

**SPECIAL STUDY**

# **Supply Chains and Backward Linkages**

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**EBRD EVALUATION DEPARTMENT**



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for Reconstruction and Development



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## Abbreviations

EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction & Development
ETC	Early transition countries
EU	European Union
EvD	The EBRD's Evaluation department
GAP	Good Agricultural Practices set by the Food and Agriculture Organisation
HACCP	Hazard Analysis Critical Control Point
IFS	International financial standards
ISO	International Standards Organisation
M&S	Manufacturing and services
R&D	Research and development
SCBL	Supply chains and backward linkages
SUV	Sports utility vehicle

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## Executive summary

Bank projects often target transition impact by “extending markets” through direct or indirect positive effects on supply chains and backward linkages (SCBL). Where this is done it is generally the main or even sole expected source of transition impact. This evaluation examines a representative sub-set of projects where this has been done, assessing how and in what circumstances SCBL elements are integrated into project design and the performance observed against the SCBL objectives as stated. It finds significant shortcomings in key aspects of the Bank’s approach and application, and it recommends a number of specific measures to strengthen both.

The evaluation began with a desk review of over 100 projects across various sectors, which confirmed that SCBL objectives appear most frequently, indeed almost exclusively, in food retail and automotive projects. The evaluation therefore focuses specifically on the SCBL elements in a sample of 16 projects in these sub-sectors in 9 countries; 8 of these are examined more in-depth as case studies. Thus the observations and ratings presented here relate to SCBL dimensions only; a full evaluation of project performance against all operational and transition objectives could well yield different ratings.

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## Main findings

- **Overall strategy:** The Bank lacks a clearly articulated strategy on how to approach SCBL systematically. There is neither a broad conceptual framework nor specific guidelines against which to assess and structure SCBL-related components at the project level, and to implement and monitor those included.
- **Presence in sector and country strategies:** Treatment of SCBL issues across sector and country strategies is inconsistent; only the agribusiness sector strategy mentions SCBL, and then in only general terms; several country strategies make only passing reference to supply chain issues.
- **Objectives:** Where SCBL related objectives appear they are heavily concentrated and narrowly drawn: concentrated almost exclusively in agribusiness (85 per cent of projects) and manufacturing and services projects (70 per cent of projects); narrowly drawn in being limited almost exclusively to quantitative benchmarks targeting only the number or share of local suppliers; qualitative benchmarks tended to be poorly defined.
- **Project design:** Commonly found project design issues include: uneven and often insufficient analysis of sector conditions; weak or absent discussion of causal links between SCBL-related

benchmarks and project activities; this sometimes coupled with unrealistic expectations for SCBL effects given the structural and business realities or relationships with suppliers; and, imprecise baseline data.

- **Demonstrated effects:** The flow of relevant and useful data on SCBL effects was insufficient in all but a few cases, often reflecting lack of client awareness of the objectives set for their projects, absence of adequate recordkeeping, and lack of assigned responsibility for monitoring and reporting.

### Agribusiness - food retail

- **Behavioural or qualitative changes:** Except for one case, there was little evidence that projects prompted behavioural or qualitative changes among local suppliers. The large supermarket chains, usually financed by the Bank, work mainly with large, already well-established local suppliers. These tend to be few and they had usually been working with the client before the project.
- **Local supplier training:** Supermarkets were generally not enthusiastic about providing structured training to local suppliers – as a project component – because their relationships tend to be short-term and transactional. Provision of ad hoc advice and periodic audits were preferred and were effective.
- **Supplier consolidation:** Supermarket chain expansion projects can strengthen their negotiating power relative to suppliers, which can produce supplier consolidation rather than expansion.
- **Poor infrastructure:** Especially in less advanced countries, poor infrastructure was viewed as a main hurdle to more procurement from local suppliers (for example they needed better storage, or adequate road infrastructure). However infrastructure considerations rarely figured in project design or analysis.

### Manufacturing and services - automotive

- **Transfer of research and development (R&D):** While references to “R&D transfer” were often-cited SCBL components, little genuine such transfer is observed. However in some cases, advanced process engineering was transferred.
- **Quality issues:** Vehicle producers and their higher tier suppliers generally meet high quality standards; therefore, purely quantitative targets for local supplier participation may also capture key quality issues.
- **Sourcing own suppliers:** Appearance parts producers had very little flexibility in sourcing their own suppliers as most were designated by their original equipment manufacturer clients and many were foreign-owned.

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## **Recommendations**

1. Produce clear operational guidelines on how to identify, structure, implement and monitor the effectiveness of SCBL components where they are intended to contribute to the performance of specific Bank projects. Guidelines should clearly set out all necessary process and accountability issues.
2. Projects targeting SCBL effects as transition drivers should include these specifically in their results framework, clearly identifying appropriate and measurable outcome objectives, baseline data and interim benchmarks, and setting out how effective monitoring will be accomplished.
3. When sector and country strategies identify SCBL-related transition issues and opportunities as a justification for Bank operations, these should be incorporated clearly into their results frameworks and reasonable clarity provided as to the expected focus of operational efforts to address them.
4. Responsibilities for implementation of specific actions related to SCBL objectives, along with monitoring, data collection and reporting, and any related resource requirements should be explicitly agreed and captured in the project's legal or other documentation.

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# 1. Introduction

## 1.1 Purpose

This report evaluates the performance of a selected group of Bank projects with respect to their directly intended or implied effects on supply chains and backward linkages (SCBL). This impact, reaching beyond the EBRD's client-borrower, has often featured as a key transition objective of projects in the agribusiness and manufacturing & services (M&S) sectors. In some projects it constituted the only expected transition impact – the main reason for the Bank to provide finance.

The objective of this thematic evaluation is to assess the extent to which the expectations of a positive impact on suppliers and other entities cooperating with the Bank's client, as articulated at project approval, have been fulfilled and tries to identify other backward linkages-related impacts of the Bank's projects on the relevant sector or wider economy. The evaluation reviews both qualitative and quantitative impacts on suppliers, highlighting the channels or processes through which third party local suppliers benefited from Bank projects.

## 1.2 Evaluation questions

To fulfil the study objective, this report strives to broadly answer the following evaluation questions:

- 1. Was ex-ante specification of the SCBL-related objectives and benchmarks adequate?**
- 2. What were the SCBL-related results (as measured at the client level)?**
- 3. What were the results at the supplier level (particularly in terms of qualitative/behavioural change)?**
- 4. Can any SCBL-related impacts be identified at the wider sector/economy level?**

## 1.3 Methodology

In the first phase of the study, the evaluation team conducted analysis of the conceptual and strategic background which guided the inclusion of SCBL objectives in the Bank's projects, and a desk review of over 100 projects to identify the most common SCBL-related objectives and assess the quality of their ex-ante specifications. Also 10 country strategies were reviewed.

To provide greater depth of analysis, the evaluation then focused on two sub-sectors, one from each agribusiness and M&S – food retail (supermarkets) and automotive (vehicles and vehicle's parts production) respectively. These were chosen because their projects included SCBL-objectives far more frequently than in other sub-sectors

and often they were the only source of transition impact. Both sub-sectors have been very important for the Bank, with nearly €1 billion of financing being signed in each of them during the last five years.

To assess SCBL-results, eight case studies of projects (covering nine operations) with particularly strong supply chain and backward linkages enhancement objectives were selected and examined in detail, including surveys of and interviews with the clients and key suppliers.<sup>1</sup>

To increase the study sample, the SCBL-related performance of seven projects from the two focus sub-sectors, which have been evaluated by EvD in the last five years, has also been included within the scope of the in-depth evaluation.

In total, the combined in-depth evaluated sample included 16 projects and accounted for 40 per cent and 38 per cent of the total number of projects signed by the Bank in food retail and automotive sub-sectors respectively in the five years from 2010 to 2014.

## 1.4 Limitations

An evaluation of this nature has some limitations. The main challenge was to ensure the cooperation and openness of the suppliers. They do not have a relationship with the Bank, while the Bank's clients' have also been their clients. Also the sample of any particular client's suppliers has been relatively limited. Given the time-frame of the study, it was not practical to interview more than 4 to 5 agribusiness suppliers during each visit, while each client typically works with hundreds of suppliers. Organising meetings with automotive suppliers proved to be even more difficult as it turned out that the Bank's clients had only a very limited number of local suppliers. The main concern was whether the suppliers would be willing to discuss their business openly with the evaluation team, particularly to make any critical comments about their relations with the Bank's clients. However, following the interviews, the evaluation team believes that suppliers and others consulted were open and frank, and that data and opinions gathered can be considered trustworthy.

The sample of the case study projects included very diverse projects in countries at very different transition stages (such as Slovenia and Kazakhstan). Trying to derive conclusions common to both focus sectors and provide universally applicable recommendations was challenging as it is recognised that these sectors have important differences.

Moreover, attributing changes in the wider economy to the Bank's financing/projects, which often had narrow objectives, was difficult. This was exacerbated by generally poor definition of expected results in evaluable terms.

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<sup>1</sup> In addition, the proposed case studies were discussed with the banking teams and their suggestions were generally followed. Care was taken to diversify countries and regions of case study projects. Finally, EvD followed the recommendations in respect of some of the case study projects provided by Management in their comments to the Approach Paper. Copies of all surveys received from clients and selected suppliers are kept on the study's file and are available for review by interested parties.

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## Focus only on issues related to supply chains and backward linkages

It needs to be stressed that this evaluation (and the resulting performance ratings) *seeks to isolate and focuses only on SCBL-related issues and effects*. It does not cover the projects' overall transition impact and other transition objectives that may be present. Were these projects to be evaluated against the full range of their objectives – operational and otherwise – final ratings could very well be different.

## 1.5 Report structure

Chapter two provides a brief conceptual and strategic background to this evaluation. It also identifies the most common SCBL-related objectives in the Bank projects and assesses their design quality, the ex-ante specifications of SCBL-related objectives and their monitoring.

Chapter three presents the SCBL-related results of the Bank's projects measured at client level,

Chapter four discusses the results identified at supplier level.

Chapter five presents SCBL-related results which could be detected at the wider economy level.

Chapter six provides overall conclusions, key findings and recommendations.

Each of the case study projects was rated for realised as well as potential SCBL-related impact. This is because most of the case studies relate to on-going projects and although most of them have made only a modest impact on local SCBL to date, some clients had genuine and well-defined intentions to increase local sourcing in the near future. SCBL-related impact was rated using the four-grade system of the new evaluation methodology, that is: *excellent; fully satisfactory; partly unsatisfactory; and unsatisfactory*.

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## 2. Conceptual and strategic background

### 2.1 Supply chains and backward linkages as part of the transition impact concept

#### Part of market expansion

The transition impact set out by the Bank provides the conceptual underpinning for inclusion of SCBL as a source of transition impact. It is considered specifically as part of the *market expansion* category, which is one of seven<sup>2</sup> attributes applied by the Bank to assess a project's transition impact potential:

*“Expansion of markets: A project can help expand access to market services or put relationships in other markets on a more competitive basis, through interactions of the project entity with suppliers and clients, or project contributions to the integration of economic activities into the national or international economy. Examples include development of input suppliers; expanding client access to finance, enhancing distribution networks; trade integration; cross-border infrastructure investments, and foreign direct investment/ mergers and acquisitions among transition economy firms.”*

This definition implies that to be considered a contributor to transition, a supply chain effect should have not only quantitative but also a *qualitative* dimension, for example improve efficiency or competitiveness, reducing existing supply chains barriers or improving supply chain structure or functioning. Therefore a case where increased industrial production capacity or expanded network of supermarkets results in a greater volume of inputs or a higher number of suppliers should not therefore automatically fall under this category, even if it brings other positive results from a socio-economic perspective (job creation, economic growth).

Such an interpretation of SCBL-related impact is made even more explicit in the “Transition Impact Analysis” checklist, used by the Bank’s Office of the Chief Economist to rate the transition impact potential of proposed projects. Its “Markets Expansion - Changes at Project/Corporate Level” section contains the following questions:

“(a) To what extent does the project change the market behaviour of local suppliers of inputs (backward linkages)?

(b) To what extent does the project change the market behaviour of downstream marketing and/or processing activities of customers (forward linkages)?

*Main items:* Increase or consolidate competitive behaviour through:

- The project entity’s interactions with suppliers and clients
- Project contribution to the integration of economic activities into the national, regional or international economy, in particular by lowering the cost of transactions.

This methodology clearly concentrates on measuring changes to the market *behaviour* of local suppliers (or customers, in the case of forward linkages), to be brought about by the project, while disregarding any quantitative change (volume or number of suppliers/customers).

This understanding of SCBL-related transition impact is also implicit in the Bank’s Agribusiness sector strategy, which alongside the M&S sector accounted for almost all projects with SCBL objectives:

*“[...] significant challenges remain in promoting market linkages to primary production in order to create incentives to upgrade quality and hygiene standards. Low capacity and expertise of processors and the packaging industry represent a significant bottleneck in the food supply chain between primary production and food distributors across the Region. [...] Agro-processors face the challenge of upgrading their own standards and translating the standards required by modern distributors back towards primary producers [...] further development would raise sectoral standards by promoting backward and forward linkages. [...] the Bank will continue to support improvements in and upgrading of effective and qualitative production processes and integration of activities along the production supply chain, leading to improvements in productivity.”*

These quotes also point to additional expectations from the enhancement of supply chains in the sector, such as the dispersion of standards, good practices and skills along the vertical links. This objective, while important, does not really focus on the structure or expansion of markets but rather on the setting of standards for business conduct and/or transfer of skills and technology.

#### Skills transfer

Although “skills transfer” and “new standards for business conduct” are classified as a different type of transition impact attribute, in certain circumstances they may be seen as contributing to backward linkages. The Transition Impact Analysis checklist, mentioned above, contains the following question under “transition impact at the economy level”:

*“Skills Transfer: to what extent does the project contribute to significant upgrading of technical and managerial skills in the sector or the economy beyond the client company?”*

This concept clearly points to impact “beyond the client company”. However, the majority of skills transfer objectives set for Bank projects are directed towards improving skills at the client companies, while only a

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<sup>2</sup> The seven attributes used by the Office of the Chief Economist to assess transition impact of Bank projects are: competition, market expansion, private ownership, framework for markets, skills transfer, demonstration effect, and new standards for business conduct.

small number of projects clearly target skills transfer to suppliers or other entities (see section 2.3).

Such “internal” skills transfer, (directed towards the client’s staff), is equally important, however in terms of transition impact categorisation it can be argued that it brings “lighter” or “semi-” SCBL impact at most because it benefits only the client, at least in the short-term. However, a case can be made that know-how obtained by a client’s employees as a result of a project, stays with these employees, rather than the company. The employees have freedom to move jobs and therefore benefit their subsequent employers, dispersing good standards and applying know-how obtained during training along the economic chain.

Nevertheless, activities falling into the “skills transfer” category do not really affect the structure or extent of the markets and therefore the resulting impacts have been treated in this review as secondary to those which affect third party entities – such as suppliers, research institutes and universities.

### Definition of a local supplier

The Bank had no universal definition of a “local supplier”. Based on discussions with the Office of the Chief Economist, such an entity was understood to be: *a company whose operations were based in the same country as the project and which was contractually obliged to provide production inputs or merchandise to the Bank’s client.* This definition was sometimes expanded to include companies whose operations were based in the Bank’s countries of operation. This was often the case with projects where the suppliers’ base in the project country alone was seen as limited (for example in the automotive sector in smaller countries). The definition generally included locally-owned and foreign-owned companies, however for some projects separate benchmarks were set for foreign-owned and locally-owned suppliers.

## 2.2 Supply chains and backward linkages in the Bank’s sector and country strategies

### Agribusiness strategy

SCBL are highlighted as an important feature of the Bank’s activities in only one of the Bank’s sector strategies – agribusiness, where it is prominent from the beginning. In the executive summary, the agribusiness strategy stipulates that:

“The Bank’s investments [in the agribusiness sector] target the development of local supply chains to increase efficient production”.

and

“Through selective investments in efficient retail, distribution and food processing activities, the Bank has not only contributed to diversity in local food supply, but has also created important

backward linkages towards agricultural and ancillary products and services, thereby exerting a multiplier effect on several segments of the value chain.”

In total, the agribusiness strategy makes 13 references to SCBL, mainly in respect of food retail and primary agriculture. Importantly, SCBL are also mentioned under the Strategic Objectives and Priorities section, in reference to Food Security, where it stipulates that the Bank intends to target primary agriculture, including commodity traders “*whose buying activities create backward linkages to the local farmers*”.

Interestingly, the annex “Selected Lessons from Agribusiness Evaluations 1996 to 2009” contains the following lesson:

“Enhancing backward linkages in the Agribusiness sector cannot be left to the sponsors alone and should in selected projects be supported by technical cooperation funding and other operations by the Bank.”

This evaluation demonstrates the continued relevance of this lesson (and the fact that it has not yet been fully learned) and therefore it includes it among its findings and recommendations.

Although the agribusiness strategy refers to SCBL relatively frequently, it is short on specifics and does not offer any explanation (even in general terms) of the actions or channels through which the Bank’s agribusiness projects will impact on local suppliers.

### Manufacturing and services

The Bank does not have an M&S sector strategy as “manufacturing and services” covers many different sub-sectors and therefore it was deemed impractical to adopt one unified strategy, although elements of M&S sector strategy have been incorporated into the Knowledge Economy Initiative and Small Business Initiative strategies.

### Country strategies

The evaluation team also reviewed ten<sup>3</sup> of the Bank’s country strategies and identified references to SCBL in seven of them – Ukraine, Turkey and Russia (2), Poland, Croatia, Serbia and Georgia (1). These references were made primarily in relation to Bank’s planned operations in agribusiness or small and medium size enterprise development. The importance of integrating local businesses into global supply chains was also stressed by several strategies. Some examples:

**Ukraine:** Ukraine’s strategy listed the country’s “*deeper integration into global production and supply chains*”, as one of the Bank’s strategic priorities. It also stipulated (under its agribusiness section) that “*there is potential in future for sustainability initiatives related to supply chains*”.

**Turkey:** Similarly, Turkey’s strategy pointed to the existence of “*a great potential for medium-sized companies for further integration into global supply*”

<sup>3</sup> Country strategies reviewed: Kazakhstan, Romania, Ukraine, Croatia, Poland, Turkey, Russia, Slovak Republic, Georgia, Serbia.

chains” (the same sentence appears twice) It is noted however that in both Turkey’s and Ukraine’s strategies, the references to SCBL are outward-looking, while the Bank’s SCBL concept is internal one.

**Russia:** Russia’s strategy refers to SCBL in the context of “Core Operational Objectives”. One of them stipulates: “Support agribusiness [...] by projects that [...] set higher standards in the food supply chain”. In its Environmental section the strategy states that “In agribusiness projects, clients are required to [...] increase potential for supply chain sustainability”.

**Others:** The strategies for Serbia and Croatia mention improvement of and finance for supply chains as factors impacting small and medium size enterprises development in these countries, while the strategy for Georgia states that “the Bank will support the agricultural sector by developing the local supply chains”.

In conclusion, forging SCBL to the local economy by the Bank’s projects was mentioned in the country strategies only in passing (typically limited to one sentence). It usually appeared in the context of the Bank’s planned activities in the agribusiness sector but it was formulated in very general terms. The importance of integrating local businesses into global supply chains was also highlighted in several country strategies. However none of the country strategies provided more meaningful analysis or discussion of SCBL-related issues.

## 2.3 Sources of transition related to supply chains and backward linkages

Backward linkages to the local economy have stemmed from nearly all of the Bank’s projects, for example through construction contracts, for which local firms were well placed to compete, or through consultancy, transportation and other services related to project execution.

### Sustainability of linkages to local economy

However, to qualify as contributing to the “extension of markets”, linkages to the local economy should be sustainable in nature, that is, a project should create the potential for a regular relationship with local suppliers, which could translate into behavioural changes. Ideally (but not necessarily) a project should have the potential to create a “chain reaction”, that is, to reach further up

the supply chain to create a wider effect on different categories of local suppliers (such as farmers/raw materials producers, primary processors, secondary processors).

A review of a sample of 100 Bank projects from all sectors, signed in recent years, confirmed that SCBL objectives targeting the enhancement of regular relations with local suppliers were set almost exclusively in agribusiness and M&S sector projects.

Projects in other sectors very occasionally targeted “skills transfer” as a transition objective, which was usually related to know-how transfer or training of local staff. As explained in section 2.1, such objectives were important but their potential impact on strengthening SCBL could only be viewed as secondary and highly hypothetical.

SCBL-related objectives were identified in recently implemented projects in sectors other than agribusiness or M&S, including property and tourism, natural resources, transport and financial institutions sectors.

All of these objectives were related to training local staff (usually the client’s) and therefore their potential to strengthen backward linkages to wider economy was limited. No SCBL-related objectives were identified in projects reviewed from any other Bank sectors. This was not surprising as projects outside of the corporate sector usually target many other transition objectives, while an increase of local supplies or content was not of critical importance for these sectors.

The situation was different in the corporate sectors, particularly in agribusiness and M&S, where SCBL were often central to transition impact, which was critical to qualify the project for the Bank’s financing. Although SCBL were usually only a part of a larger “transition story”, uniquely in the food retail and automotive sub-sectors, SCBL sometimes constituted a project’s only transition impact

The case study projects for this study were purposefully selected for the importance of their SCBL-related objectives. However a review of a larger random sample of agribusiness and M&S projects (20 from each sector) implemented in recent years, indicated that 85 per cent of agribusiness and 70 per cent of M&S projects reviewed had one or more SCBL-related objectives. The table below illustrates the occurrence of the most common types of SCBL-related benchmarks in agribusiness and M&S projects.

Table 1: Occurrence of most common supply chain and backward linkage benchmarks in projects reviewed

Type of SCBL benchmark	Agribusiness	M&S
Number of local suppliers or value/share of local supplies in total production/sales	70%	40%
Training of suppliers/farmers/customers (skill transfer to external beneficiaries)	40%	10%
Training of staff, know-how transfer, R&D development, number of new hires/interns, cooperation with local universities (skill transfer to internal beneficiaries)	20%	45%
Increase in local suppliers complying with certain standards (such as GAP, HACCP, ISO)	15%	15%
Development of new market segment	5%	20%
Location of suppliers	0%	25%
Pre-financing of suppliers/farmers	10%	0%

Table 1 illustrates the prevalence of the “number or volume of suppliers/supplies” set as an SCBL-related objective in agribusiness projects, followed by training of suppliers/farmers as a distant second. “Training of staff and know-how transfer” accounted for 20 per cent, while the “increase in local suppliers complying with quality standards” occurred in only 15 per cent of the projects reviewed. Moreover, only 10 per cent set “pre-financing of suppliers/farmers” as an objective. The SCBL-related objectives were more evenly spread among the M&S projects, with “Training of local staff, know-how transfer, R&D development, increase of local hires/interns or cooperation with local universities” cited in nearly half of them. However, this objective was usually accompanied by one or more other SCBL benchmarks.

This analysis shows that the SCBL-related benchmarks most frequently set in the Bank’s projects offered quantitative targets to measure SCBL impact (such as number of new local suppliers, staff trained, new hires). Occasionally, transition targets formulated in this way were accompanied by a description of the qualitative aspects of a given target, such as specification of training, or even better, targeting a number of suppliers who were to comply with specified quality standards.

A specific case was represented by projects in the M&S sector (mainly automotive industry), where the objective of localising suppliers was expected ultimately to drive development of more sophisticated technological manufacturing and research and development in the country.

In conclusion, there has been a variety of SCBL-related transition sources in the Bank’s corporate projects. This variety underpins the need for substantial clarity at the project design/approval stage as to specific expectations for the channels through which SCBL effects are expected to occur; and from this to a plausible set of associated

benchmarks and targets, as well as a monitoring and reporting plan capable of providing useful feedback.

## 2.4 Ex-ante specification of supply chain and backward linkage objectives in case study projects

Setting SCBL-related transition benchmarks has been challenging because the expected changes were to take place not at the Bank’s client level but at the level of its clients’ suppliers, where data and monitoring capacity was much more limited. Nevertheless, understanding the structural or behavioural changes expected/accomplished at supplier level necessarily requires the corresponding information to be collected during transition impact monitoring.

Probably due to this fact a substantial proportion of SCBL-related benchmarks in the projects reviewed (38 per cent on average in food retail and 44 per cent in automotive) used mainly quantitative benchmarks to measure SCBL impact. The mix-type benchmarks, which contained some description of their qualitative aspects, while setting a quantitative target, were also relatively frequent (44 per cent in food retail and 38 per cent in automotive). This could signal a positive trend as such benchmarks are most desirable. However, the definition of their qualitative features was usually poor, very limited and too general to effectively measure the impact – in other words, not evaluable. Table 2 analyses the structure of SCBL-related benchmarks in the case study and earlier evaluated projects from the two focus sub-sectors.

Table 2: Types of supply chain and backward linkage related benchmarks in sample projects

Project	Total transition impact benchmarks	SCBL-related benchmarks (% in total benchmarks)	Mainly quantitative type benchmarks (SCBL-related)	Mainly qualitative type benchmarks (SCBL-related)	Mixed benchmarks
<b>Food retail</b>					
A	7	3 (42%)	2	1	0
B	9	4 (44%)	0	1	3
C	4	4 (100%)	2	0	2
D	7	6 (85%)	4	0	2
E	10	5 (50%)	1	0	4
F	5	3 (60%)	2	1	0
G	5	4 (80%)	3	0	1
H	10	7 (70%)	3	3	1
I	15	9 (60%)	0	2	7
<i>Average</i>		<b>5 (71%)</b>	<b>1.9 (38%)</b>	<b>0.9 (18%)</b>	<b>2.2 (44%)</b>
<b>Automotive</b>					
J	10	7 (70%)	5	0	2
K	6	6 (100%)	4	0	2
L	5	5 (100%)	5	0	0
M	20	10 (50%)	0	4	6
N	6	5 (83%)	2	0	3
O	4	4 (100%)	2	2	0
P	7	7 (100%)	1	2	4
<i>Average</i>		<b>6.2 (86%)</b>	<b>2.7 (44%)</b>	<b>1.1 (17%)</b>	<b>2.4 (38%)</b>

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Large prevalence of SCBL-related benchmarks in food retail and automotive sub-sectors projects (70 to 85 per cent) illustrates the importance of developing proper guidelines for analysing and designing SCBL-benchmarks and components.

Only projects D and E offered several benchmarks, which were better suited to measure SCBL-related impact. They referred to specific quality standards and set a target of the client's suppliers share/number who were expected to introduce them. For example:

“20 percent of the local suppliers shall have implemented high-quality standards (HACCP), compared with 5 percent currently” (project D).

Also three out of project E's five benchmarks targeted an increased share of the client's suppliers who would introduce specific quality standards (ISO, IFS, HACCP). Similarly, the B project made a good effort in setting a more outcome-oriented (although not particularly ambitious) SCBL-related benchmark: *“increase the number of suppliers complying with GAP standard from three to five”*.

Nevertheless, most SCBL-related benchmarks were relatively weak, such as - training of X suppliers in certain aspects of standards, management, processing, and so forth, rather than X suppliers *implementing* certain standards, management methods for example.

Almost all case study projects (with the exception of project B and project M) set an increase of local supplier numbers or volume of local supplies as a benchmark. According to the Office of the Chief Economist, this was due to the assumption that high standards required by foreign clients, would force local suppliers to also attain them, therefore setting just numerical targets was sufficient.

Based on the review of the case studies, the evaluation team believes that this assumption might still be applicable to the automotive sector projects as foreign original equipment manufacturers or tier 1 suppliers indeed remain synonymous with extremely high quality standards in this innovation-driven, technologically advanced industry. For example, the benchmark calling for “at least one local supplier to be awarded a [top branded] supplier code” bore a strong qualitative meaning, as the top brand's supplier code has been viewed in the sector as a “quality standard” in itself, while it could be very difficult to capture and benchmark exact technological actions/changes suppliers would have to make to supply to the top brand. Moreover, in the opinion of the industry expert, most automotive manufacturers, active in today's extremely competitive market, strive to achieve quality excellence. This suggests that quantitative benchmarks for local supplier numbers or increased local content, set by the Bank in respect of other projects with leading vehicle manufacturers could also be considered acceptable.

## Food retail sector

The assumption about quantitative benchmarks alone being adequate has less applicability in the food retail sector, especially in more advanced countries, where foreign and local supermarkets (Bank clients or other than Bank clients), have been well established for many years and have been cooperating with most local suppliers, who in turn have been complying with high quality standards for a long time.

Purely quantitative, output-oriented benchmarks are generally considered insufficient to properly measure SCBL-related impact in most food retail projects (perhaps with the exception of leading brand supermarkets investing in early transition countries where large food quality/safety gaps still exist). This is not only because they cannot capture any qualitative changes in the market interactions, which are the actual objective expressed in the transition impact rationale, but also because on their own they do not reflect actual growth of the sector. Interviews with clients revealed that many supermarkets, expanding their regional networks (the primary reason for the Bank's financing), were often moving towards “supplier base consolidation”, that is, an actual reduction in the number of suppliers in order to cut transaction costs and simplify logistics. At the same time the volume of products or commodities supplied often grew or remained the same, pointing to an increased supply contract per individual supplier.

## Automotive industry

As mentioned, the characteristics of automotive sector suppliers differ substantially from those of food suppliers. In addition to the technological complexity of products supplied, the network of automotive suppliers has a truly global reach. Therefore in some automotive projects in smaller countries, “local suppliers” were sensibly defined as “suppliers from the Bank's countries of operations”, rather than those from the project country. In addition to targeting an increase in local content, some benchmarks called for outsourcing of quality testing to local universities. A fair number of benchmarks simply reflected national requirements for local content, that is, clients would have had to reach required local content with or without the Bank's financing or face high penalties. More meaningful and ambitious benchmark would aim to achieve local content beyond the legal minimum.

Some other SCBL-related benchmarks in the automotive projects were even less meaningful. For example, among one automotive company's 11 generally good benchmarks, one called for “the company to start interior manufacturing in [one country of operations]”. As the client had been manufacturing car interiors in the country for at least 10 years before the project, the benchmark was meaningless. Also, one of the benchmarks for a project with another automotive client called for “the EBRD to finance at least 2 local suppliers”. As noted in the project's validation of the self-assessment, such benchmarks should be avoided as they implicitly make

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the achievement dependent on the performance of the Bank rather than the client/project.

Skills-transfer objectives have usually been set and monitored in both sub-sectors at output level (“number of suppliers trained”), rather than outcome/impact, for example actual changes in management processes or compliance with international standards. Other benchmarks related to skills-transfer offered very little substance, for example one project benchmarks called for “organisation of annual suppliers’ open-days at the client’s distribution centre”. It did not explain how suppliers would benefit from such open days nor what changes they were expected to make as a result of the activity. Also the automotive projects had many weak benchmarks related to skills transfer, such as “increase the number of hours spent in the factory per university student from X to Y”. In such cases, a target number of students achieving certain professional/scientific qualifications or certifications, following their internship at the client’s factory, would have better captured the project’s impact, if indeed this was related to some input or conditionality provided by the project.

### Conclusions about quality of benchmarks

In summary, the quality of SCBL-related benchmarks in the sample projects was mixed. About one third of them were adequate, while the majority were solely quantitative (or quantitative with some poorly defined qualitative characteristics).

In general, the SCBL-related benchmarks should rely not only on the increasing numbers of local suppliers but should also contain an aspect of growing value added in the local supply chain to reflect the objective of increased quality standards, manufacturing sophistication or technological advancement for example, “X suppliers applying new standards/practices (following training provided by a client), rather than “X suppliers trained in the application of new standards/practices”. In short, outcome and impact-related benchmarks, reflecting behavioural changes among suppliers, (rather than those output-related) are more appropriate to measure SCBL impact.

In order to set appropriate benchmarks, a client’s industry dynamics and its strategy towards local suppliers need to be well understood, for example would they push for supplier base consolidation or expand their supplier base. Would they work with smaller suppliers or only medium to large ones? Through which specific channels is the impact on local suppliers expected to occur? To what extent are they bound in their procurement processes by their centralised or regional/headquarters’ policies? What is their view on supplier training? Would they be willing to organise structured training or would they provide ad hoc advice only? Do they have budget/staff/facilities for training? Answers to such questions could help design stronger and more plausible SCBL-related benchmarks.

## 2.5 Monitoring and implementation of SCBL related objectives

Several transition impact monitoring reports for the case study projects provided incorrect or imprecise information on the status of SCBL-related benchmarks. The most likely reason was that the information was often difficult to obtain. This was evident from the interviews the evaluation team conducted with client representatives, as many of them were only vaguely aware of SCBL-related objectives set for their projects by the Bank, particularly in the food retail sector. This might be an effect of high staff turnover (endemic among supermarkets) and individuals with whom the Bank discussed and agreed such objectives were no longer employed. Nevertheless, if the agreements had been deemed important, a well-functioning business would have ensured that appropriate information was passed on to the new managers. This underscores the weakness of just agreeing SCBL-related objectives with the client in principle rather than covenanting them. As both supermarkets and automotive clients operate under high competitive pressure, which in the Bank’s countries of operations increases year-by-year, “agreements in principle” were subsequently often forgotten or put off to be delivered in better times.

Gaps in the clients’ awareness of the SCBL-related objectives set by the Bank, may also indicate that the Bank expected them to be achieved “by themselves”, that is, through sheer regional expansion of a supermarket chain or an expansion of automotive production. This, however, was and is unlikely to happen and requires the Bank to work actively with the client.

In addition to poor awareness about SCBL-related objectives, some clients questioned the baseline data on local suppliers or market share, which the Bank presented in the Board reports and with which future growth of local supplier base was to be compared. For example, one client reported a substantially lower number of local suppliers at the time of the project approval (460 vs 690 cited in the Board report). Also two clients had some problems with reconciling historical data on local suppliers, presented in the Bank’s project approval documentation. However the correctness of such data was fundamental for tracking changes in clients’ relations with local suppliers and discrepancies made meaningful monitoring of SCBL-related quantitative benchmarks (already weak on their own) impossible.

The client interviews demonstrated that verifying SCBL-related data in food retail poses a serious challenge because:

- i) many supermarket chains’ databases do not differentiate between “local” and “foreign” suppliers;
- ii) the share of locally produced goods on offer changes seasonally, with high imports off-season and more local produce offered during the season;
- iii) most supermarkets have a large proportion of non-food products in their offer, most of which

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are imported, while their databases do not always differentiate between food and non-food products; and

- iv) a large proportion of foodstuff is purchased from local wholesalers, who have imported products in their offer, which are not always recognised as such by the supermarket's databases.

In contrast, information on different categories of suppliers was generally good among automotive clients (however on average, they had relatively few local suppliers to account for).

Nevertheless, gaps in information underscore the importance of clearly communicating to the client at an early stage of the project discussions, that the main reason for the Bank to provide finance is the expected positive impact on local suppliers. Therefore having precise data, meaningful benchmarks and an effective system of monitoring them is of critical importance for the Bank. To achieve this requires a number of undertakings from the client and the Bank. Firstly, the current state of the client's local supplier base, vs imports needs to be precisely established, while the gaps in working practices, safety or quality standards among local suppliers, which would be addressed by the project, need to be identified.

Furthermore, to ensure appropriate monitoring of SCBL-related benchmarks, the Bank should agree with a client

to create (or enhance) a database to enable tracking of local versus foreign supplies, as well as changes to qualitative aspects of local supplies. In some cases, a small technical cooperation funded project could be considered to assist the development of such a database.

The achievement of SCBL-related objectives requires not only monitoring but also active management by the Bank and the client. It rarely happens due to a supermarket merely increasing the number of its stores or expanding its production capacity. Therefore the Bank needs to agree an "SCBL-enhancement Action Plan" to be implemented, including milestones and channels through which the local suppliers are expected to benefit from the project. In some cases (early transition countries or other priority countries) a technical cooperation project should be considered to assist the client in implementing SCBL-related objectives.

## Conclusions

The most important point of this chapter is the need for, first, a good understanding of a sector dynamic and then for substantial clarity at the project design/approval stage as to specific expectations for the actions, activities and channels through which SCBL effects are expected to occur; and from this to a plausible set of associated benchmarks and targets, as well as a management and monitoring plan capable of providing useful feedback.

## 3. Client level results

### 3.1 Food retail

The Bank clients under all case study projects failed to expand their regional supermarket networks to the extent envisaged at approval. Table 3 summarises the completion status of these four projects.

Table 3: Completion status of food retail case study projects

Project	New stores planned	New stores built	Percentage completed vs planned
A	20	7	35%
B	19	7 (+ 5 under construction)	36% (63%)
C	8	3	37%
D	14	11	78%

Among previously evaluated projects, one project expanded as planned but failed to expand in one country, realising in total about half of the planned investments. Another client implemented about 40 per cent of its planned network expansion in one country of operations. Only two were on target.

The shortfall in the completion of the original investment plans was due in all cases to higher than expected competitive pressure in the food retail sector in all four countries. As organised food retail has been one of the fastest growing types of business in transition countries, the Bank clients found competition much stronger (even in regional cities) than that assessed by them or their consultants several years earlier, when the projects were prepared and financing approved. International competitors to many Bank clients moved before them, while local networks started growing quickly, offering a similar “shopping experience” to that of their international competitors, and often lower prices. “Supermarket wars”, aggressive pricing and discounting by competitors forced the Bank’s clients to put some (in most cases large) parts of their investment plans on hold. In addition, the financial crisis of 2008 to 2009 also influenced the client’s decisions to scale down their expansion programmes, which had often been prepared well before it arose.

Consequently, due to the reduced regional expansion programmes alone, the impact of the case study projects on local suppliers could not have been as strong as

expected at approval. This has been reflected in the achievement of quantitative benchmarks aimed at increasing local supplier participation. Due to imprecise data (as described in the previous chapter) it has been difficult to reconcile exact numbers. However clients for projects B and D both reported that the number of local suppliers currently contracted by them increased by about 10 per cent as compared to the pre-project numbers. The client for project B also reported that the share of local products in their offer increased in recent years to about 95 per cent in summer and 80 per cent in winter. This compared favourably with the 80 per cent local share (presumably annual average) reported in the EBRD’s Board report and indicates that although project B’s client missed the benchmark of a 15 per cent increase in the number of local suppliers, their absolute number and their share in its merchandise grew. Also project D’s client reported the increase of locally produced goods in their total sales which constituted the achievement of the benchmark. The impact of both projects was stronger in the fresh (or “super fresh”) food categories (bread, milk, meat), as could be expected, where the share of locally produced goods increased by about 20 to 40 per cent, while in the fresh fruits and vegetables category it grew as much as 150 per cent in the client for project B’s case.

Among previously evaluated/validated projects, two projects aimed to increase the number of local suppliers or locally produced goods in the client’s offer. Both clients reported meeting their benchmarks (45 per cent local products share in one and procurement from at least 200 local suppliers by the other).

As “private label” goods are usually cheaper, non-branded food products and therefore often produced locally, the Bank used the increase in their sales as a proxy to measure the increase in local supplier participation in some projects. In two cases this share increased, ensuring their benchmarks have been met (although it was only an estimate in the former, while the increase was very modest in the latter). In the case of one client, the share of private label goods sold actually decreased slightly and at 3.6 per cent it was well below the benchmark of 20 per cent. Also three projects had transition impact benchmarks aimed at increasing private label products in the clients’ total offer and at the time of EVD validation none of these benchmarks had been achieved. Table 4 summarises the performance of the case study projects against key SCBL-related quantitative benchmarks.

Table 4: Case study project performance against quantitative benchmarks

Project Benchmark	A		B		C		D	
	Target/baseline	Actual	Target/baseline	Actual	Target/baseline	Actual	Target/baseline	Actual
Increase in the share/ number of local suppliers	by 15%	10% 95%	n/a	n/a	n/a (about 200)	About 200	n/a (1340 in 2011)	About 2000 (10% annual growth)
Share of local food sold	n/a (80%)	(summer) 80% (winter)	n/a (65-68%)	65-68%	>40% (from 30%)	25-35%	> 90% (from 80%)	93%
Share of private label food sold	n/a	n/a	n/a (20% estimate)	25% estimate	>20%	3,6%	>3%	3.7%

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The main reason for the relatively modest impact of the projects on local suppliers, even in quantitative terms, were the trends in supermarket industry operations which had started to prevail at the beginning of the century, first in the Bank's more advanced countries of operations, and then also in others, namely:<sup>4</sup>

- Centralisation of food procurement and distribution;
- Large-scale (cross-border) regionalisation of procurement of certain food categories;
- Shift from the use of traditional (general) wholesalers to specialised wholesalers;
- Shift from the use of spot markets to the use of preferred supplier systems.

**Centralisation of food procurement and distribution** – many supermarket chains invested in large distribution centres, which procure merchandise products for their whole network of stores in a given country. The suppliers were expected to deliver their products to the distribution centres and the products were then distributed among the network stores by the supermarket. Centralisation allowed for substantial reduction of costs (estimated at 30 to 40 per cent) by reducing coordination costs and exercising economies of scale. Centralisation occurs fastest in relation to processed foods categories. Some supermarket chains left some degree of freedom to local store managers to procure “super-fresh products” (bread, milk, meat, fresh fruits and vegetables) directly. Due to the large distances between the capital and the regional stores, centralisation has been less pronounced in one client's procurement, giving regional managers relative freedom to buy directly from local suppliers (however prices have to be approved by the central office). Another client is now considering the introduction of a similar approach in its operations.

**Large-scale (cross-border) regionalisation of procurement of certain food categories** was an extension of above-described centralisation to an international, often pan-European level. It has been increasingly occurring in Central Europe, where the headquarter-based distribution centre conducts procurement for all its stores located in different countries. This has enabled the negotiation of even larger volumes and discounts. For obvious reasons, it was limited to processed, non- or slowly-perishable food categories. Nevertheless, it meant that local producers of such goods competed internationally and only the largest and the most efficient of them were able to secure contracts with supermarkets operating this way. This approach has been most common in the smaller countries. However, long distances do not seem to prevent this approach, as it has also been practised to

some extent by a client in one larger country in respect of procurement and supplies to a neighbouring country.

**Shift from the use of traditional (general) wholesalers to specialised wholesalers** – in many of the Bank's countries of operations the role of a wholesaler has evolved from being general (dealing with all food categories) to one specialising in a specific food category (for example fruits or meats) and/or dedicated to a given kind of client (for example supermarkets or exporters). Such wholesalers have a profound knowledge of their product markets, dealt in large volumes and are therefore able to offer best prices and short delivery periods, and supermarkets work increasingly with these specialised wholesalers. This has impacted local suppliers by limiting their opportunities to work with supermarkets directly, while having to compete globally if they want to work with the specialised wholesalers. The Bank's clients have been working with both general and specialised wholesalers, as well as directly with some producers. However they all confirmed a gradual shift of business towards specialised wholesalers.

**Shift from the use of spot markets to the use of preferred supplier systems** – which are lists of farmers and processors, with which a specialised wholesaler, acting on behalf of a supermarket, has a direct long-term contract for product supply. This approach has been common, for instance, in the fruit and vegetable category, and in dairy products in one country. On the one hand, the approach is attractive to suppliers as it reduces their risks and enables them to make long term plans and invest in new equipment, increasing the quality and safety of their products. On the other hand, it is difficult for new producers to get “on the list”. Additionally, farm-level production of fresh fruits and vegetables is the risky end of the business as it is subject to climatic conditions that can cause substantial losses. This favours the development of a few larger suppliers that can withstand such shocks, have diversified production across more than one region and/or grow in climate-controlled conditions (under glass or plastic).

Most Bank clients confirmed that they clearly favour larger, well-established suppliers, who are able to deliver large volumes of high quality products at the lowest possible price. As the number of these large local suppliers in each country is relatively limited, the Bank's clients had usually worked with them already, well before the Bank-financed expansion projects. “Super-fresh” food category suppliers are often an exception to this pattern and therefore it has been mainly them, which have benefited from Bank-financed projects. This was positive, although this category represented lower value-added food, which accounted for a relatively small proportion of client revenues, thus most benchmarks targeting an increased “share of the local food sold” were missed.

Client A mentioned that doing business with smaller food producers and processors was difficult as they were often unable to make timely deliveries and had problems when some of their products were rejected following quality inspection. In contrast, Client D stated that they have been open to working with smaller, local producers. They required training and coaching, but have been generally

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<sup>4</sup> These trends were identified (among others) in the “Central and Eastern Europe - Impact of Food Retail Investments on the Food Chain” (co-published by FAO Investment Centre and EBRD Cooperation Programme in 2004). Their impact was discussed and confirmed during the interviews with most of the case study clients.

loyal to the supermarket which helped them at an early stage (this has been confirmed during interviews with some suppliers, see the following section). Client D also thought that their products were often fresher and cheaper than those provided by larger suppliers. The specificity of the country of operation, with its large distances and challenging logistics (including high levels of traffic in larger cities), certainly played a role in the client's more flexible and accommodating approach. Also Client B mentioned that they have been open to working with smaller producers as the number of large producers was very limited in its country of operation. Nevertheless, the supermarkets' strong bias towards large producers indicates that one of the challenges in the Bank's food retail projects is to make them more inclusive of smaller farmers and producers, so that the Bank's financing has a broader impact. This could be achieved, for example, by encouraging the Bank's prospective clients to include an offer of organically-grown produce in the new stores to be financed by the Bank.

### Knowledge transfer to local suppliers

In addition to increasing local supplier numbers or the share of locally produced goods in the client's offer, all case study projects had objectives related to the transfer of knowledge to local suppliers. This was to take various forms, ranging from specialised workshops, to "suppliers' open days". As mentioned in a previous section, most of these objectives were set in terms of outputs (number of participating suppliers), rather than outcomes or impacts, therefore it has been difficult to fully assess their impact. Nevertheless, it is clear that two projects – Clients A and C failed to deliver in this respect. Client A did not organise any supplier's open days due to "lack of time resulting from the demands of its daily business". It has also failed to deliver a "fully-fledged assistance programme for its suppliers", as its Board report stipulated it would. Similarly, Client C also put aside any plans to introduce the traders' support programme, as well as to "train 80 percent of its suppliers", due to the dire situation of its finances, market pressure and internal restructuring. However, Client C did cooperate with the International Finance Corporation (IFC) on one pilot workshop on food packaging, labelling and quality standards, which benefited 10 of its suppliers. It reported that the results of this workshop were encouraging, however there was no follow up on it, and the number of participants was too small to justify any claim of a substantial impact on supplier practices in the country.

All four benchmarks in Project B were related to knowledge transfer and all were largely achieved. However, it is noted that two workshops (due since 2013) were organised only recently, after the evaluation team's visit, and attracted lower participation than the (already modest) numbers planned, that is, the workshop on Global GAP was to attract at least 10 suppliers, however only five of them participated. The workshop on the Global Reporting Initiative came closer to achieving its quantitative benchmark of training five suppliers as four of them took part. Due to such a limited participation both workshops can be seen only as "pilots" and indeed Client B stated that it plans to organise additional Global GAP and Global Reporting Initiative workshops in 2016.

Moreover, the project had one benchmark, which was a relatively good mix of qualitative and quantitative aspects – the increase of suppliers complying with Global GAP from current three to five, presumably to result from the GAP workshop. Although the workshop happened only recently, already during the interview the client reported that the number of GAP compliant suppliers has reached 19. This indicates nearly four-fold overachievement of the benchmark; however the attribution of this achievement to the project is difficult as no specific activities by Client B or the Bank leading to this result have been identified.

Client D has clearly been the most systematic of all case study clients in pursuing knowledge transfer to its suppliers. Two of Project D's five benchmarks and five of Project E's aimed at increasing their suppliers' knowledge, training or compliance with quality and safety standards. There has been evidence that the client conducted structured training for its suppliers in the framework of its training academy, particularly for those in a "high risk" category (milk, dairy, meat, fresh fruits and vegetables). The training covered product packaging, labelling and quality standards. About 25 per cent of its suppliers were trained (nearly all of those in the high risk category). Two of the benchmarks called for the client's suppliers to achieve HACCP standards (20 per cent under Project D and 100 per cent under Project E). By the time of the evaluation team's visit the client reported 95 per cent compliance with HACCP among its suppliers. However, it confirmed that this result was most likely only partially due to its own actions, as following the EAEU's (Eurasian Economic Union) directive all food producers in one country of operations were legally obliged to comply with HACCP by the end of 2013.<sup>5</sup> An exception was made for meat and fish suppliers who were granted a two year postponement in HACCP implementation (that is, they were required to comply by the end of 2015). The benchmarks related to ISO and IFS standards compliance were due only in 2017 and the client reported progressive work with many of its suppliers to ensure their achievement.

### Knowledge transfer – supermarkets to local suppliers

The results related to knowledge transfer from supermarkets to local suppliers were also mixed among previously evaluated/validated projects. One client reportedly organised suppliers' open days as agreed with the Bank, although it is unknown what impact they had (if any) on suppliers. Two other clients hired dedicated food technologists to work with suppliers on increasing their food quality and safety. There has been some anecdotal evidence that the results of their work were positive. The benchmarked percentage of suppliers complying with HACCP was reported as achieved by one client (40 per cent vs 20 per cent benchmark) but not by the another (11 per cent vs 20 per cent benchmark). A further client reported full achievement of the benchmark related to training (of an unspecified nature) of all its new local suppliers.

<sup>5</sup> Euroasian Economic Union – an economic union of Belarus, Kazakhstan, Russia, Armenia and Kyrgyzstan.

In general, the supermarkets (particularly in more advanced countries, where competition was strong) expressed reluctance to organise structured training (in class, including workshops or seminars) for their suppliers, as most of them considered their relations with suppliers to be of an uncertain and transient nature. Their mutual relations have been based on relatively short-term contracts (maximum one year) and both parties constantly looked for better business opportunities. Only in one country, where there was a limited number of reliable local suppliers, while imports were relatively expensive compared to people's incomes, supermarkets were prepared to invest time and money in training local suppliers, with whom they hoped to develop and maintain longer-term relations.

The situation was similar in another country and it is considered that the client there genuinely planned to invest in training its suppliers as part of its expansion programme. However due to the company's acute financial problems, training plans were put on hold.

This does not mean that supermarkets haven't been contributing to their suppliers' professional development. All supermarkets interviewed reported that their work with suppliers has been based primarily on day-to-day coaching in respect of specific issues or problems, rather than through structured programmes, workshops or seminars. All the supermarkets' Distribution Centres had dedicated staff responsible for relations with suppliers, who worked with them when problems occurred with timely delivery, product quality, packaging or labelling. These were face-to-face or telephone sessions and the supermarkets considered them as an effective and efficient way of improving suppliers' knowledge and performance, addressing particular gaps and practical issues.

In addition, all four clients reported that they periodically audited their suppliers. The audits were an occasion to identify concrete gaps in the suppliers' practices in relation to food safety and quality and to make recommendations for improvement. This was considered a very effective and practical approach (and it was confirmed as such by the suppliers interviewed, see the next section). All supermarkets interviewed reported that during recent years they have observed a gradual improvement in the safety and quality of the local

suppliers' products. They attributed this development partially to suppliers working with them.

## Conclusions

In conclusion, all projects reviewed fell short of their physical expansion targets. This alone limited impact of these projects on local suppliers. The supermarkets' procurement process centralisation and regionalisation, as well as other trends in modern supermarket operations, considerably limited opportunities stemming from such regional expansions for local suppliers, particularly the smaller ones. Only Client D (which had largely decentralised procurement) registered more substantial increase in the number of local suppliers contracted following the Bank-financed project. The achievement of quantitative targets related to the increase of locally produced goods in supermarkets' offer and the increase of private label products was mixed. Most projects failed to meet them, while it was difficult to attribute the increases achieved to the clients' very limited regional expansions (with the exception of Client D). Also in respect of more qualitative objectives, especially knowledge-transfer related, the performance was weak. Some clients failed to organise activities agreed with the Bank, in other cases participation in training was very limited, while its impact on suppliers' behavioural changes was uncertain due to weak causal link. However there was clear evidence that the supermarkets have been contributing to the local suppliers' professional know-how. Such knowledge transfer was channelled primarily through daily coaching and periodic audits. This approach was considered the most effective by both supermarkets and suppliers.

## 3.2 Automotive sector

Most of the Bank's automotive projects reviewed under this study achieved only marginal SCBL-related results. This was particularly the case with the achievement of desired impacts categorised as "expansion of markets", that is, in terms of local suppliers' participation, rather than in terms of transfer and dispersion of skills category, where results (mainly in terms of outputs) were slightly better. The table below summarises these results against the projects' SCBL benchmarks.

Table 5: Case study project performance against selected quantitative benchmarks

Benchmark	Project J		Project K		Project M		Project L	
	Targeted/ (baseline)	Actual	Targeted/ (baseline)	Actual	Targeted/ (baseline)	Actual	Targeted/ (baseline)	Actual
Increase in the local content / number of local suppliers	90% for tier IV engine  30 suppliers involved in tier IV development	0% (tier IV engine on hold) So far none but a long list of potential suppliers prepared	15% (from 5%)	6% (expected 10% in 2016)	n/a	n/a (2% for interiors)	30% by 2013 50% by 2016  of which 10% from Russian-owned suppliers	35% for cars, 25% for SUVs (inc. about 5% direct + 5% indirect local owned) 2016 target unlikely.
Specialized training (number of staff trained)					15-20 in prototype tooling  35-50 electric division prototyping 20-25 electric division R&D in Tunisia	70  250 20		

General training (hours)	250 man-months 3-5 interns (from 0)	120 man-month so far 3 intern 2013 7 in 2014	36 per employee (from 26) 160 per uni intern (from 120)	36 Up to 300 for up to 8 interns	Dual educ. system at local college	Dual system introduced. 30 interns per annum	500,000	No exact data, estimated at 500,000+
R&D related	120 employees (from 50)	120 R&D specialists employed	Outsource one product testing to local uni.	None	Develop electric division center Invest 10% of loan in R&D	No R&D center created, no R&D investment, however process engineering developed ilocally and other countries		

In two out of three previously evaluated/validated projects, results were reportedly better (although they were not fully verified). Project M achieved its benchmarks of “at least 10 new suppliers to enter the local market to supply the client” (nine new suppliers had entered at the time of validation in 2013 but reportedly there are more than 10 now); “at least 3 new suppliers to produce components new to the local market” (five new components have been introduced); and “at least 1 other vehicle manufacturer to work with at least one of the new suppliers”. At the time of validation (2012), Client O was reportedly on track for 85 per cent local content for its cars (82 per cent) and reportedly has since achieved the benchmark. At the time of evaluation Project N had partly achieved its 10 per cent local content, however since then the assembly plant has closed down.

There were various reasons for generally disappointing results and the limited impact of the Bank’s automotive sector projects on local suppliers. They included the following:

- Critical importance of quality and reliability in the automotive industry’s supply chains, which makes it difficult for new, even cheaper suppliers to replace “tried-and-tested” existing ones, particularly in the high-tech parts segment;
- Generally, a limited number of suitable local suppliers in the Bank’s countries of operations, able to comply with quality requirements of modern original equipment manufacturers (particularly ensuring consistency of serial production);
- Specificity of the automotive industry, which makes it expensive for original equipment manufacturers to switch suppliers;
- Characteristics of certain types of products, where lower tier suppliers were imposed on the higher tier suppliers by their clients (for example, interiors or other appearance items).

These were pre-existing sector characteristics and should have been taken in to account in the project design. In addition, there were also other impediments to the success of the Bank’s projects, which were difficult to predict at approval, such as the following:

- Delays in governmental decisions, which have postponed (for now indefinitely) the introduction of new, lower emission standards, requiring some projects (and their potential SCBL-related impacts) to be put on hold;
- Collapse of the car market in one country in recent years due to the macroeconomic situation, which

impacted demand for parts supply, both local and foreign.

The main motivation for Bank clients to expand their local supply base is the pervasive pressure to decrease their costs, which due to lower labour, utility and many primary material costs, motivated them to locate in the Bank’s countries of operations in the first place. In one country, an additional incentive has been the recent currency devaluation, which has doubled the cost of imported parts.

From the very start many original equipment manufacturers operating in the Bank’s countries of operations experienced difficulties in obtaining supplies meeting the expected standard from local companies. This obliged most of them to encourage investment by their home base suppliers and therefore the majority of backward linkages to locally-owned companies have been indirect, that is related to what local 1st tier (usually foreign-owned) suppliers purchase locally from 2nd or 3rd tier suppliers. This has been often limited to primary products (steel) or less technically-advanced but labour intensive items (interiors, seats, wiring). For example, one client, a tier 1 supplier to original equipment manufacturers, produces integrated car interiors and electrical wiring in several countries of operations. However 75 per cent of interior part components are specified by its original equipment manufacturer customers, as are the terminals on the wiring harnesses. In effect, only about 2 per cent of the client’s parts and materials were locally procured.

Other automotive clients had complete freedom to buy where they chose. However they faced another dilemma if they wanted to change suppliers, such as the high risk and associated cost. These clients had a central R&D developing the product with tried-and-tested home-based suppliers, who coped with all the development changes, invested in facilities, obtained the tooling and supplied the limited volume of parts for testing at a loss. These home suppliers were therefore a logical choice for larger volume contracts when the development of a new car was completed.

Moreover, some Bank clients stressed that the components of technically complex automotive parts (such as transmissions) have a limited “product life”. Cost-benefit analysis based on the estimated length of this “life” largely impacts the decision on whether or not to introduce a new supplier. If the part is relatively new (therefore with a longer “life”), a new supplier has a better chance of being contracted (provided that his products meet stringent quality requirements). However there are very limited prospects for alternative suppliers

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to replace the existing supplier of a part, which has been in production for a long time because its “life” is seen as limited. If a new supplier is introduced, the remaining “life” of a car model needs to be long enough to justify the costs of an additional set of tooling and all the testing time (a valuable and scarce resource) at the client’s central R&D. To select an unknown supplier for a new model development with a longer life, however, carries its own obvious risks. Any change in sourcing must therefore have a very strong economic justification.

For one client located in the EU with no import barriers and in the Eurozone, it has not been easy to justify economically and it will be difficult to meet the benchmark target of 15 per cent of local content in its technologically advanced products (dual clutch transmissions). The client currently sources only 6 per cent of its parts in countries of operations (only one percent increase since the project was approved in mid-2012), while 66 per cent come from Germany and the rest from other western European countries and Canada. However pressure from original equipment manufacturers to decrease costs has recently forced its management to set up a new purchasing unit specifically dedicated to finding suppliers in eastern Europe and Turkey, with a view to reducing costs not only in the country of operations but world-wide. Moreover, one of the client’s suppliers is in the process of moving to another country, so later in 2016 the client’s local content (from the Bank’s countries of operations) is expected to reach 10 per cent.

Another client had the same dilemma but the government requirement to source a percentage of supplies locally has provided a strong motivation. However, the difficulty of finding locally owned suppliers willing to meet the stringent quality requirements is common to all “foreign” original equipment manufacturers in the country. The client has achieved a significant percentage of local content for cars and SUVs but the future objective higher will be difficult to meet. Generally, the client reported problems in finding local suppliers able to supply parts, which would be of consistent quality when in serial production. Difficulty to communicate in English was cited as another barrier to closer cooperation with foreign original equipment manufacturers.

### **Impact of local currency and markets**

There were two additional developments in one country last year, which will have a strong impact on the future operations of the Bank’s automotive clients –firstly, the fall in the value of the local currency, effectively doubling the cost of imported components, which has given ample economic justification for re-sourcing, and secondly - the collapse of the local car market. Sales have decreased to less than half of predicted figures and all automotive plants are taking extended shut downs. Clearly any decision-making for companies in these circumstances is difficult but preparatory work is going ahead, with components being targeted for re-sourcing and considering which Russian suppliers could be chosen to participate in programmes to improve their performance and potential. Moreover, it should be noted that low market demand was not confined only to this country, it

also impacted European original equipment manufacturers (although to a much lesser extent) and resulted in many ambitious programmes being put on hold.

There was yet another obstacle to the fulfilment of SCBL-related objectives found in one case study. Because the government decided to delay the introduction of the mandatory requirement for Tier IV emission engines, the part of the project related to the development of Tier IV engine has not been implemented (and the whole SCBL-related impact of this project depended on it). The delay was not of the client’s choosing and nor could it have been realistically foreseen at the time of approval. However, the client’s production capacity extension and the R&D department expansion were completed. Also, the identification of potential parts suppliers for the new engine was on track. The key parts that ensure Tier IV level emissions, the injection equipment and after-treatment (such as catalysts) will, however, all have to be imported as they would be by, say, a UK diesel engine manufacturer. This is due to the limited supply base for such advanced products, whose producers are based (with their substantial R&D) in western Europe or the USA.

### **Transfer of skills - research and development**

There are many references to “R&D transfer” or “R&D strengthening” in the approval documentation for the Bank’s automotive projects, including in three of the case studies. Except for one (where R&D had already been established before the project), no evidence was found that transfer of *sensu stricto* R&D occurred. All the clients explained that it would be very unlikely that they (or any other automotive producers) would transfer such *sensu stricto* R&D to the Bank’s countries of operation, one reason being the importance of proximity and links between R&D and the original equipment manufacturers (the majority of which are still in western Europe). Nor would it be economically or logistically viable to transfer an established research base (human and infrastructure). For example, one of the many benchmarks of one project called for the investment of at least 10 per cent of the Bank’s loan in a local R&D centre. The client confirmed that no R&D centre was created and no investments have been made in any R&D in the Bank’s countries of operations. However, they noted (and the evaluation team confirmed) that some fairly advanced process engineering functions were transferred to the client’s plants in another country. These functions included simulation, testing, technology and tooling development, prototyping and software programming. This constituted an important know-how transfer and indeed likely the most important transition impact of this project. However it certainly did not involve “Research”, while there are different views among experts whether these activities can be referred to as “Development” transfer as commonly understood in the automotive industry (see definition below).

“Research and Development (R&D), is a general term for activities in connection with corporate or governmental innovation. R&D is a component of Innovation and is situated at the very front end of the Innovation lifecycle. There are two primary

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models, with an R&D department being either staffed by engineers and tasked with developing new products, or staffed with industrial scientists and tasked with applied research in scientific or technological fields, which may facilitate future product development. In either case, R&D differs from the vast majority of corporate activities in that it is not often intended to yield immediate profit, and generally carries greater risk and an uncertain return on investment.” (Wikipedia)

The Bank’s clients stressed that what their engineering departments have been doing in the Bank’s countries of operations was not a “development of new products” but rather the adaptation of new products designed/invented by their home-based R&D centres to mass production. So, they have been trying to find solutions to “how to make it” but not “what to make”.

Such “process engineering”, although it only follows the product development process, also requires high skills and innovative thinking and involves the use of advanced technologies. The evaluation team visited one client’s engineering department and was impressed by the high quality and technologically advanced nature of its work. This department employs over 80 engineers, many of them recent graduates from universities across Romania. Their number tripled in the last three years, which can be partly attributed to the Bank-financed project. The department’s focus is on prototyping and tooling (machine-building for mass production of newly designed parts), however it increasingly performs more advanced tasks such as simulations or crash tests. The department serves not only the local client car interior plant but also other company plants across the world (such as China, Mexico and Germany). The parts for which tooling is designed and manufactured are mainly dashboards, central consoles and internal door parts for premium cars such as Porsche, Maserati or BMW. About 50 per cent of materials for the production of tools come from the country of operations (such as steel, cabling and electric parts).

Nevertheless, the client’s engineering department is relatively unique among the client’s investments in the country, where the company employs over 15,000 people in five plants, most of whom are production workers. They are all well trained to ensure the products comply with the requirements of extremely discerning premium original equipment manufacturer clients. To ensure the availability of well-trained employees the client sponsors a programme of dual-type education at one of the local colleges. It follows the German vocational education system and involves in-class theoretical courses prepared

in cooperation with a school in Germany, as well as parallel internships at the client’s plants. The programme includes such specialisations as mechatronics and during the last three years about 90 students have benefited from this programme, of which about 60 were hired by the client. Moreover, the company, together with eight other automotive companies active in the country, sponsors a professional master’s programme in advanced manufacturing and process engineering at the local university. Graduates of this programme often find employment at the engineering department of the client’s plant.

The client also briefed the evaluation team on its cooperation with universities in other Bank countries of operations (activities which were within the scope of the Bank-financed regional project). Most importantly, the company supported engineering programmes at two universities. This was done with the participation of a German university. Furthermore the company encouraged anew cross-border cooperation in software engineering between the two universities and two of the client’s plants whereby several employees have been enrolled for a two-year study period. The client also supported development of automotive degrees with two universities.

This client wasn’t the only Bank automotive client which entered into cooperation with local universities as all three of the other case study clients established similar cooperation programmes. However they were limited to offering internships and sometimes one-off projects for students. More ambitious expectations of cooperation (which were often expressed at approval) such as for the involvement of local universities in “R&D-related” services for a client, did not materialise.

## Conclusions

In conclusion, all of the Bank’s automotive clients were well motivated and willing to source part supplies locally. However, the specificity of this industry made it difficult to change suppliers, while in many countries local suppliers were simply not able to adhere to the extremely stringent quality standards required by this industry. The Bank’s projects made a greater impact in terms of know-how transfer. This did not involve *sensu stricto* R&D, however there is clear evidence that under some projects advanced process engineering functions were transferred and contributed to growth in a more innovation-driven economy. There has also been a substantial skills transfer through on-the-job training, internships and support provided by the clients to local universities.

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## 4. Supplier level results

### 4.1 Food retail

The evaluation team interviewed 18 local suppliers to the Bank's clients (4-5 per client), all of which were large to medium-size. Most of them have been working with the client for several years and for the majority of them (with some notable exceptions) their business with the client accounted for a relatively small percentage of their total business, typically one to eight per cent of total sales. This was because experienced suppliers, who have been growing their businesses successfully for some time, are well aware of the need to diversify their customer base. They typically work with several supermarkets as well as wholesalers, exporters, state agencies, and in a few cases they export directly themselves.

Most (but not all) suppliers reported that their business with the Bank's clients had increased during the last five years, typically by three to ten per cent per annum. However most were unable to provide any historical data or to link the increase to the project. There were several suppliers who reported unchanged or slightly decreasing business with the client. Fluctuation in volume due to seasonality and the short-term nature of most of the contracts made it impossible to establish exact figures. Many of the suppliers interviewed attributed the increase in orders from the Bank's clients to (i) their own increased production capacity, and (ii) the increased purchasing power of the local population. Some suppliers interviewed were aware of their clients' regional expansion programmes, however most (with the exception of one client's suppliers) considered them as relatively limited. Many of them stressed that their position in the market was strong and if not the Bank's client, other supermarkets or wholesalers would have taken their products.

#### Mixed effects of supermarket network regional expansion

Suppliers to two clients were more inclined to attribute their increased business to these supermarket networks expansion projects. One of the client's suppliers pointed out that, thanks to this supermarket's regionalisation of procurement (on a European scale), his products entered neighbouring countries' markets. However, on the other end of the spectrum, another supplier indicated a loss of business, probably due to such regionalisation, which in his case resulted in the replacement of his products with similar but cheaper ones made by a Hungarian producer. Also, another supplier reported decreasing business with this supermarket and even compared the sector to a "new colonialism", in reference to the constant pressure from (mostly foreign) supermarkets on local suppliers to decrease prices.

This wasn't a unique comment as several local suppliers interviewed pointed out that following regional expansion and rising market share, some supermarkets used their increased negotiating power to put more pressure on suppliers to achieve better prices. Other suppliers

declared that they preferred doing business with local wholesalers, rather than large supermarkets due to simplified logistics (wholesalers buy at a producer's own premises and provide an immediate quality check vs. expensive transportation to the retailer's distribution centre and potential losses associated with possible rejection of orders due to inadequate product quality).

#### Suppliers valued partners but subject to competitive pressures

On the positive side, a large majority of the suppliers considered the Bank's clients to be valued and solid business partners, who respect their contract terms (which wasn't always the case with local, smaller supermarket networks). They stressed however, that the food retail business is an extremely competitive sector in all four countries and this competitive pressure is in turn reflected in the supermarkets' relations with suppliers. Thus, a typical supply contract is for a period of one year, mainly price-driven and subject to short term profit maximisation, assuming quality standards were respected. Even private label contracts are usually short term (three months to one year). Price is subject to regular revisions and negotiations.

#### Supplier improvements not always attributable to Bank interventions

Almost all suppliers stated that improvements to their product quality and working practices have been driven by their own development strategy and general market requirements, rather than specifically by the Bank's clients, the project or any other supermarkets. Many of their key improvements and certifications, such as ISO, Global G.A.P. and HACCP were introduced or obtained well before the Bank projects. Suppliers in two countries cited EU directives on food safety as having the most influence on their process/behavioural changes and improvements, while those in two others mentioned the EAEU requirements, particularly the legal obligation to comply with HACCP, as the strongest incentive for them to improve their product safety and quality. One of the client's suppliers mentioned the introduction of advanced animal welfare improvement measures, reaching far beyond the minimum EU requirement, in order to retain its reputation as a leader in its product segment.

Nevertheless, several of two client's suppliers pointed out that their cooperation with these supermarkets, particularly in the early days, was instrumental in improving their products and production processes. Importantly, they felt that their work with such well-known supermarkets gave them confidence and motivated them to professionalise their businesses. Moreover, the prospect of larger and stable orders from such solid partners enabled them to make investments in modern machinery and equipment, which translated into improved product quality and safety and eventually the growth of their business. These comments confirm the important role played by international supermarket chains in less advanced countries, particularly in the early stages of food retail market development. However almost all suppliers confirmed that today supermarkets rarely provide any special incentives or support to

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suppliers to increase their product or process quality standards, beyond advice in reaction to a concrete problem with supplied goods or as a part of an audit. The supermarkets rather require compliance with national and international (EU, EAEU) standards and in some cases with specific requirements (“private standards”) collectively set in a given market by wholesalers, exporters and supermarkets, as a condition for doing business with them. Except for one client’s suppliers, no training has been ever offered to those interviewed. However all of them confirmed that if they were offered such training, aimed at increasing competitiveness, efficiency of operations and logistics and product quality they would welcome it.

The periodic audits conducted by a supermarket’s experts, or consultants contracted by the supermarkets were usually appreciated by the suppliers. Some pointed out the cost of such audits (as supermarkets make the suppliers pay for them), however most of them considered them to be important and useful. Again, those most satisfied cited practical improvements in terms of food handling hygiene and workers’ personal hygiene, as well as production or packaging process improvements introduced following an audit.

## Conclusions

In conclusion, most local suppliers interviewed felt the Bank’s projects had a positive but very modest impact on their businesses. This was primarily due to the relatively small share any given supermarket held in their total business – the result of their attempts to diversify their client base. Furthermore, it was difficult to establish any causal link between a Bank-financed project and any such increase in the suppliers’ business, primarily because of the lack of precise data and the centralisation of procurement (which distorted the projects’ potential “regional effect”). Most suppliers have been constantly improving their production process and product quality in response to national, international, as well as overall market requirements. They well understood that this was the only way for them to remain competitive. Requirements coming from any particular supermarket/Bank client were less important for them, except for one client’s suppliers, with whom this supermarket worked very closely, aided by decentralised procurement and targeted supplier training programmes.

## 4.2 Automotive sector

In contrast to relatively large number of local suppliers working with the Bank’s clients in the food retail sector, there are very few in the automotive sector. As explained in the previous chapter, most projects failed to meet their expectations in terms of sourcing from local suppliers due to the inadequate quality of local supplies and the high costs involved in changing automotive suppliers. Moreover, one project’s Tier IV project was postponed indefinitely, while another project had numerous skills and know-how transfer objectives but nothing related to local supplier content increase as most of its suppliers were imposed by its client original equipment manufacturers.

Nevertheless the evaluation team interviewed three local suppliers to the Bank’s automotive clients. Brief interviews were held with representatives from two universities, which have cooperated with the Bank’s clients.

One supplier has been working with a client on the development of a Tier IV basic engine. This type of engine does require very substantial improvements to materials and manufacturing tolerances of its parts and following numerous tests the supplier has recently achieved engine component castings of a quality acceptable to the client. These new components will enter serial production when the Tier IV engine programme starts. To develop the component, the supplier had to introduce an advanced iron analysis and purchased new machinery for this task. Some help was provided by the local university but it was limited in scope and mainly related to analytical assistance. This example demonstrates the potential of the project to make an impact on local suppliers, who will have to advance the quality of their products or production process to comply with Tier IV requirements. However it will only be possible to verify if and when the Tier IV programme is eventually implemented.

In one country of operations the involvement of local suppliers has been driven by a government decree which stipulated that to continue their duty free imports, foreign manufacturers had to commit to producing a set number of vehicles a year each, with a local content of a per cent of revenue, rising in the sixth year of production. It also requires them to have local stampings, engines and R&D. However, in reality it soon became obvious that foreign original equipment manufacturers will not be able to comply with some of these requirements if they are to maintain the quality of their end-products, particularly in respect of local R&D and engine production. Therefore most existing investors were able to negotiate exceptions. Nevertheless, original equipment manufacturers encouraged a number of their home-based parts suppliers to relocate to the country in question.

By mid-2015 one client had already achieved localisation of a significant per cent for cars and SUVs, which is still growing. It buys most of its stampings from a local supplier. Other large car-parts are also located there and are major suppliers to the client. These companies are foreign-owned and have on average a third of locally sourced materials, although some have much higher local content. For example, during a meeting with one client, it was confirmed that almost all the primary materials it used were local, the only imports being individual items for which the small volume made expensive tooling uneconomical. The stampings from another client are all made from local steel.

In terms of buying from local-owned suppliers in another example, the client has made a considerable effort to encourage their participation. Teams of experts have visited potential suppliers, providing audits on 15 key elements such as quality, logistics and packaging. For all the effort the results have been so far disappointing with only four producers qualifying as direct suppliers (as compared with 25 local foreign-owned suppliers). In total, the client directly sources only about 5 per cent of their total supplies from local-owned suppliers. However, if indirect supplies are taken into account, the company’s

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backward linkages to local-owned supply chains (tier 2 suppliers of raw materials) would be much stronger, probably exceeding the 10 per cent benchmark. In total, the client estimates that nearly 100 local producers contribute as direct and indirect suppliers to its vehicles.

However, the car market in the country is in a deep crisis. The client's production was on hold during the evaluation team's visit and while such a large manufacturer can probably withstand a downturn for some time, its suppliers may not. Another client's management was uncertain of its future. All its production had ceased except for one order for the low cost car, while the original workforce of 200 had been halved. This illustrates the paradox of the Bank's operations in this country – the only country (among those reviewed here) where the Bank's automotive projects made a considerable impact on local suppliers (although they were mostly foreign-owned and their participation forced by the legal requirements), but this impact is at risk of being lost due to the automotive market slump. One Bank client has already left the country, while the future of those remaining is very uncertain.

The representative from the local university there confirmed the importance of cooperation with automotive producers, who sponsored their regional branch and until recently offered employment to its graduates. The university has not undertaken any major research work for any of the companies as cooperation has been limited to training engineers through sponsoring the branch and offering internships. As with overall industry prospects, the future of the local university branch is uncertain.

Another project set a number of backward linkages objectives related to know-know transfer, however not for the increase of local supplies. This was because of the nature of its main product – car interiors, where almost all parts and materials suppliers were specified by the client's original equipment manufacturer clients. In the company's second line of business – electric harnesses - the terminals were also specified by the clients, with one client only able to choose its own supplier for plastic covered copper wire. A manufacturer of such cables is the main supplier to the client's plants around the world and in 2013 the client encouraged it to invest in a wire production plan in one particular country to reduce the distance to the client's production plants.

The supplier is now located next door to the client, within the same free trade zone. As a production facility, it is a complete contrast to its customer, as it is highly automated with very few employees. The single strand

copper wire is imported from Europe braided according to the varying diameters required and coated with different colours to identify it. The coated wire is then spooled on to drums and shipped. The supplier delivers it to other client locations and to some of their own wire harness-making plants. The plant does not have any wire drawing equipment, which would enable it to, for example, buy copper bars in Eastern Europe. Such an investment could perhaps be justified in the future on capacity grounds.

Another client confirmed that it added only one new supplier from the Bank's countries of operations since the project was signed. However it has been strengthening its backward linkages to local educational institutions by cooperating with a technical university, whose representative was invited to the meeting with the evaluation team and presented the highlights of relationship. He stressed the importance of such cooperation, which has been growing. For instance, in addition to internships offered to its graduates, the client has recently sponsored a competition project for the university's students to build cut-through models of different types of power shifts, which it produces. These models first had to be designed using CAD technology and then produced by students, ensuring the workings of all the shift's elements, which required relatively advanced skills and engineering knowledge. The high quality of the models produced demonstrated the supplier's capacity to undertake engineering tasks for the client. The company followed it with orders, laboratory measurements and plans to use the supplier more extensively in the future.

## Conclusions

In conclusion, there was limited opportunity to measure the impact of the Bank's automotive projects at the level of local suppliers as such suppliers are relatively rare. Nevertheless there is evidence of a growing determination among some clients to increase local content, as well as strengthen cooperation with local educational institutions on engineering projects. Therefore there is some hope of the impact from the Bank's automotive projects increasing in the future. The strongest positive impact was made on local suppliers (although they were mostly foreign-owned), however there is real risk that this achievement may soon be lost due to the slump in this country's car market.

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## 5. Sector or wider economy level results

The study was able to identify only minor links to other entities, beyond the clients' suppliers. The clients cited several types of local businesses which cooperated with them during the implementation and operation of Bank-financed projects, most importantly local construction companies, which built their facilities (automotive plants or supermarkets), as well as property developers, who in some cases developed and owned their facilities. Moreover, the Bank's clients also engaged local entities to supply various services during the operational phase of the projects – such as maintenance, utility, security, catering, logistics and transportation operators (although many clients, particularly in the automotive sector, had their own staff providing these functions, while supermarkets usually had their own truck fleets). Smaller local businesses, cooperating with (mostly) supermarkets included hotel restaurant and catering sector equipment and shelving suppliers, certification and audit providers, marketing and advertisement services, as well as packaging producers and label printers (for private label products). Tools and machine park service and maintenance were often provided to the automotive sector clients by local branches of machine manufacturers, although part of this service was done in-house. Both sectors sourced their computers, office equipment and part of their IT network infrastructure locally.

In terms of the projects' impact further up the supply chain, two of one client's suppliers-food processors reported that they have been passing know-how gained during audits or training organised by the client and related mainly to HACCP requirements, to their own local suppliers (farmers and fishermen). These primary product suppliers, especially in far-flung regions, had limited access to practical information on upcoming legal requirements in respect of food safety, and no assistance in implementing them. Therefore the assistance provided by the client's suppliers was very important and a good example of wider dissemination of know-how stemming from a Bank project.

Only one client among the food retail sector case studies reported cooperation with a local university. The client contracted this university to conduct a number of tests and biological analyses of some of its products. However, the service was only provided by the university occasionally, when specific issues occurred with the supplied products (the client has its own laboratory at its distribution centre in the country, which handles routine tests).

Cooperation between Bank clients and local universities or colleges was more frequent in the automotive sector (as described in previous chapters). Although it related

mainly to training graduates through internships, there were also cases when testing and analysis was contracted out to the universities.

Most of the case study projects (as with the majority of Bank projects) were designed to make a relatively narrow impact in terms of SCBL, usually limited to the client's direct suppliers. However there were assertions made in several project approval documents indicating wider impact objectives. For example, one client was to forge stronger “forward linkages” with its own clients (small food retailers), but failed to achieve it. The Board report for the project also stipulated that the Bank's client was “currently exploring the possibility of establishing a financing programme for its customers via local banks to provide sufficient funding for investment needs resulting from the client's recommendations”. However, the programme has not been established.

Also, one of the projects' objectives was to increase cross-border links with suppliers in different countries, as the new stores were to be located close to the borders with these countries. However, as the client substantially scaled down its investment programme, its management did not confirm any increase of business with the suppliers from these countries in recent years.

In terms of unexpected, potentially negative impacts of Bank projects, as already mentioned, some suppliers felt that due to regional expansion, the supermarkets' negotiating power grew and this encouraged some of them to demand lower prices from suppliers. However these were relatively isolated comments and it would be difficult to classify such actions as clearly negative without knowing the details and the context of each case (this type of pressure certainly motivated suppliers to increase efficiency).

In conclusion, all the projects reviewed established linkages to the wider economy, however they usually did not go beyond standard investment and operation related supplies and services. Automotive sector clients tended to have their own staff, providing various services in-house, therefore the wider impact of such projects was very limited. In food retail, with the exception of one client, no meaningful sector-wide impacts of the case study projects were identified. In most of the project countries the food processing and retail sectors are relatively well developed and it was unlikely that a limited expansion programme of any single supermarket network would make any substantial contribution on a sectorial or wider economy level. The client which had a meaningful impact had a unique position among the case study projects as it was operating in a market dominated by national food retail networks, therefore its practices and processes had a stronger “demonstration effect” than in other countries where international supermarket chains prevailed. Moreover, recent political and macroeconomic developments in the country, including currency devaluation and an embargo on food imports, provided additional motivation to the client to intensify its cooperation with local suppliers.

## 6. Conclusions, ratings, key findings and recommendations

Overall, results related to SCBL were positive although relatively limited. It is difficult to generalise as there have been clear differences between specific projects, sectors and countries, with those in one country showing the strongest positive impacts and the best results in both focus sectors. In other cases, despite evidence of some Bank clients increasing the local content in their business, almost all of them missed their SCBL-related benchmarks and objectives. All the food retail projects reviewed fell considerably short of their physical expansion targets and this alone limited their impact on local/regional suppliers. Moreover, centralisation and pan-European regionalisation of supermarket procurement processes and other trends in modern supermarket operations considerably limited the opportunities which the Bank's projects can offer to local suppliers, particularly the smaller ones. Those who benefited were typically suppliers of less-processed, "super-fresh" products.

One client had largely decentralised its procurement and operated in the local market, dominated by local retailers, and registered a larger increase in the number of local suppliers contracted and influenced their operations and processes more substantially. Also another client achieved considerable local participation, although it was legally required to do so, while the suppliers were mostly foreign-owned. Out of previously evaluated projects, two achieved their SCBL-related benchmarks. However, there was little evidence of other projects contributing to increased local participation or influencing behavioural changes among local suppliers. Most projects missed their qualitative objectives, for example some clients failed to organise training for suppliers, others were able to attract only very limited participation, while the impact of the training on the suppliers' behavioural changes was uncertain due to the weak causal link. Nevertheless, there was clear evidence that the supermarkets have, to a certain extent, contributed to the improvement of local supplier know-how through ad hoc coaching and periodic audits – activities which have been considered by all parties as the most effective channels of knowledge transfer in this fiercely competitive sector.

The Bank's automotive clients were highly motivated and tried hard to source part supplies locally. However, the specificity of this industry made it difficult to change suppliers, while in many countries local producers were simply not able to adhere to the industry's extremely stringent quality standards. The Bank's projects made a better impact in terms of know-how transfer. This did not involve *sensu stricto* R&D (which was often targeted at approval), however it supported advanced process engineering functions, which were successfully relocated to the Bank's countries of operations as part of several projects. This made an important contribution to the

development of an innovation-driven economy in these countries (although there is no realistic prospect of real R&D being transferred there by any of the clients). Moreover, all automotive sector projects supported skills transfer through on-the-job training, cooperation with local universities and internships.

Similarly, Bank projects in both sectors made only a modest impact on the sector or larger economy level, with the exception of one client, where evidence was found that know-how transferred by Bank clients to local suppliers was disseminated further up the supply chain to primary goods producers. The table below presents the rating of SCBL-related results of the case study projects – both realised and potential, the latter because all projects are still ongoing. The section further below presents findings and recommendations from this study. They are based on the analyses of the Bank's approach to SCBL, as well as on the eight case studies.

**Table 6: Ratings of case study projects regarding SCBL realised and future potential**

<i>Project</i>	<i>SCBL-related results rating</i>	<i>Future SCBL-related potential rating</i>
<b>Food retail</b>		
Project A	Partly unsatisfactory	Partly unsatisfactory
Project B	Partly unsatisfactory	Fully satisfactory
Project C	Partly unsatisfactory	Fully satisfactory
Project D	Fully satisfactory	Fully satisfactory
<b>Automotive</b>		
Project J	Unsatisfactory	Partly unsatisfactory
Project K	Unsatisfactory	Fully satisfactory
Project L	Fully satisfactory	Partly unsatisfactory
Project M	Fully satisfactory	Fully satisfactory

### 6.1 Findings – overall framework

- The Bank lacks a clearly articulated strategy on how to approach SCBL systematically. There is neither a broad conceptual framework nor specific guidelines against which to assess and structure SCBL-related components at the project level, and to implement and monitor those included.
- Treatment of SCBL issues across sector and country strategies is inconsistent; only the agribusiness sector strategy mentions SCBL, and then in only general terms; several country strategies make only passing reference to supply chain issues.
- Where SCBL-related objectives appear they are heavily concentrated and narrowly drawn: concentrated almost exclusively in agribusiness and M&S projects and in these cases in 85 per cent and 70 per cent of projects, respectively; narrowly drawn in being limited almost exclusively to quantitative benchmarks targeting only the number or share of local suppliers; qualitative benchmarks tended to be poorly defined.
- Commonly found design issues at the project level

include: uneven and often insufficient analysis of sector conditions; weak or absent discussion of causal links between SCBL-related benchmarks and project activities; this could be coupled with unrealistic expectations for SCBL effects given the structural and business realities or relationships with suppliers; and, imprecise baseline data.

- The flow of relevant and useful data on SCBL effects was insufficient in all but a few cases, often reflecting lack of client awareness of the objectives set for their projects, absence of adequate recordkeeping, and lack of assigned responsibility for monitoring and reporting.

## 6.2 Findings – agribusiness (food retail) sector specific

- Monitoring and verification of SCBL-related data in food retail posed a challenge because many supermarket chain databases did not differentiate between “local” and “foreign” suppliers, their share of locally produced goods on offer changed seasonally, and they had a large proportion of non-food products in their offer, most of which were imported. Moreover, a large proportion of foodstuff was purchased from local wholesalers, who had imported products in their offer, which were not always recognised as such.
- Most regional expansions of supermarket chains had only a moderate impact on regional suppliers as the chains have procurement/distribution centres which purchase merchandise centrally in large quantities, allowing them to negotiate the best prices. Regional store managers sometimes had the freedom to recommend or even buy from local producers but this was limited to “super-fresh food” (milk, bread, meat and fresh fruit and vegetables).
- Supermarkets were generally reluctant to offer structured (in-class) training or workshops to local suppliers as their relations were based on short-term, price-driven contracts. Instead, supermarkets often provided ad hoc coaching and practical advice on product quality and safety improvements. They also conducted audits at their suppliers’ facilities and recommended improvement measures.
- Except for one client, there was little evidence that the Bank’s projects prompted behavioural or qualitative changes among local suppliers. For most medium to large-size suppliers, sales to any single supermarket accounted for a relatively small share of their business. Such suppliers have been constantly improving their product quality as part of their own strategy to remain competitive in the market. This process was guided by EU or EAEU regulations and driven by the collective requirements of the market, including wholesalers, exporters and supermarkets. Operating in the local market, which is dominated by local networks, the

client differed from other competitors in terms of transparency, professionalism and support for suppliers.

- Large supermarket chains (those usually financed by the Bank) were mainly interested in cooperating with large, well-established local suppliers, who would be able to reliably supply required, generally large volumes of consistent quality products at the lowest possible price. In many countries of operations, the number of such suppliers was limited and they had usually been working with the client already, well before the project.
- Supermarket chain expansion projects also strengthened their negotiating power, which encouraged a number of them to exert pressure on local suppliers to decrease their prices further, forcing some to sell below (already very low) cost to keep business going, while discouraging smaller suppliers from engaging. Network expansions also led sometimes to “suppliers’ base consolidation”, resulting in cooperation with fewer local suppliers.
- International supermarket chains increasingly regionalised their procurement at the European level, that is, they purchased foodstuff in large quantities in one country (often their own) and distributed them to their stores across Europe. Although this approach generally constituted a disadvantage for local suppliers, it also helped some of them enter export markets.
- In less advanced countries, poor infrastructure was the main hurdle preventing supermarkets procuring more products from local suppliers. In particular, fresh produce storage and specialised warehousing (for example for “shock-freeze”), as well as adequate road infrastructure, would help supermarkets to increase their backward linkages to local suppliers.

## 6.3 Findings – manufacturing and services

- Most well-known vehicle producers (and their higher tier suppliers) are synonymous with extremely high quality standards. Therefore, setting purely quantitative targets/benchmarks for local supplier participation in automotive projects was more acceptable than in less technologically-intensive industries.
- Pressure from the original equipment manufacturers to reduce prices was the main driver for automotive parts producers to actively seek cheaper suppliers in the Bank’s countries of operations. However only a few suitable suppliers were found, most of them foreign-owned. Therefore backward linkages to locally-owned companies have been indirect in the majority of projects, that is related to what 1st tier suppliers purchased locally from 2nd or 3rd tier suppliers.
- The cost of introducing a new automotive parts supplier is very high as the contracting party has to cover the cost of new tooling (part of the

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machinery) for the new supplier. Therefore switching is often economically unjustified, even if the new supplier offers a part at a substantially lower price.

- Moreover, automotive components have a limited "product life" and therefore local producers have more chance of being contracted when a part is new, while their prospects of replacing an existing supplier are limited.
- Automotive parts producers assembling appearance items (for example car interiors) have very limited flexibility in sourcing their suppliers as most of them are designated by their original equipment manufacturer clients (and are often from western Europe, well known to the original equipment manufacturers).
- References to "R&D transfer" were imprecise in the approval documentation for automotive project because automotive producers generally had no intention of transferring *sensu stricto* R&D to the Bank's countries of operation. This was because of the required proximity and links to the original equipment manufacturers (most of which are still in western Europe) and the established research base in terms of human capital and infrastructure.
- However, there was evidence that many advanced process engineering functions have been transferred, including testing, simulation, minor parts design, technology and tooling development, prototyping and software programming. This constitutes an important know-how transfer and was often the main transition impact of the Bank's automotive sector projects.
- It was very unlikely from the start that automotive parts producers would contract out any R&D to universities in the Bank's countries of operations (an objective of some projects) as the development of complex automotive parts is a highly specialised area that universities would be unable to contribute to. However many of the Bank's automotive clients cooperated with local universities, sponsoring targeted engineering programmes and offering internships to their graduates.
- Programmes involving complex technologies, such as the introduction of lower emission engines, rarely presented real potential to strengthen linkages to local suppliers and research institutes as the component producers of such advanced technologies are well established (together with their considerable R&D infrastructure) primarily in western Europe and the USA.
- Governments may indefinitely delay the introduction of new regulations (for example lower emission engines), upon which the transition impact of the Bank's automotive projects often depends.

## 6.4 Recommendations

1. Produce clear operational guidelines on how to identify, structure, implement and monitor the effectiveness of SCBL components where they are intended to contribute to the performance of specific Bank projects. Guidelines should clearly set out all necessary process and accountability issues.
2. Projects targeting SCBL effects as transition drivers should include these specifically in their results framework, clearly identifying appropriate and measurable outcome objectives, baseline data and interim benchmarks, and setting out how effective monitoring will be accomplished.
3. When sector and country strategies identify SCBL-related transition issues and opportunities as a justification for Bank operations, these should be incorporated clearly into their results frameworks and reasonable clarity provided as to the expected focus of operational efforts to address them.
4. Responsibilities for implementation of specific actions related to SCBL objectives, along with monitoring, data collection and reporting, and any related resource requirements should be explicitly agreed and captured in the project's legal or other documentation.

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# Annex 1 : Management Comments

Management would like to thank EvD for the study and appreciates the analysis that demonstrates how the Bank's activities address supply chains and backward linkages (SCBL), and suggests ways to improve the Bank's approach and application of SCBL. Improving SCBL has indeed been an important transition objective pursued by many of Bank's investments in the corporate sector. Management welcomes the study findings highlighting both generally positive results achieved by operations in expanding the clients' local supplier base (including with evidence of qualitative changes on the suppliers' level) as well as identifying difficulties in addressing SCBL in particular countries, sectors and contexts. Management would like to emphasise that these findings are very important and form the basis for identifying useful lessons for future investments that support expanding markets through SCBL that could be part of study recommendations.

Management has undertaken or commissioned a number of studies to better understand and assess the economic and social impact of the automotive and retail sector, as well as the effect on the supply chains and backwards linkages. Also, to promote modern food retail formats and facilitate sustainable agricultural supply chains, Management hired external expertise to develop the Sustainable Enterprise and Environment Diagnostic (SEED) tool. The Tool is aimed at assessing food retailers' sustainability practices looking at both supply chain performance as well as their own operations, against specific benchmarks (including average EU retailer standards and objectives of the EBRD's Environmental and Social policy) and within the specific country context (i.e. emerging, growing or mature food retail markets). The assessment identifies areas for improvement that lead into the development of Action Plans for improving the food retailers' sustainability performance over a 3 to 5 year period. Management also notes that it is currently developing a sector-wide technical assistance programme with the European Union to tackle value chains and incentives for SMEs and local suppliers and enable links between aggregators and suppliers in the SEMED region. In this context, the EBRD has set up a working group focusing on instruments to maximize the positive impact of these interventions on value chains.

Management also welcomes the analysis of the current approach and application of SCBL considerations both ex-ante and ex-post, that are the focus of study recommendations. Management appreciates the rationale for a more systematic application of SCBL during an investment project's approval and monitoring, while noting that it is important to ensure that specific aspects of recommendations are feasible and consistent with the ongoing initiatives currently being undertaken by the Bank. Such challenging aspects are considered in the context of this ongoing work (for example Transition impact concept review and project Christopher), that take

a broader, more systematic view on assessing and measuring impact, including related to SCBL in other sectors.

Management's extensive comments provided to the draft study have been partly reflected by EvD in this final version of the study.

## Study's recommendations

**Recommendation 1:** *"Produce clear operational guidelines on how to identify structure, implement and monitor the effectiveness of SCBL components where they are intended to contribute to the performance of specific Bank projects. Guidelines should clearly set out all necessary process and accountability issues".*

Management agrees with this recommendation to preparing SCBL-related guidance as part of ongoing work. As described in the study, the concept of backward/forward linkages and value chains has been engrained in the transition impact methodology from the very start, as evidenced in the original paper on Transition Impact methodology of investment projects, further elaborated in follow on papers prepared by the Office of the Chief Economist, and reflected in the transition impact analysis checklist. Nevertheless, clearer guidelines for considering and operationalising the SCBL component for the Bank's activities would be beneficial.

Management highlights the ongoing review of the transition impact concept, as well as streamlining of transition impact assessment of projects ("Project Christopher") and improving the project-level results framework, currently underway. These work-streams take a broader review of improving all aspects of the transition impact design, appraisal and monitoring, in particular, with a view of streamlining transition impact definitions and metrics. Management believes that development of operational guidelines regarding SCBL should be contemplated as part of, and in line with principles of, these work-streams and will look at ways of structuring, assessing, implementing and monitoring SCBL elements within this ongoing work (i.e. not as stand-alone product dedicated specifically to SCBL) as a more efficient way of addressing this recommendation.

**Recommendation 2:** *"Projects targeting SCBL effects as transition drivers should include these specifically in their results framework, clearly identifying appropriate and measurable outcome objectives, baseline data and interim benchmarks, and setting out how effective monitoring will be accomplished."*

Management agrees with this recommendation. As indicated in the study, SCBL effects targeted by operations have already been specifically included as transition impact benchmarks for relevant operations. Management agrees however that the consistency of applying the benchmarks for SCBL-related operations could be improved. Indeed, as part of the work currently underway to streamline transition impact ratings of projects (Project Christopher), Management is developing

and will include harmonised monitoring indicators for each channel of transition, as well as ensure a systematic collection of the baseline data. Harmonised indicators for measuring SCBL will also be derived as part of this exercise. Management will also prepare guidance on transition impact monitoring that aims to improve the effectiveness of monitoring, including SCBL components.

Management believes that for the purposes of transition impact monitoring, a careful attention should be given to identifying indicators that are both measurable and meaningful at the project level. Management notes that, while measuring qualitative changes beyond the client would be beneficial to show the impact of the Bank's activities, it is extremely challenging to collect such information from clients (mainly due to their limited visibility to such changes or, as is the case in automotive sector, high sensitivity/confidentiality of such data), as evidenced by the difficulties in obtaining it for most projects during the study itself. Moreover, the analysis of the impact beyond the client level requires more rigorous assessment, with thorough examination of counterfactual and incremental change, as well as comparative work across the industry. Such an assessment is best achieved through in-depth evaluation products, such as this study and the work done by Management described above, using appropriate evaluation methods (e.g. through surveys) at the aggregate portfolio level rather than through an individual project-level transition impact monitoring.

**Recommendation 3:** *“When sector and country strategies identify SCBL-related transition issues and opportunities as a justification for Bank operations these should be incorporated clearly into their results frameworks and reasonable clarity provided as to the expected focus of operational efforts to address them.”*

Management agrees with this recommendation. A broader identification of SCBL-related opportunities and ways to operationalise them as part of sector and country strategies is important for a longer term strategic approach to Bank's support in this area. The thematic approach to country strategy priorities applied in the past two years facilitates this broad approach to challenges and opportunities in a given area. At the same time, it is expected that the country strategy diagnostics will serve as a good basis for a more elaborate discussion of constraints to private sector development in the EBRD's countries of operations, including, when applicable and relevant, suppliers in the corporate sector. Subsequently, in cases where improving SCBL is identified as a challenge in a given country context, a country strategy will discuss how the Bank could address this challenge as part of its operational response and results framework. The work currently underway to review country strategy process and content (as part of transition impact concept review and Operation Efficiency and Effectiveness, OE&E, programme) is expected to contribute to creating a more effective and operationally relevant country strategies. The parallel results management review work-stream within OE&E will focus at ensuring an effective transition impact results framework architecture that allows an

alignment of objectives and measurements of results of the Bank's activities to those identified as key priorities at the country level.

Management would like to also note that it has already undertaken sector-wide initiatives to strengthen SCBL links of the Bank's activities. For instance, a multi-sectoral team has already been formed to explore ways of implementing an effective value chains approach for the corporate sector (mainly agribusiness and M&S), aimed at enhancing sustainability and competitiveness of companies, in particular, SMEs and MSMEs that already work with aggregators/sponsors. The underlying objective of the value chain approach for suppliers/SMEs/MSMEs would be to link less advanced companies to more advanced aggregators in the context of strong value chains. The approach would consider both the use of EBRD investments, grants and technical assistance to provide incentives to invest in activities targeted at enhancing suppliers/SMEs and helping them to innovate and move towards higher value added activities. Management believes that such programmatic approach, based on clearly articulated objectives and linked to specific TC/grant umbrella would be an example of reflecting SCBL in the Bank's strategies.

**Recommendation 4:** *“Responsibilities for implementation of specific actions related to SCBL objectives, along with monitoring, data collection and reporting, and any related resource requirements should be explicitly agreed and captured in the project's legal or other documentation”.*

Management disagrees with this recommendation. Management believes that while the client awareness on SCBL provisions reflected in monitoring benchmarks could be improved, a formal agreement with the client either in legal documentation or even through MoUs may not be commercially feasible. Formal and complex control frameworks may also go contrary to the ongoing efforts for increased efficiency and business simplification.

Management thinks it is not commercially feasible to covenant objectives related to SCBL in legal documents, as in the majority of cases their implementation would primarily depend on the performance of third parties (rather than the Bank's counterparty), which is beyond the client's control. Borrowers will not accept inclusion of such requirements into legal documentation, as a breach of such provisions (which is outside their control) can trigger a default on the EBRD loan and, in turn, cross default on other loans. Therefore, this recommendation, if implemented, would significantly undermine the Bank's ability to carry out business in the corporate sector and would result in a diminished impact not only in relation to SCBL, but also in relation to other important transition objectives the Bank's projects. This is an important consideration given the significant role food retail, automotive and other sectors play, particularly for employment in countries of operations.

Adding another layer of covenants into legal documentation will also go against the current

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endeavours to increase efficiency of investment process, as an excessively complex control framework may lengthen the project signing process. The same holds true for agreeing other formal documents with clients specifically covering SCBL aspects – preparation and finalisation of side letters or MoUs for the purpose of SCBL actions and reporting will still require a lot of procedural work involving multiple departments within the Bank. This would extend the project signing time and may still not be acceptable for some clients.

At the same time, Management recognises the need to increase the clients' awareness of transition impact benchmarks related to achievement of SCBL targets and

inconsistencies in data collection. Management believes that ensuring a systematic discussion of SCBL benchmarks with clients at the approval stage, as well as an explicit identification of the source of information for collecting SCBL-related updates within a transition impact benchmarks table (presented to the Board) will be an effective way of addressing this issue. Management will look into ways of reinforcing such an explicit discussion of SCBL components with clients as part of project preparation, including by modifying the transition impact monitoring table accordingly to include the source of information.