered in the study is insufficient to provide conclusive evidence of the importance of the factors in securing investment performance and they are unlikely to be the only important factors for investment performance as many other streams of work by us, NDs, shareholders and management teams contribute to the success of businesses in which we invest.

Nevertheless, Management thinks these early indicators are important and warrant further study.

### ***Interpreting the Compass Study and implementation of its recommendations:***

The first Compass study was a survey of only the EBRD appointed NDs. It asked for their views on the functioning of the boards they sat on and any shortcomings they observed across various functional board responsibilities. When the study was repeated after the first year, Management expanded the respondents to include board chairs as well and added telephone interviews with the surveyed NDs and chairs in addition to questionnaires that were filled in by them after each board date. In essence, it was a way to aggregate the views of the board members themselves and see if there were common issues/themes emerging. This is a useful perspective to have on board dynamics but Management was not convinced of the value of repeating it each year as the composition of companies in our equity portfolio and the composition of their boards does not change much from one year to next. Management explored the possibility both with Compass and with other providers of doing other types of studies on boards but did not find a sufficiently different offering.

Compass's surveys were instrumental in improving our understanding of challenges common to many boards and has helped us improve/revise views and practices around board member training in annual ND events, their recruitment to address board talent gaps, the general importance of the EBRD ND role as a vehicle for transition and value creation, and in highlighting the EBRD's need to better manage this resource as an institution.