

# EBRD strategy for Poland 1998-99: a summary

Poland has made significant progress in transition across all areas, including its enterprise sector and its institutional and legislative structure. The transition, together with macroeconomic stability, has brought seven years of economic growth. The key challenges in the coming years are to strengthen the institutional structure, particularly in capital and financial markets, to help private enterprises grow in increasingly competitive global markets, to improve the infrastructure and to restructure certain sectors.

## Overview of EBRD activities to date

The European Bank for Reconstruction and Development (EBRD) has been an active participant in Poland's transition, principally through:

- the financing of private sector projects across a broad range of industrial and service sectors;
- support for financial institutions and equity funds;
- the mobilisation of domestic and foreign investment;
- the financing of both public and private infrastructure.

## Strategic objectives

The EBRD is to pursue four operational objectives. The Bank will:

- promote privatisation, restructuring, competition, sound corporate governance and competent management in those sectors that face severe restructuring needs as a result of the heavy legacy of the old regime;
- continue to promote the development of dynamic private enterprises, particularly through financing of small and medium-sized enterprises (SMEs);
- seek to promote the supply of a broader range of financial structures and products and will cooperate closely with local financial institutions to help expand their capacity to provide innovative forms of financing;
- endeavour to finance increased infrastructure, municipal and environmental investment and to contribute to the increasing use of local currency financing in infrastructure/utilities projects.

## Restructuring

Sectors in need of restructuring include agriculture and agribusiness, coal mining, fuels, chemicals, steel production, shipping and press distribution.

By providing and catalysing investment funds, the EBRD will demonstrate how the social cost of structural adjustment can be contained while realising the potential of these sectors within an increasingly competitive environment. Support for the government's policy of stepping up the pace of privatisation is a key component of this approach. Because of the lengthy time involved in privatising larger enterprises, the Bank will offer, wherever appropriate, pre-privatisation financing.

In some cases, such as agriculture and certain related activities, the EBRD's approach is to involve and strengthen the local financial sector to enforce market disciplines. In others, the Bank will encourage the support of local and foreign strategic investors.

## Priorities

In the **agribusiness** sector the EBRD will focus on financing capital expenditure in preparation for Poland's accession to the European Union. This will include companies that need to upgrade their hygiene and quality standards, make environmental investments, align their packaging or labelling capabilities to EU requirements or more simply invest in order to remain competitive in the face of competition from European companies. A key related project will be the privatisation of BGZ, the state-owned agricultural bank.

In the **steel** sector the EBRD aims to participate in the privatisation of at least one of the country's three largest steel mills - Huta Sendzimir (flat products), Huta Katowice (long products) and Huta Czesochowa (ship plate) - which together account for 72 per cent of the country's crude steel capacity and 53 per cent of employment in the sector. The Bank is now engaged in discussions with each of the three mills and with strategic investors to identify ways of contributing to their modernisation.

The EBRD could participate in the privatisation of profitable **coal** mines if these can be unbundled from centrally managed holding companies as part of the government's latest coal restructuring

programme. The World Bank has agreed to cooperate in identifying potential mines for pre-privatisation financing from the EBRD. In addition, the Bank is considering ways of encouraging the private sector to develop commercially oriented clean-up programmes to overcome environmental damage linked to mining activities.

The EBRD is exploring the possibility of providing pre-privatisation financing to the proposed merged **petroleum** company, Plock-CPN, before the planned initial public offering takes place in 1999.

There is an urgent need to unbundle potentially profitable **chemical** operations from state-owned holding companies, and to provide focused financing to operations with a competitive future. The EBRD will undertake such an analysis as a basis for proposing an investment strategy to the government.

The first private equity placement in the **shipbuilding** sector is scheduled for late 1998, and the EBRD may participate in it. There may also be opportunities for the Bank to become involved in the main shipping companies.

The EBRD will offer to participate, alongside strategic investors, in the privatisation of the state-owned **press distribution** company, which has a virtual monopoly in this sector.

### **Private sector**

The EBRD will promote the development of private enterprises, principally through financing SMEs. The Bank will still have a direct equity role in specific sectors in which it has developed expertise - agribusiness, light industrial and consumer products, building materials and certain service sectors. However, the principal source of SME financing will be equity funds.

Where direct operations can be considered, the EBRD's chief aim is to accompany outside investors or to prepare companies for eventual access to the markets. In the case of smaller companies, the Bank will work in conjunction with financial intermediaries.

### **Priorities**

Direct operations with **local companies** will enable the EBRD to have a direct impact on corporate governance and business standards in sectors such as energy, oil and gas storage and transmission, real estate, building materials, consumer products and packaging, and food distribution. Whenever possible, the Bank will invest alongside another financial investor with experience of investing profitably in the specific industry.

The EBRD will continue to participate in the establishment of focused **venture capital** funds managed by qualified equity investors. If warranted, the Bank could promote SME credit financing by local banks through instruments such as guarantee arrangements and local currency co-financing.

Another on-going initiative will be **bilateral co-financing facilities**, with the EBRD investing or lending alongside bilateral agencies and their national private investors in Polish enterprises. The Bank is also in discussions with the European Investment Bank and EC-Phare in establishing an **SME credit line** with a local financial institution to help business start-ups in regions undergoing restructuring.

### **Financial sector**

The EBRD will seek to promote the supply of a broad range of financial structures and products. It will cooperate closely with local financial institutions to help expand their capacity to provide innovative forms of financing and to compete as the financial sector is deregulated and opened-up to more foreign entry. The Bank will continue to make direct investments in local financial institutions.

A key objective for the EBRD is to strengthen the response of the financial sector to the demand for financial services through diversification into retail and savings products, an increased emphasis on non-bank financial institutions and through the lengthening of maturities. The Bank will continue to support the privatisation of financial institutions.

### **Priorities**

Key projects include the **privatisation** of the state-owned "monopoly" insurance company, PZU, and the pre-privatisation restructuring of the agricultural bank, BGZ.

To support the growth in **mortgage** financing and diversification of **retail banking**, the EBRD would consider making equity investments in specialised financial vehicles sponsored by reputable and qualified strategic investors and providing long-term local currency support financing to such vehicles.

The EBRD approved recently an investment in a **pension** fund management company in advance of the introduction of the multi-pillar pension system, which is due to be implemented on 1 January 1999. This could be followed by a second investment in a voluntary pension fund. These two investments will contribute to the development of the management infrastructure necessary to support the development of the pension industry.

## Infrastructure and environment

The EBRD will endeavour to finance increased infrastructure, municipal and environmental investment and expand the use of local currency financing in infrastructure/utilities projects. Key areas of Bank involvement will be the sub-sovereign financing of projects at the municipal level, the promotion of a range of options for private sector participation in motorway and power projects, the commercial financing of property infrastructure and urban services, and the unbundling and privatisation of gas distribution. The EBRD will engage in sovereign financing together with other international financial institutions (IFIs).

The EBRD's strategic aim over the coming years is to demonstrate feasible approaches for infrastructure development. It will be particularly important for the Bank to draw private funding into the sector, both equity and debt, to supplement limited public budgets. The EBRD also intends to play an active role in promoting investment in environmental infrastructure.

The EBRD's emphasis on innovation and its ability to influence and stabilise the regulatory environment will generally ensure that its activities remain "additional" to commercial sources of funding and, indeed, stimulate such funding. In addition, a major aim for the coming years is the development of local currency instruments for the financing of infrastructure, an area in which the Bank can play a pioneering role given its capital structure and ability to work with its partners in the financial sector. The development of local capital markets, including municipal bonds and other debt securities, will go hand in hand with expanding investment in infrastructure.

### Priorities

The EBRD has an active pipeline of **municipal and environmental infrastructure** operations in the form of loans to creditworthy cities (without sovereign guarantees) and private sector investments involving private-public partnerships. The Bank's strategy is to: (i) improve the quality of essential urban services – in so doing it will help municipalities meet EU accession requirements in urban transport, water supply and waste-water collection and treatment, solid waste management and district heating; (ii) develop private-public partnership projects in a number of larger cities; and (iii) develop operations involving loans to small and medium-sized municipalities for multi-sector infrastructure investment.

The EBRD will typically assume risks that commercial banks or capital markets may not yet be

willing to take. It will provide investment finance to creditworthy municipalities and to municipal utilities with or without municipal guarantees, or will invest equity and convertible debt in creditworthy municipal utilities where such financing may facilitate their commercialisation and, possibly, privatisation. The Bank will expand the Municipal Public Private Partnership Programme of technical cooperation aimed at developing projects in cities that wish to initiate public-private partnerships. At the same time, the EBRD is exploring ways in which it can finance programmes through selected specialised financial intermediaries or cooperation with dedicated environmental funds.

Following the Wroclaw transport project to finance the modernisation of the flood-damaged **urban transport** infrastructure, a similar project in Krakow, to be co-financed with the European Investment Bank (EIB), is at an advanced stage of preparation. The EBRD will lend to the City of Krakow on a sub-sovereign basis. Other projects are being developed for Lodz and elsewhere.

The EBRD has been active in the **motorway sector**. The Bank has indicated its willingness to consider financing the A1 (between Gdansk and Torun) and A2 (from Polish/German border at Swiecko to Strykow, north of Lodz) projects. The EBRD would also be willing to consider financing road network management operations by the private sector or public-private partnerships.

The government is considering ways to restructure and commercialise the Polish **railway industry** by splitting the national rail company (PKP) into separate operating companies. The Bank could play a role, initially through a sovereign-guaranteed loan to PKP in association with other IFIs.

The EBRD will seek to support further private sector involvement in specialised **port terminals**. In respect of **ports**, the Bank will look at opportunities for co-investing with experienced port operators.

The EBRD will focus on cooperating with individual **energy** facilities to advance the process of individual privatisations. EC- Phare co-financing will be used to accelerate the pace of environmental upgrades and modernisation. Possible Bank financing of **gas distribution** projects will depend on the decentralisation and the unbundling of distribution facilities into entities that can be financed on a project basis.

In respect of **energy efficiency**, the EBRD has already supported the setting up of three energy service companies (ESCOs). A special focus for the Bank will be the financing of district heating projects, either through direct involvement or indirectly through ESCOs. The EBRD will also seek to support

industrial companies with the implementation of comprehensive investment programmes aimed at reducing excessive energy consumption.

The EBRD's additionality in the **property** sector in Poland lies in providing equity and long-term debt to stimulate development activity. In the **tourism** sector, the Bank is working on several projects that would involve the construction or refurbishment of a number of hotels in Poland. In general, these projects focus on mid-market hotels, a sector where demand is growing quickly.

In the **telecommunications** sector the EBRD could support further liberalisation of the market through a possible involvement in the privatisation of TPSA (the incumbent operator) as well as the financing of a second (alternative) operator. The EBRD would also consider financing telecommunications services operators as well as projects in electronic media.

### **Cooperation with other IFIs**

The EBRD is cooperating closely with other IFIs. In March 1998 a Memorandum of Understanding (MOU) was signed between the European Commission, the World Bank and the EBRD setting out the parameters for their cooperation in respect of EU accession countries. This involves bilateral co-operation, particularly in the field of co-financing.

The EBRD has started to explore with Phare the possibility of creating a financing facility for the dairy sector. This facility would allow selected farms and dairies to be upgraded to EU standards. An SME Facility is being developed in cooperation with Phare.

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| This summary is based on the Strategy for Poland, which was approved by the Board of Directors on 15 September 1998. |
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