DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

AGRIBUSINESS SECTOR STRATEGY

As approved by the Board of Directors at its meeting on 6 July 2010

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ABBREVIATIONS / DEFINITIONS

Advanced Countries	Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia
ABV	Annual Business Volume
ADB	Asia Development Bank
CA region	Central Asia (Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan, Uzbekistan)
CEB region	Central Europe and the Baltics (Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia)
CIS	Commonwealth of Independent States
CPR	“Cédula de Produto Rural” (Certificate of Rural Product)
€ / EUR	Euro
EC	European Commission
EBRD	European Bank for Reconstruction and Development
EEC region	Eastern Europe and Caucasus (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine)
EU	European Union
ETC	Early Transition Countries (Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan)
FAO	Food and Agriculture Organisation of the United Nations
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HACCP	Hazard Analysis and Critical Control Point
HSE	Health, Safety and Environmental
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFI	International Financing Institution
IFRS	International Financial Reporting Standards
ISO	International Organization for Standardization
LTT	Legal Transition team
MPF	Multi-Project-Facility
OCE	Office of the Chief Economist
SAPARD	Special Accession Programme for Agriculture and Rural Development
SEE region	South Eastern Europe (Albania, Bosnia & Herzeg., Bulgaria, FYR Macedonia, Montenegro, Romania, Serbia)
SIC	Standard Industry Code
SME	Small and Medium Enterprises
TC	Technical Co-operation
TIMS	Transition Impact Monitoring System
USD	United States Dollar
WHR	Warehouse Receipts (Programme)
WTO	World Trade Organisation

EXECUTIVE SUMMARY

The global food crisis has demonstrated the importance of the Agribusiness sector. Across much of the transition region, agricultural production could be dramatically increased through investment in new farming and in particular by raising the yields of existing production.

The Bank can leverage its position to help meet this challenge. Its investments target the development of local supply chains to increase efficient production. It has played a substantial role in introducing financing schemes that tackle the chronic lack of capital in the sector. It has also intensified its policy dialogue efforts, bringing together investors, distributors, processors and retailers in collaboration with the United Nations Food and Agriculture Organization, to stimulate discussion on the possibilities of improving agricultural practices and removing current obstacles. There is much at stake: the scope for increased food production in the EBRD region is great enough not only to address supply within the region but globally as well.

In recent years the Bank has progressed on many of its strategic objectives. It is considered one of the leading international financial institutions for Agribusiness related projects in the region. This has been achieved via a demand-driven approach that targets projects with high transition impact by focusing on downstream activities in the Agribusiness value chain. 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).

Nevertheless, the region still faces substantial transition challenges that prevent it from exploiting its large unrealised production potential. In order to realise this potential fully, persistent market inefficiencies throughout the food chain must be addressed – from insufficient competition and cumbersome administrative barriers in retail and distribution, low quality standards and productivity in processing and packaging, to inadequate access to finance, weak institutions and policies in primary agriculture.

Upstream, the main challenges include inefficient farming techniques, inputs and agricultural machinery as well as bottlenecks to export (such as the lack of sufficient transport infrastructure and storage facilities). The farming sector is additionally affected by pressing policy and regulatory issues such as unclear land property rights, inadequate access to finance and fragmented land ownership. Progress still needs to be made in the development of clear, long-term policies and legislation to attract sufficient private sector investment to enable the agricultural sector to access finance through collateralisation. Further downstream the agricultural potential of the region is still undermined by unsatisfactory quality standards and weak local brands, fragmented production units and inefficient retail formats and distribution networks that need to be addressed via a mix of private sector investment and specific policy dialogue.

The Bank will pursue these goals right along the value chain in the private sector and will complement its activities with continued policy dialogue. To its successful approach based on individual projects, the Bank will add an integrated approach, clustering banking project work with technical cooperation and policy dialogue in selective key areas to augment the overall impact of its efforts.

Fundamental transition challenges vary within the region and must be approached accordingly. Particularly in Early Transition Countries quality standards and controls are inadequate, growth of competition and restructuring remain slow, the necessary transport infrastructure is often lacking, modern retail business is still non-existent and finance is often unavailable. In a number of these countries, state interference in the sector still remains pervasive. In more advanced transition countries such as in the Western Balkans challenges are clustered around upstream production as well as SMEs particularly in rural and more remote areas and hence require a different set of investments.

Given the Agribusiness sector's impact on its surroundings – particularly in primary agriculture – it has become obvious that a sustainable investment approach addressing environmental and social aspects in a more systematic manner than before will become critical for the coming years.

The Bank intends to address these challenges by pursuing the following strategic objectives:

1. Food Security – maximise the region's potential and help address global food imbalances by promoting market-orientated, systemic change: The Bank will continue to support projects that aim to increase the level, productivity, quality and safety of output for domestic consumption and export in a sustainable way. It will contribute to the increased availability of food through its investments and promote better market access (by improving price signals, transport infrastructure, storage facilities, etc). It will improve accessibility of food products and increase food safety domestically, enhancing the market in rural areas especially. The Bank will expand efforts to promote financing solutions for primary agriculture in accordance with sound banking principles. In order to achieve this, the Bank will continue to cooperate with successful local entrepreneurs as well as multi-national companies, other international (financial) institutions and commercial funding sources, as well as through rural credit lines all of which are critical to the sector's transformation into a healthy, modern economic channel for uninterrupted food supply and increased food security.

2. Maximise transition impact through a focused investment approach and increased regional differentiation (with an emphasis on ETCs and the Western Balkans): The Bank will continue to pay special attention to countries at earlier and intermediary stages of transition where Agribusiness plays an important role but still lacks efficiency due to limited market orientation. In these countries, the Bank will continue to work throughout the entire value chain, with a greater emphasis on regional investment in the case of Russia and Ukraine and continuous attempts to support upstream agriculture through vertical integration. In more advanced transition countries, the strategic focus will be on upstream industries in close proximity to primary agriculture as well as medium-sized rural enterprises.

3. Promote a sustainable investment approach addressing environmental and social issues, including gender, energy efficiency and climate change adaptation more systematically. A specific focus will be on investments linked to energy efficiency, carbon emission reduction and environmental improvements, in particular through new initiatives such as the proposed Agribusiness Sustainable Investment Facility that targets energy efficiency as well as environmental and social investments. This will entail closer co-operation with the Bank's Environment and Sustainability Department and the Energy Efficiency and Climate Change team (E2C2) on a project level. Typically such an integrated investment approach will address enterprises in more advanced countries of operations in the first instance while gradually widening its scope to less advanced countries as awareness and willingness to adjust grow.

4. Continue to pursue its policy dialogue agenda. In order to be effective, the Bank's policy dialogue initiatives will remain linked directly to EBRD core competencies, i.e. investment related programmes such as support for warehouse receipt financing legislation and collateralisation of already privatised land. It will also build further on the ongoing co-operation between the private and public sectors with the objective of intensifying dialogue concerning key issues affecting private sector investment. It will provide assistance to countries in developing an Agribusiness strategy that clearly sets out national sectoral development priorities. Policy dialogue will continue to rely on the successful EBRD/FAO cooperation agreement and the EastAgri network, but specific TC funds will also be used for other initiatives such as co-operation with the Bank's Legal Transition team. Geographic and sub-sectoral programmes will be designed with the objective of translating policy dialogue, technical assistance and specific financing solutions into bankable projects addressing transition bottlenecks in different regions.

The recent global financial and economic crisis has constituted a significant setback to realising the region's potential in the Agribusiness sector. Thanks to its transaction expertise and knowledge of the sector, the EBRD continues to be uniquely placed to help the region tackle remaining transition challenges and increase production. Assuming that commercial funding will continue to be constrained as the region emerges from the global crisis, demand for the Bank's financing will intensify. As a result of the crisis, existing clients are expected to approach the Bank with new projects, and fast growing local companies have also shown a willingness to align themselves with EBRD transition objectives and quality standards. The Bank will seek to develop projects with high systemic transition impact, including in such areas as environmental and social sustainability, energy security and efficiency. Where possible, the Bank will look for opportunities to cluster its operations, technical assistance and policy dialogue in selected countries and sub-sectors into an integrated approach in order to enhance its transition impact beyond what individual projects can accomplish.

The attached Sector Strategy outlines the EBRD's approach to tackling the diverse challenges present in its sector, taking into account the current environment in the Bank's countries of operations as well as the global economic conditions, the extensive experience of the Bank in the sector, and specific lessons learned. In order to implement its strategic objectives, the EBRD will continue to strengthen its local presence and continue with its disciplined business driven approach to deliver high quality projects.

1. SECTOR UPDATE

1.1 Main trends in the Sector in the Bank's Countries of Operations

Agribusiness is an important sector in the Region. It represents a major proportion of the Region's employment, economic output and future growth potential. Its 200 million hectares equal 13% of the world's total arable land. In output terms, it has become a leading global supplier of basic foodstuffs like corn, wheat, rice, sunflowers and oil, and barley, though this positive trend needs to continue in other areas of the value chain. For example, the region contains 7% of the world's population but produces less than 3% of its meat.

Since the last Operations Policy[1] ((BDS02-23) approved by the Board in 2002) significant positive developments have materialized in the sector. These include *inter alia* the emergence of strong local players throughout the value chain; a retail revolution that has greatly improved the quality and format of retail operations; progress in reducing tariffs and trade barriers under the aegis of the World Trade Organisation and an increasing awareness of sustainability issues. Primary agriculture yields have improved as a result of higher investment and better integrated agri-industrial companies and their expanding use of modern agricultural practices and machinery. In recent years, the region has moved from being a net importer to a net exporter of certain agricultural commodities and a notable contributor to international supply. Russia, for example, has moved into the top five grain exporters globally while it was previously a large importer of grain.

The recent world food crisis had a significant impact on the region, which translated into record price increases in the first half of 2008 and affected nearly all food commodities. Two divergent consequences were visible: on the one hand, higher prices provided the sector an opportunity to expand production. A rush on land occurred, as demand and prices for primary agricultural commodities rose. On the other hand, retail prices for basic foodstuffs like bread, milk and butter rose, and vulnerable groups were worst affected. Food still accounts for a major part of the typical consumer basket of goods in the region: it comprises 40% in Russia, over 50% in Ukraine and even in countries like Romania, still over 40%. Government responses to the food crisis included interventions aimed at bringing down these price increases. Export bans and price controls, implemented in for example Russia, Ukraine, Kazakhstan and Serbia count amongst these measures, which ultimately damaged profitability, reduced investment and hence decreased supply.

Prices have since fallen from their 2008 peak but any benefits from falling world cereal prices have been more than offset by the global economic downturn. This second crisis created a new set of challenges, including inter alia severely restricted financing for the sector, much higher re-financing risks and large exposure to hard currency denominated debt.

[1] The term Operations Policy has been replaced by Sector Strategy. The new term will be used henceforth.

The fact that food supply disruptions were increasing even before the food crisis suggests that markets are not functioning correctly and that the fundamental challenges in the Agribusiness sector remain. In the transition region these supply disruptions are partially rooted in the collectivisation of land and agricultural assets and the absence of pricing mechanisms along the food value chain. The UN FAO estimates a need for an additional 30 million hectares of agricultural land worldwide by 2017. FAO estimates that 1.02 billion people were under-nourished worldwide in 2009. This represents more hungry people than at any time since 1970 and a worsening of the unsatisfactory trends that were present even before the economic crisis. The region could provide part of the solution. For example, combined EBRD/UN FAO research shows that Russia, Kazakhstan and Ukraine alone could quickly increase their arable land under production by returning to use 13 million hectares of land that has not been used since the early 1990s.

1.2 Developments by Sub-sector

The rapid development of the way consumers can access high quality food at affordable prices is the most significant change since the last strategy. This improvement is mainly due to the liberalisation of the former state-controlled retail sector and hence the opportunity for international and local players to penetrate this market, shifting consumer behaviour and increased income levels.

These new format retailers favour suppliers that can deliver larger volumes of food of higher quality standards on a more consistent basis. As a result, suppliers worked to increase their efficiency and quality standards in order to meet modern distributors' expectations. In return, suppliers benefited from improved contract terms and more reliable off-takers. Thus, throughout the region, higher product quality, hygiene standards and modernised store formats can be observed, leading ultimately to lower prices for the end consumer with greater food safety, choice and availability.

Further downstream integrated agro processors and food and beverage manufacturers in the region have evolved in two waves over the period: first, global or Western players entered the market often following international retail chains they were supplying elsewhere. Following Western markets entrants, a class of local entrepreneurs emerged. This class initially included "deal makers", who often gained access to privatised state assets and sometimes have intransparent business standards. But the most recent emergence was of a new generation of young entrepreneurs who place greater emphasis on sound business standards, transparent corporate governance and high quality production techniques.

International players entered the market with more efficient production technologies, superior marketing and sales activities as well as the introduction of strong brands. Successful examples are players in the dairy and FMCG sectors (e.g. Danone, Nestlé, Bel, Kraft) as well as beer and soft drinks manufacturers (e.g. Heineken, Carlsberg, Efes, Coca-Cola) that entered the markets via a greenfield investment or by acquiring a local company, often the market leader. However, global players often struggled to build a solid supply base for their raw materials by developing adequate backward linkages.[2]

Driven by the growing demand for predictable food supply of higher quality standards, more and stronger local players established their presence in the market. During this period one could observe the creation of large, vertically integrated agro-processors (e.g. Victoria Group, Yug Rusi, Astarta) in the grain and oilseed sector that were able to grow effectively thanks to important backward linkages to the primary agriculture sector. Domestic players often successfully challenged the global competition also in the FMCG sector, for instance in soft drinks with notoriously short reaction times, better understanding of consumers' needs and value for money (e.g. European Drinks in Romania, Wimm-Bill-Dann in Russia and Hoop in Poland).

In primary agriculture, soft commodity prices which drive activity upstream, remained low from 2002, but almost doubled from end 2006 to mid 2008. The region benefited as investments and production rose in response to increased profit expectations. Though prices have fallen in the wake of the global financial crisis, the problems of global supply of primary agricultural products continue to attract attention, with industrial, political and investor attention shifting to increasing current productivity levels and yield.

1.3 EBRD Activity over the Previous Period

1.3.1 Implementation of the Previous Strategy

The previous strategy for the Agribusiness sector was Board approved in May 2002 (BDS02-23) and identified four major objectives:

Objective 1: Continue to finance the downstream food and drink sectors as an effective means to support upstream primary production and related industries.
Objective 2: Expand the range of financing products specifically geared to the Agribusiness sector (e.g. regional Warehouse Receipt Programme, Leasing etc.)
Objective 3: Improve rural credit systems.
Objective 4: Increase policy dialogues with member countries in co-operation with other development institutions.

While many transition challenges remain, the key messages of the previous strategy have proven to be correctly identifying the main issues in the sector. The Bank's Evaluation Department rated this performance as *successful* in 2008, citing as effective the Bank's food chain approach, which has allowed it to address areas in which investments are key to catalysing the development of the entire Agribusiness chain, particularly in the light of its small project volume vis-à-vis total market size.

[2] For example the beer market in the Bank's region grew substantially over the period and is expected to continue to grow as it approaches Western consumption levels (per capita) but a shortage of high quality malt produced locally and import issues continue to affect production. The same holds true for dairy producers that often struggle to source raw milk at sufficient quality and quantity.

The modern **Food Supply, Retail and Distribution** sector witnessed the highest growth rate of all market segments since the last strategy. The Bank's own investments in the sector grew more than 300% since 2002, contributing to the transition process, increasing food diversity and safety, even in rural areas and following its first Objective set in 2002. The Bank focused investments on the back-end of the value chain to maximise transition impact through backward linkages. Examples include the Bank's investment in "Monetka", a regional Russian supermarket chain in various Urals and Volga regions and thus reducing regional and structural discrepancies whilst being the first well-organized retailer in smaller locations. In the ETC an equity investment in "Monkhangai Group", which owns "Minii Delguur", Mongolia's largest supermarket chain supported consumers' access to a greater variety of competitive and affordable products in a hygienic environment.

The **Processing and Packaging** sub-sector grew to occupy a significant share of the overall portfolio (17%). The Bank has successfully supported its Western clients whose experience enabled them to improve local quality standards bringing about new production technologies and marketing tools. Examples include the Bank's investment in Ukraine with a stake in one of the country's largest cheese producers, Shostka City Milk Factory, acquired by one of the world's leading branded cheese manufacturers, the French Group Bel. Increasingly the share of local companies grew within the Bank's Agribusiness portfolio as national players started to adhere to higher corporate governance standards and became more receptive to the Bank's high standards and requirements, both in terms of transparency as well as environment/sustainability. Successful investments include projects with strong local sponsors like Agrokor (Croatia), Victoria Group (Serbia) and Yug Rusi (Russia).

In **Primary Agriculture and Farming Support,** the Bank met the rush to invest in primary agricultural projects throughout the boom period with caution, and did not support any of the numerous investment proposals brought forward, including for biofuels. Involvement in the primary sector takes longer to develop than projects further down the value chain as it is more complex to find viable financing structures and counterparts. Rural agriculture financing schemes remained extremely challenging to structure and execute. Nevertheless, investments in integrated agro-processing groups closely linked to primary agriculture with strong backward linkages have proven an effective way to reach the primary sector, as shown for example by the Bank's support of Agroinvest, Victoria Group, Astarta or Agrokor.

The Bank's investments in the grain sector have possibly altogether provided for the most significant backward linkages to the farming sector. Large grain traders such as the Bank's clients for working capital facilities including Louis Dreyfus, Toepfer and Bunge, inject much needed capital into the sector and invest in infrastructure and storage facilities. The Bank has contributed to the availability of more financing to the farming sector through the development of suitable financing instruments such as the Grain Receipt Programmes in the region or rural credit lines accessible to SMEs in co-operation with the Financial Institutions Business Group. Financing instruments such as the Tajik

Agricultural Finance Facility, for instance, aim to reach small farm holdings in less advanced rural economies.

When engaging in **Policy Dialogue and Sector Analysis** the Bank was active along five key initiatives:

1) **Food crisis response:** The Bank spearheaded four substantive initiatives on the question of how the region can contribute more significantly to global food security in the face of the food crisis. The meetings it organised took place in London, Kiev, Moscow and St. Petersburg from March 2008 to June 2009, and brought together public institutions with private enterprises, which together with listening and engaging with stakeholders has helped define the key objectives of the new Agribusiness Sector Strategy, outlined herein.
2) **Technical Assistance for new financing instruments:** The Bank developed for example a very successful Grain Receipt Programme in a number of countries in the region that supported local legislation by supporting the introduction of a warehouse receipt law allowing farmers to pledge grain in certified warehouses to gain access to credit. In a second step the Bank extended credit lines to local banks sharing direct farming risk when accepting warehouse receipts as collateral. Similar programmes were introduced in other countries and initiatives are ongoing in Serbia, Russia and Ukraine.
3) **Specific sub-sector support:** Specific studies, conducted in cooperation with the UN FAO, included an analysis of the Georgian Wine Sector, the Armenian fruit and vegetable processing sector, sunflower seed support in Kazakhstan, the fishery sector with a focus on Far East Russia; several studies focused on the grain sector and agricultural land investments in CIS.
4) **Policy dialogue with other development institutions through EastAgri:** EastAgri is an informal platform for sharing information, best practices and lessons learned on agricultural and Agribusiness financing and rural development among key practitioners working in Eastern Europe, Central Asia and the Caucasus. It was created in 2002 by the UN FAO, EBRD and the World Bank. Besides maintaining its web site as a key information sharing tool, EastAgri organises annual meetings to discuss recent events and trends in the Agribusiness sector (about 100 participants attend each meeting), facilitates policy dialogue and organises sector workshops and study tours. To date, 23 of these events have been held.

1.3.2 Lessons Learned

As the sector evolves, so does the financial, transition and environmental risk profile of the Bank's transactions. The EBRD uses the lessons learned database, which is maintained by the Bank's Evaluation Department, which in 2008 also produced an in-depth evaluation of the sector's performance (PE07-378S). Lessons below have been identified around key, recurring project elements. A summary of pertinent sectoral lessons is provided in Annex 1.

Optimal Corporate Governance. Lessons here refer to the importance of the Sponsor's strong environmental culture and business ethics in selecting partners in the region, to the composition of the supervisory board in successfully restructuring projects, and to the

Bank's prerogative in appointing key personnel and making sure that experienced sector specialists are hired.

Risk Identification and Mitigation. Lessons refer *inter alia* to the importance of combining risk assessment with appropriate action securing that identified risk mitigation solutions are implemented, of reporting Bank exposure that is not related directly to the project at hand, and identifying systemic risk when dealing with particular agricultural traders. The Bank must also address market concentration concerns in analysing potential sponsors.

Sponsor Selection. This represents a key focal point in lessons since the Bank's first operations in the sector. The lessons seek to aid the Bank in selecting optimal partners on the one hand and avoiding pitfalls on the other. Thus, sponsors adhering to good governance at home and demonstrating long-term engagement in the region are more reliable partners in Bank-sponsored projects, but large enterprise privatisation with no strategic partners means high potential risk. Nor should the Bank finance private sector projects where the risks of failure need to be covered by a government guarantee.

Enhancing transition impact through technical cooperation, policy dialogue and project sequencing. Lessons refer to the Bank's ability to enhance transition impact by exploiting technical cooperation projects at the project level and policy dialogue, and by focusing projects to maximise backward linkages towards primary agriculture.

1.3.3 Environmental and Social Sustainability

To date, almost all operations in the sector have been categorised "B" by the Bank's Environment and Sustainability Department, implying that environmental and social impacts are typically site-specific and/or readily identified and mitigated. Certain projects within the Agribusiness sector must be addressed with particular caution, however. These include smallhold farms, which raise important social issues or the retail sector, for instance for its labour and gender issues. Other sectors such as primary meat production for instance require special attention: In 2009, the Bank's project with "Kuzbassky Pischekombinat", a Russian regional meat processor in Siberia, was the first Agribusiness project to be rated "A", requiring a full environmental and social impact assessment, public hearings and grievance procedures to be implemented.

Wherever applicable, project work took heed of the fact that the modernisation and intensification of agriculture is associated with increasing mechanisation and use of chemical inputs and fertilisers, significant alteration of landscapes, the promotion of monoculture and associated loss of the benefits of crop diversity. While this enables a substantial increase in production, it can also dramatically increase environmental and social impacts[3]. Intensive animal farming likewise, involving very large numbers of

[3]for example, decreasing the competitiveness of small farmers, shrinking the number of rural jobs, increasing erosion, contamination of water with agricultural chemicals, and destruction of landscapes, and landscape features, vital for biodiversity

animals raised in limited space, may carry the risk of poor animal welfare standards and associated pollution and health issues.

Energy efficiency also emerged over the period as a critical force in establishing the sector's environmental and economic sustainability, particularly in light of the significant energy price fluctuations. Starting in 2006, the Bank committed €131 million to energy efficiency investments across some 28 projects. The largest energy savings were delivered through the replacement and upgrade of processing machinery, particularly in malting, sugar and glass packaging. Many of the Bank's energy efficiency investments were initiated after the 17 TC funded energy audits that were arranged to support its Agribusiness clients in assessing sustainable energy solutions.

1.4 Portfolio Update

By end 2009, the Bank's direct net cumulative commitments in the sector equalled €4.6 billion across 343 projects. 98% of these were private sector operations directed to the enterprise sector. In addition to direct lending, the Bank has also channelled investments through commercial banks' MSE and SME credit line products, some of which are dedicated exclusively to Agribusiness clients.

The Bank's Agribusiness portfolio (i.e. cumulative portfolio net of all reflows) grew by 96% from 2002 to end 2009, standing at €1,046 million across 77 projects at end 2002 and €2,045 million across 159 projects at end 2009. The end 2009 portfolio covered 26 countries of operations and equalled 8% of the Bank's total portfolio. Its share of the Corporate Sector's annual business volume (ABV) increased from 36% in 2002 to 43% as at end 2009.

Annual business volume increased from €388m in 2003, of which €64m was syndicated, to €786 in 2009, of which €147m was syndicated. A lesser share of syndication in 2009 compared to 2008 & 2007 reflects the challenging commercial financing conditions now present in the sector and region.

Financial Products

Debt remains the predominant form of financing. The small increase in equity financing is a function both of the number of equity investments increasing 50% over the period and the signing of two large equity investments - with Agrokor for €110 million (in 2006) and with Lenta Hypermarkets (in 2007) for € 92.2 million.

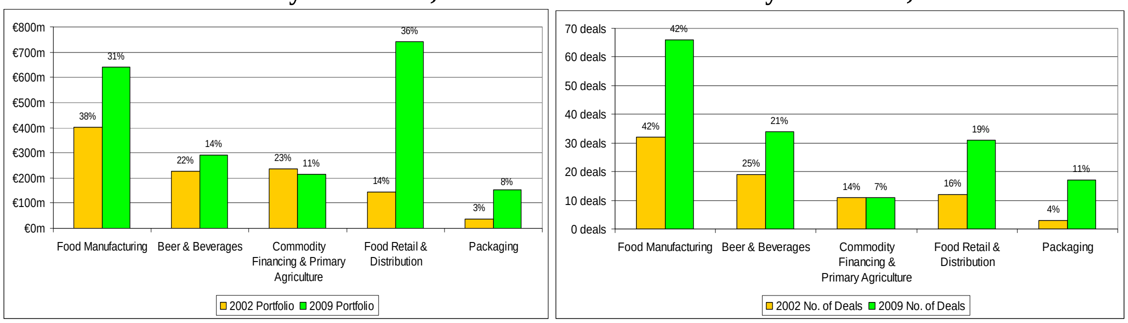
Agribusiness Portfolio by Type of Financing Instrument, 2002 and 2009

Portfolio (€ million)	2002	% of total	2009	% of total
Debt (Incl. Guarantees)	897.5	86%	1,699.4	83%
Equity	148.4	14%	345.4	17%
Total	**1,045.9**	**100%**	**2,044.8**	**100%**

Distribution across Sub-sectors

The sub-sectors with the highest proportion of the portfolio are food retail & distribution, followed by agro processing, food packaging and primary agriculture & commodity finance.

Portfolio Volume by Sub-sector, Portfolio Number of Deals by Sub-sector, 2002 and 2009



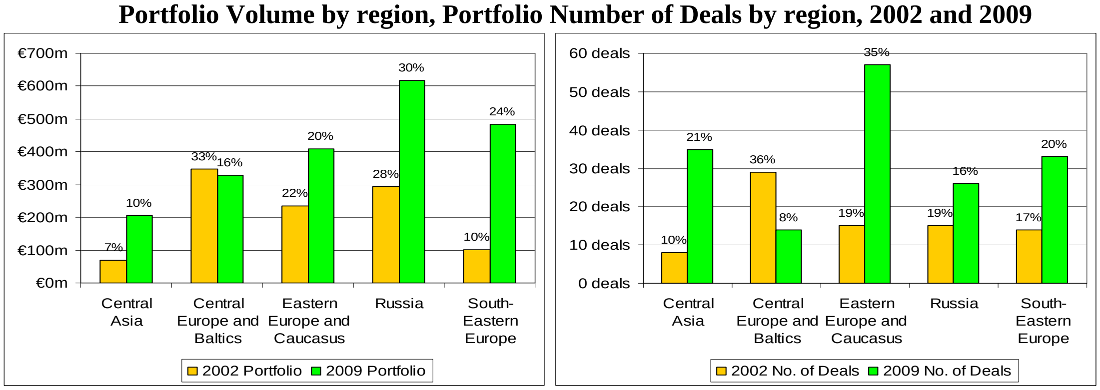
(Note, figures include only operations conducted directly by the Bank's Agribusiness department and therefore do not include loans made to agribusinesses through credit lines executed by the Financial Institutions department.)

Since the 2002 Sector Strategy, there has been a significant wave of expansionary investments by foreign and local food retailers in the Bank's region to satisfy consumers' demand for a wider variety of choice and better hygiene standards. This has also had a noticeable effect on the downstream food processors and packaging companies, resulting in increased demand for EBRD financing. The figures above show the respective portfolio amounts per sub-sector and growth over the period:

Geographical Distribution

Agribusiness investments have shifted south and east since 2002, in line with the Bank's strategic objectives. Except for Central Europe and Baltics, all areas have grown in absolute portfolio terms:

Portfolio Volume by region, Portfolio Number of Deals by region, 2002 and 2009

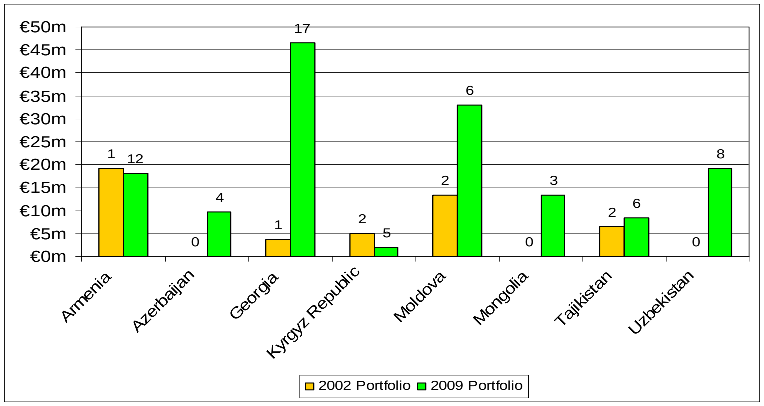


Note: regional projects are counted once per region in which they are located.

The average total growth over the period was 96%, but in South Eastern Europe the portfolio more than quadrupled (371% growth), albeit starting from a low base. The other regions in which growth was above average are Central Asia (199% growth) and Russia (111% growth). Although Eastern Europe and the Caucasus grew in absolute terms, the growth rate of 74% was low, mainly due to the expiry of large warehouse receipt projects active in 2002. This is borne out by the fact that the number of Agribusiness portfolio projects in 2008 in Eastern Europe and Caucasus was 46, i.e. triple that of 2002 when only 15, much larger Agribusiness projects were active.

This is most starkly illustrated in the Agribusiness activity in Early Transition Countries (‘ETC’).

Portfolio Volume and Number of Deals by ETC Country, 2002 and 2009



Portfolio Quality

The average weighted risk of the portfolio has increased by 10% on the Bank’s scale from 5.3 at the end of 2002 to 5.9 as at end 2009. This compares favourably to the Bank's average of 5.6 at the end of 2002 to 6.1 as at end 2009.

The increase in the Agribusiness portfolio risk can be attributed to a gradual shift towards higher risk projects, for example in moving away from sponsor guaranteed projects towards projects with local clients, an increasing proportion of equity investments or a geographical move south and eastwards into higher risk countries. The financial crisis has also increased the overall risk rating.

	2002		2009	
Country	**Portfolio (€m)**	**Risk**	**Portfolio (€m)**	**Risk**
Central Asia	69.1	5.6	206.5	6.2
Central Europe and Baltics	346.4	5.6	328	5.8
Eastern Europe and Caucasus	235	4.6	409.8	6.3
Russia	292.8	5.1	617.3	6.1
South-Eastern Europe	102.6	6.6	483.2	5.3
Total	**1,045.9**	**5.3**	**2,044.8**	**5.9**

Comparison with other International Financial Institutions

Commitments by international financial institutions active in the sector in the region – namely the European Bank for Reconstruction and Development, the World Bank, the

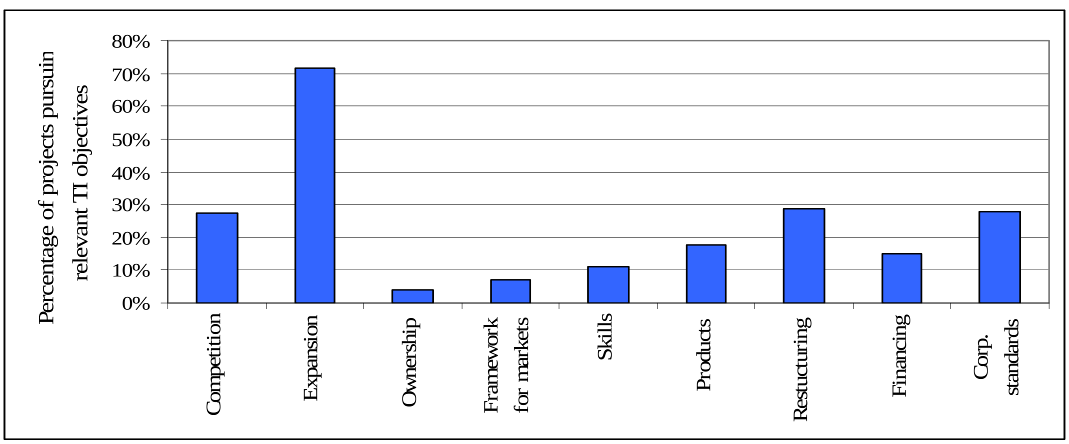
International Finance Corporation, the Asian Development Bank, the Islamic Development Bank and the International Fund for Agricultural Development - rose from approximately USD 950 million in 2006 to approximately USD 1.2 billion in 2008[4]. Of this, the Bank committed some 60% on an annual basis, confirming its leading position in numerical terms.

Transition Impact of the Portfolio

Since the last strategy up to the first quarter of 2009, the Agribusiness TIMS portfolio includes a sample of 128 rated projects[5]. The average rank of Bank operations, which combines transition impact potential and risk to transition impact ratings, stands at 3.96, which is slightly better than the overall stock of the Bank's projects (4.17).[6] Agribusiness operations ranked from 1-4 account for 78.1 per cent of the sample. This result exceeds the upper end of the range of 50 to 60 per cent of the institutional target set in 2005 (BDS04-148).

In terms of transition objectives pursued by Agribusiness projects, almost three-quarters of operations focus on "market expansion", emphasising the Bank's mandate through the stimulation of competitive behaviour through the project entity's interactions with suppliers (i.e. backward/upstream linkages) and clients (i.e. forward/downstream linkages), as well as its contributions to the integration of economic activities into the national, regional or international economy. As shown in the graph below, other important transition objectives pursued are "competition", "restructuring" and "corporate standards" which are encompassed in almost 30% of all projects[7].

Transition Objectives pursued by Agribusiness Projects



[4] Note that country, sector and exchange rate discrepancies render these statistics only approximately accurate.
[5] The total Agribusiness stock of operations is 302. The actual number of TIMS rated projects is 143. A total of 15 TIMS-rated operations have however been cancelled, hence their ratings are not reflected in this section's analysis.
[6] With 1 being the best possible ranking (e.g. Excellent potential with negligible risks) and 8 the worst outcome (e.g. Unsatisfactory potential with negligible risks).
[7] Not all 302 projects have detailed transition objectives. Numbers are based on a sample of 154 projects, i.e. 51% of total Agribusiness stock of operations.

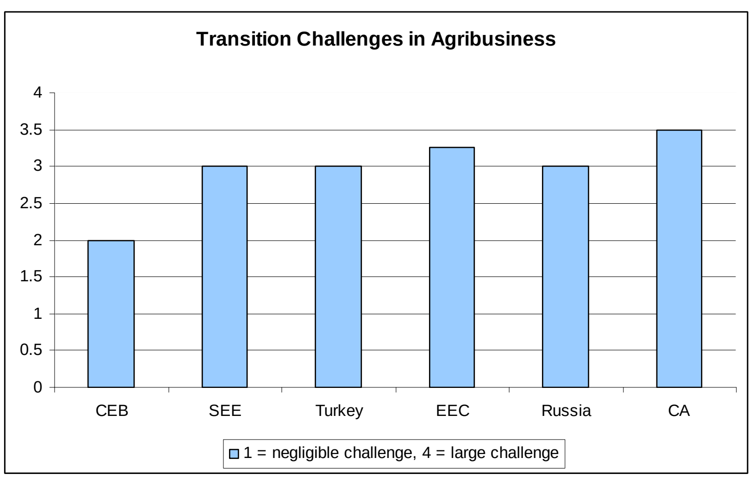
2. TRANSITION CHALLENGES

2.1 Overall Transition and Sector Reform Environment

Critical challenges in the Agribusiness sector remain across the Region. The legacy of arable land and asset collectivisation, the history of inefficient and highly subsidised input usage and the non-existence of price mechanisms along the whole food value chain has had a lasting effect on the Region's yields and levels of production. Despite some progress, market reforms in Agribusiness in general still lag behind most other sectors. To address remaining transition challenges and fully unlock the Region's significant production potential, market mechanisms and institutions still need to be substantially strengthened.

In addition the global food crisis recently demonstrated the important role that the transition region could play in addressing global food shortages – but only if transition challenges are tackled appropriately and the Region's production potential is realised. Underlying global economic and demographic fundamentals clearly point towards increased and sustained pressure on global food supply (and hence on food prices). The UN FAO estimates that to respond to increased demand, food production will need to increase by about 70 percent by 2050. This equates to 1 billion additional tonnes of cereals and 200 million tonnes of meat. The UN FAO also estimates that 90 per cent of the necessary production increases will need to come from yield increases and cropping intensity and only 10 per cent from the expansion of arable land. Whilst the Bank's countries of operation contain 13 per cent of the world's arable land, they produce only 6 per cent of its crops and 2.6 per cent of its meat. Unlocking the Region's potential in a sustainable manner is therefore a key transition challenge.

Geographical Distribution of Remaining Transition Challenges



Source: Assessment of Transition Challenges 2009, OCE[8].

[8] For a more detailed analysis of the recent "Assessment of Transition Challenges" by country and sector, see Annex X.

Despite significant variation of transition challenges between countries and even between regions within the same country, a number of transition challenges are common along the food value chain across the Region. Please refer to Annex 2 for a more detailed country-by-country breakdown of the remaining transition challenges taken from the recent Assessment of Transition Challenges (CS/FO/09-11).

2.2 Transition Challenges by Sub-sector

2.2.1 Food Supply, Retail and Distribution

Transition challenges across the Region in downstream food supply relate mostly to a lack of competition and high administrative barriers for new entrants that prevent distribution, wholesale and retail markets from functioning efficiently (particularly in less advanced countries). Furthermore, adequate produce traceability, quality control, and hygiene and food safety standards constitute challenges for the downstream industries across the Region. These challenges lead to an inadequate level of access to high quality food at affordable prices especially in remote areas.

Improvements in food supply, retail and distribution developed in phases and were not uniform across the Region. Western Sponsors were quick to enter the more developed areas with high population density and per capita spending across the Region, but many remoter areas have been left untouched. In the more advanced countries and certain cities further east (such as Moscow and St. Petersburg) Western sponsors early on in the transition introduced new retail formats and contributed to significant knowledge and skills transfers. Their investments also led to substantial linkages to suppliers. In those countries / cities where retail penetration is by now firmly established, where markets are operating competitively and which are going through a phase of consolidation, the principal remaining challenge is to ensure more variety and better quality products. However, there are still many lesser developed regions and countries which have still not been reached by either international or domestic modern retailers. This is particularly true for ETC countries and some countries in the Western Balkans (namely Bosnia and Herzegovina and FYR Macedonia).

Furthermore, across the Region there is insufficient spill-over along the food value chain of competitive market practices that could lower transaction costs on a sustained basis. Inadequate infrastructure, distribution and supply networks are a bottleneck that constrains efficiency along the whole value chain. Specialised distribution, for example of chilled products, is under-developed. Rail infrastructure assets, and grain wagons in particular, are depreciating rapidly. Computerised logistics systems are still rare and there is little know-how transfer from processors to independent distributors – the exception being a small number of high-end modern processors that have a fully integrated distribution system. Specialised wholesalers, distribution centres and storage with adequate quality control are still lacking across the transition Region.

Lastly, the Region as a whole still faces a number of challenges regarding produce traceability enforcement, quality control and hygiene and food safety standards, to bring local produce in line with international best practice. This includes monitoring and enforcement procedures. Higher food safety standards can be achieved by imposing requirements on distributors and/or their suppliers. The development of private labels is a good indicator of internalising the benefits of higher value-added locally produced products.

2.2.2 Processing and Packaging

In processing and packaging, the main transition challenges are related to out-dated and energy intensive production technology and incomplete restructuring that are significantly constraining improvements in productivity. Secondly, 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. The processes of privatisation, restructuring, consolidation and entry and exit must continue throughout the Region to increase quality, productivity and competition in the processing and packaging sub-sectors. Significant investment is still required to promote restructuring and the adoption of modern technologies and skills. The packaging industry across the Region still suffers from low competitiveness and poor quality standards (with a low percentage of private label products). In both the processing and packaging sectors improvements in energy efficiency and environmental standards would increase both competitiveness and sustainability.

Significant challenges still remain for virtually all countries in the CIS and the Western Balkans to enable increased efficiency (including energy efficiency), effective competition and best practice corporate governance and business standards in the processing sector. The state also continues to play a large – and in some areas growing – role in the economy, especially but not exclusively in strategic sectors. Differences also persist across regions within one country. In the Russian Federation for example, a number of government support measures remain in place which are lacking coherence and distorting prices and linkages along the whole value chain.

The processing and packaging sectors also still suffer from the low quality of locally produced inputs, old and substandard equipment, little adherence to international standards (i.e. HACCP or ISO) and low quality control and monitoring enforcement standards. Agro-processors face the challenge of upgrading their own standards and translating the standards required by modern distributors back towards primary producers, and in doing so, raising supply quality, financing availability and expertise throughout the supply chain. Numerous agro-processors are active in the region, but further development would raise sectoral standards by promoting backward and forward linkages.

In the most advanced region in Central Eastern Europe and the Baltic countries (CEB), most countries have aligned their institutional frameworks with EU norms. The remaining challenges relate to improvements in efficiency and hygiene standards of agro-processors and in the distribution/packaging sectors (ensuring the traceability of produce, the development of private labels, specialised wholesalers, distribution centres, etc).

2.2.3 Primary Agriculture and Farming Support

The biggest transition challenge in primary agriculture is to improve yields and realise the Region's production potential. This requires supportive institutions and long-term policies, increased investment and improved access to finance. Supportive institutions include both financial institutions supporting access to credit in the primary agricultural sector and consistent and non-distortionary government institutions and policies that set the right incentives for increased private sector investment into sustainable agriculture.

Transition challenges for primary agriculture form a vicious circle: liquidity for working capital purposes and long-term capital expenditure financing is lacking as a result of the absence of suitable policy frameworks and financing instruments (e.g. through collateralisation of agricultural commodities and land) – leading to low investment levels in the sector – leading to poor yields – leading to less output in the sector – leading to state intervention in the form of subsidies. The need to develop tailored, responsive financing methods throughout the primary agricultural spectrum, from individual farmers to large, integrated agri-holdings, remains a key challenge.

With increased interest in farming and primary agriculture, more investor attention has been directed towards mass agricultural development. However, increased investments in farmland have not always proven to be sound and profitable, especially if the supportive institutional framework is lacking. Russia, Ukraine, Kazakhstan, as well as parts of Eastern Europe, experienced an unprecedented influx of foreign investment directed towards agricultural land in 2007 and 2008. While some large agro-holdings developed successfully, many business plans (often from new players) made over-optimistic projections on business growth, yield improvement and land bank consolidation. Working capital requirements were under-estimated and led to a cash drain early on. The supportive institutional framework was lacking.

A first order institutional challenge is the establishment of an appropriate legal framework for private land ownership, exchanges and pledges. This includes the establishment of defined property rights over land, through the creation of cadastres and land title and the development of functioning land markets (the ability to use land as collateral). Legislation which will allow pledges over future crops could facilitate an increase in pre-financing.

Another important institutional challenge is the creation of functioning rural financing schemes. This would involve moving from Soviet-type "Agrobanks" as the sole financing channel towards an efficient financial system for agriculture, agribusinesses and services. Rural finance systems include standard rural banking systems, but also financing instruments such as warehouse receipt programmes, leasing and supplier schemes through credit and risk-sharing arrangements and insurance products. While some countries have - with the assistance of the EBRD - successfully introduced a warehouse receipt programme (such as Kazakhstan), most countries haven't yet started the process and Ukraine, Russia and Serbia are at different early stages in its development.

The threat of higher food prices has triggered, and is continuing to trigger, protectionist policy responses in some countries of operations. However, government intervention can increase price volatility, distort investment incentives and impact negatively future market development. The removal of price controls, state procurement at non-market prices, distortionary subsidies, quantitative and administrative import and export restrictions, import and export tariffs, direct involvement by ministries and state-owned trading companies can be integral to establishing an efficient and sustainable agricultural market. Removing price distorting support policies can be essential to promoting increased investment into efficient production based on market signals and consumer orientation.

Another institutional challenge that negatively impacts food security concerns climate change. The challenge for the coming period is to move decisively on climate change mitigation and adaptation through modern sustainable crop rotation and low fertilisation techniques. While the natural resource base shows worrying signs of degradation globally, the region's arable land and water resources (in particular in the CIS) are considerable, but countries have shown limited concerns for environmental sustainability.

As a result of the lack of an appropriate legal framework, functioning rural finance systems, supportive government policies, and climate change considerations, primary agriculture in the Region has suffered years of under-investment, resulting in inefficient production processes and low quality standards. A lot still needs to be done to improve the institutional frameworks across the Region and promote economically efficient investment in sustainable production processes.

3. STRATEGIC OBJECTIVES AND PRIORITIES

3.1 Key Transition Objectives

The Bank's short-term crisis response took precedence in 2009, as 42 per cent of the sector's annual business volume was directed towards crisis response programmes. The Bank benefited from its experience of the 1998 Russian Crisis, mostly to support existing clients that had encountered short-term difficulties and new clients whose project financing needs remained commercially viable in the pressured economic environment. Consumer spending and financing availability will both remain under pressure until the financial and economic aspects of the recession have passed. Please refer to Annex 3 for more background on how the financial crisis affected the Agribusiness sector.

Nevertheless, the medium to long-term trajectory of the sector, both regionally and globally, demands that attention return to the long-term goal of addressing food supply and food security in a sustainable manner. Fundamental challenges in the Agribusiness sector remain, particularly in the less advanced transition economies. The UN FAO estimates a need for an additional 30 million hectares of agriculture land worldwide by 2017, but in order for the region truly to realise its potential, persistent transition challenges must be addressed. Also critical to the region's further development is environmental and social sustainability, which the Bank will address under Phase II of its Sustainable Energy Initiative and new initiatives such as the proposed Agribusiness Sustainable Investment Facility. The agribusiness sector plays a significant role in the region's future environmental and social sustainability.

In order to address these challenges, the Bank will continue to apply its value chain approach in the sector, seeking out individual opportunities that can exert a positive and sustainable impact all along the food value chain. To this already successful individual approach, the Bank will add an integrated approach, clustering banking project work with technical cooperation and policy dialogue in selective key areas to augment the overall impact of its efforts.

The majority (between an estimated 40 and 60 percent) of the Bank's project work will continue to be focused around the centre of the food value chain, namely in food manufacturing, processing and packaging operations. Such projects tend to offer the highest 'value-added' for domestic production and the strongest linkages forward and back along the economic value chain. The remainder will be split approximately equally between primary agriculture and agricultural inputs at one end and wholesale and distribution at the other end, whilst always emphasising backward linkages for downstream investments. Nevertheless, the Bank will remain fundamentally demand driven to ensure the financial viability of the projects it undertakes. For a breakdown of priority activities per region, reflecting the advancement of the "transition frontier" east and south, please see the summary table in section 3.1.

Operations in the sector will focus around the four new operational priorities, as shown below.

Food Security - maximise the region's potential and help address global food imbalances by promoting market-orientated, systemic change.

- Overall, the Bank will support projects that increase the sustainable productivity, quality and safety of output in the region by addressing persistent market inefficiencies throughout the food chain, ranging from lack of competition and administrative barriers in retail and distribution, low quality standards and productivity in processing and packaging, to inadequate access to finance, weak institutions and policies in primary agriculture. In order to achieve this, the Bank will continue to cooperate directly and indirectly with successful local entrepreneurs as well as multi-national companies, other international (financial) institutions and sources of commercial funding - all of which are critical to the sector's transformation into a sustainable, modern economic structure for uninterrupted food supply and increased food security.
- In primary agriculture and farming support, the Bank can be instrumental in helping introduce much-needed financing to farmers and primary food processors. Directly, this equates to support for large primary agricultural operations (i.e. large farms) and for commodity traders whose buying activities in the region inject capital into the sector through backward linkages to the farmers. Such investments will be approached cautiously, with a view to both individual and portfolio risk. Indirectly, this refers to Bank participation in developing systemic solutions to lacking the capital in the sector, including schemes with a high demonstration effect like financing against grain warehouse receipts, new initiatives like promoting legal reform on collateralization of agricultural land (i.e. Certificates of Rural Product or CPRs) and rural credit lines. Rural credit lines fall under the remit of the Bank's Financial Institutions department and are handled by the appropriate team.
- The Bank can be instrumental in providing farms with modern technology and inputs, including seed multipliers, agri-chemicals[9] and machinery, thus addressing the sector's need to replace outdated farming technologies with more efficient equipment. The Bank will seek to support both domestic and foreign input suppliers/manufacturers in meeting this objective.
- The Bank can support important capital expansion projects at farm level when integrated in a structured financing approach with a financially sound sponsor capable of implementing modern, sustainable farming techniques.
- The Bank will aim to support infrastructure for storage and handling infrastructure such as grain terminals, warehouses and distribution networks, and in doing so address a clear infrastructure gap and contribute to efficiency gains along the value chain.
- In agro-processing and in food and beverage manufacturing, 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 that are still absent from the sector.

[9] Note that the Bank routinely measures the level of its investee companies' agri-chemical use as part of its environmental and social due diligence.

- The Bank will also support investments in high quality packaging equipment and material, ensuring higher hygiene and product shelf-life, in order to increase food quality and availability.
- In food supply, retail and distribution, the Bank will aim to play an important role in supporting the roll-out of modern format food retail chains in rural areas and hypermarkets/malls in suburban areas of large cities, thereby increasing the accessibility of affordable, locally manufactured and packaged food products of superior quality for wider parts of the population[10] and promoting good labour standards and working conditions in the sector. Where appropriate and feasible, the Bank will seek to accompany such project work by supplier financing support, enhancement of food quality standards, safety and hygiene measures, social and gender issues and other concerns that might be addressed in parallel with financial lending.
- Aspects of food supply that have received less attention to date but are gaining momentum are, *inter alia*, specialised wholesalers but most importantly investments related to distribution such as more sophisticated logistics networks and high quality storage (including cold storage). The Bank will aim to strengthen its presence here.
- The Bank will aim to support the establishment of strong local brands together with labelling and traceability through both TC and project work. Such local brands serve to set quality standards thereby having an important demonstration effect as well as improving food security. This will lead to a stronger presence of locally manufactured produce in modern retail outlets.
- Geographic and sub-sectoral initiatives will be designed with the objective to integrate policy dialogue, technical assistance, specific financing solutions and bankable projects addressing transition bottlenecks in different regions. In this regard co-operation with OCE /LTT will be important.

Maximise transition impact through a focused investment approach and increased regional differentiation (with an emphasis on ETCs and Western Balkans).

- The Bank will aim further to increase its activities in ETC countries, where the Agribusiness sector is one of the most important sources of economic and institutional development. To this end the Bank will collaborate extensively with the Resident Offices since this has proven to be the most effective way to process deals. It will support bankable projects that address inefficiencies and low productivity, particularly where up-to-date techniques and machinery can be introduced. Sponsors in such projects can extend important linkages to suppliers improving market competition and quality standards.
- Investments in ETCs often require technical assistance funds to support project preparation through the introduction of IFRS accounts, management support or

[10] Modern format retail still accounts for only about 25% of the total retail market value, whereas in the developed markets of United Kingdom, Germany and France, it accounts for 89%, 85% and 80% respectively, according to Business Monitor International. Furthermore, the food retail market is still fragmented and consolidation is to be expected. The aggregate market share of the top 5 players is on average below 35% compared to 62% in UK, 61% in France, 78% in Germany.

environmental and social audits. The Bank will continue to use TC money for this purpose as necessary.

- The Bank will aim to structure equity investments where risk return profiles are attractive and continue with secured debt transactions in more challenging markets.
- In other countries, the Bank will continue to work throughout the entire value chain, with a greater emphasis on regional investment in the case of Russia, Turkey and Ukraine and continuous attempts to support upstream agriculture through vertical integration, which can improve market efficiency along the food value chain.
- In more advanced transition countries the strategic focus is on upstream industries in close proximity to primary agriculture as well as medium-sized rural enterprises.
- In the Western Balkans many companies still require further improvements in efficiency and hygiene standards to develop product traceability and local brands which the Bank will aim to support, also with the help of the UN FAO and tailor-made TC programmes. Institutions and policies such as issuing bodies for quality inspections and labelling are important to support the market in this regard.
- The Bank will assist enterprises to attain and implement European Community standards (in particular phytosanitary standards). This will assist European enlargement countries to adapt their agricultural sector towards sustainable production and also aid rural areas in the process of preparation for accession to the European Union. For other countries, it will increase the competitiveness of their agricultural products for the export into the European Union.
- Private labels and specialised wholesalers in more remote areas need to improve competition in the market for the benefit of better access to high quality food at affordable prices for the consumer - even in more advanced transition countries.

Promote a sustainable investment approach addressing environmental and social issues, including gender, energy efficiency and climate change adaptation more systematically.

- A specific focus will be on investments linked to energy efficiency, emissions reduction and environmental and social improvements, in particular through new initiatives such as the proposed Agribusiness Sustainable Investment Facility. The objective of this facility will be to extend debt and equity financing linked to TC funding towards projects that improve companies' energy efficiency, environmental and social performance. It represents a first attempt to extend the approach of combining technical cooperation with commercial lending that has proved very successful in energy efficiency projects to a wider range of sustainability issues like resource minimisation, climate change adaptation and mitigation, traceability, biodiversity, recycling, renewable energy use, water conservation and working conditions including health and safety. The facility seeks to overcome the considerable barriers to investment that currently exist and is designed to be scalable in response to growing demand. The Bank will work with the Energy Efficiency and Climate Change team (E2C2) as well as its Environment and Sustainability Department to develop shared environmental facilities such as the use of biomass and biofuel for energy, shared water treatment facilities, etc. Small scale renewable

- The Bank will encourage sponsors to consider additional project aspects which promote best practice in environmental, health and safety and human resources management, reduce environmental impact, and increase occupational health and safety and community benefits.
- Finally, the Bank will consider standalone projects for the specific financing of projects which address key environmental and social impacts in the Agribusiness sector.
- For smaller local producers the Bank will attempt further to link them into the food chain by helping them improve their production standards and comply with food safety regulations such as ISO and HACCP; this may help them improve their long-term commercial viability and competitiveness.
- By requiring all projects to meet their Performance Requirements, as laid out in the Bank's 2008 Environmental and Social Policy, the Bank will promote environmental and social sustainability throughout its entire agribusiness portfolio, supporting responsible food processors and retailers and projects which promote sustainable agriculture and the establishment of food supply chains that are sustainable at every stage[11]. The PRs include a number of key requirements for the agribusiness sector including, *inter alia*: pesticide reduction and integrated pest management, habitat protection, the application of EU environmental requirements such as managing nitrate run-off, animal welfare and husbandry standards, and additional habitat protection measures; a precautionary approach to the release of GMOs into the natural environment;[12] avoidance of community exposure to disease; sustainable supply chain management; assessment and mitigation of the impact of land acquisition on communities; the implementation of good labour and occupational health and safety practices;[13] and effective stakeholder engagement.[14]
- In the context of the EBRD's Gender Action Plan, the Bank has initiated a number of pilot projects in banking sectors, including Agribusiness, to integrate gender issues. The aim of the pilot projects in Agribusiness is to identify and encourage clients to adopt gender balanced approaches in their human resources policies and practices (such as work-life balance, flexible working hours, family friendly initiatives, etc). The intention is to inform the Board and external stakeholders regularly on progress made.

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[11] I.e. from source through processing to final distribution of goods.

[12] As outlined in Performance Requirement (PR) 6, para 17 the Bank requires clients within EU Member States and candidate countries to comply with applicable national and local requirements and policy which would include EU directives covering the deliberate release of GMOs into the environment; the placement on the market of food or feed products containing or consisting of GMOs; export of GMOs or the unintentional transboundary movement of GMOs; contained use of GMOs and labelling and traceability. Clients in other countries would be required to follow their national requirements and must adopt the precautionary approach, conducting risk assessments in line with EU requirements and EBRD's Performance Requirement 6: Biodiversity Conservation and Sustainable Management of Living Resources.

[13] See PR 2: Labour and Working Conditions

[14] See PR 10: Information Disclosure and Stakeholder Engagement

Continue to pursue its policy dialogue agenda, as suggested in the 2008 Evaluation of the Agribusiness Operations Policy report.

- All policy dialogue efforts conducted by the Bank will remain focused on the Bank's core competencies, i.e. on investment related issues. The Bank will approach other, non-investment related issues like land privatisation or ownership, very selectively and in support of other leading international institutions more active in this field. Whilst land rights are crucial, the Bank will remain active where it can exert maximum influence, i.e. in promoting the use of land as collateral.
- Dialogue efforts will continue to bring together the private and public sectors with the aim of intensifying dialogue over key issues affecting barriers to private sector investment.
- Building on its efforts in 2008-09, food security will remain a centrepiece of policy dialogue. This demands the engagement of key players from the public and private sector, focusing on institutional bottlenecks to private sector development, good governance and the investment constraints.
- Climate change mitigation and adaptation, desertification, biodiversity conservation and other sustainability challenges will be a key aspect of policy dialogue.
- The Bank will aim to enhance its relationship with the public sector and related entities across the region as this aspect previously received insufficient attention, and use this opportunity to address market distortions such as bureaucratic interference. The Bank will work with the public sector to identify key obstacles to investment and support the definition of appropriate policies that support private sector engagement instead.
- Policy dialogue will continue to rely on the successful EBRD/UN FAO cooperation agreement and the EastAgri network but specific TC funds will be used and raised for other initiatives.
- Geographic and sub-sectoral initiatives will be designed to integrate policy dialogue, technical assistance and bankable project work to address selective transition bottlenecks that would benefit from a concerted, multi-dimensional approach to enhance transition impact potential. In this regard co-operation with OCE /LTT will be important.
- Policy dialogue will form an important part of these initiatives both in the form of public private partnerships and expanded dialogue with authorities.

New initiatives will be developed in sectors of critical importance to the local economy. Two such sectors already under consideration are:

1. Agricultural Commodity Financing and Food Security, to include private sector investments in all commodity related sectors along the whole value chain, policy dialogue to foster regulatory reform and technical assistance to support legal reform (including preparation of financing schemes such as warehouse receipt) and skills transfer. Such a combination would augment the Bank's leverage vis-à-vis public institutions and provide a strong demonstration effect to other entities.

2. Retail in Russia, to include private sector development of modern food retail formats in regional locations, development of supporting infrastructure for suppliers and distributors alike and policy dialogue to address market entry obstacles, supplier/retailer relationships and competition in the market. Such a programme would effectively address the persistent shortage of modern retail formats in regional Russia. Further, the Bank will analyse options of how best to support locally manufactured and packaged food products' access to modern format food retail chains.

A breakdown of regional priorities for each of these four main objectives is presented in the below summary table.

Agribusiness Objective	**Main Operational Priorities**
Food Security – maximise the region's potential and address global food imbalances by promoting market-oriented systemic change	Food supply, retail and distribution: - Specialised wholesale and distribution operations, such as frozen distribution operations, will be supported throughout the region. - In South Eastern Europe, Russia and Turkey, the Bank will pursue opportunities principally in regional and rural areas; in Central Asia, Eastern Europe and the Caucasus, support to investments will be evaluated on a case by case basis. - The introduction of domestically produced private labels will be supported across the region The majority of the investments (around 40%-60%) will be in food manufacturing, processing and packaging: - In agro-processing and food & beverage manufacturing, the Bank will support local and international sponsors throughout the entire region. - The Bank will support value-added domestic production, the use of local inputs and the emergence of strong local brands. - Likewise, the Bank will support investments in high-quality packaging operations throughout the region, ensuring higher hygiene standards and product shelf-life, in order to increase food quality and availability Primary agriculture and farming support: - Direct support for primary agriculture and farming support operations will focus around the region's principal grain producers, namely Russia, Kazakhstan, Ukraine, and South Eastern Europe. On an exceptional basis projects in some countries of the CEB region could be supported. -

	- Indirect support for primary agriculture through rural credit lines will focus principally on smaller and less economically advanced countries.
Maximise transition impact through a focused investment approach and increased regional differentiation (with an emphasis on ETCs and the Western Balkans)	- In Central Europe and the Baltic States, support local agribusiness sponsors with cross-border expansion plans into countries of operations where transition is less advanced. - In countries with more developed capital cities, Bank support will focus increasingly on regional and rural investments. This is the case for Russia, Eastern Europe and the Caucasus (Ukraine) and Turkey. - In South Eastern Europe, target market leading local agriculture processors and food distributors that require assistance with their domestic and cross-border expansion plans and/or compliance with EU quality standards. - In less advanced economies, in particular the ETC and Western Balkan countries, the Bank will promote the development of the local private sector through standard financing and rural micro-credit programmes (for example rural credit lines in co-operation with the FI Team), supported by technical cooperation funds; such investments may be found at any stage in the food value chain.
Promote a sustainable investment approach addressing environmental and social issues, including gender, energy efficiency and climate change adaptation more systematically	- The Bank will support environmental and social sustainability projects throughout the region. - The Bank is committed to raising standards, in particular to promoting European Union environmental and health and safety standards in its direct investment projects, regardless of the country of operation, through the implementation of its Environmental and Social Policy Performance Requirements. - The Agribusiness Sustainable Investment Facility will address commercial opportunities with a sustainability aspect throughout the entire region.
Continue to pursue the Bank's policy dialogue agenda in the sector	- Continue work on developing warehouse receipt programmes in South-Eastern Europe and Russia. - Promote the use of bills of exchange of rural products in Russia, Eastern Europe and the Caucasus (Ukraine) and Central Asia (Kazakhstan). - Exploit the EastAgri forum as a platform to address topical and critical development issues and facilitate public-private sector exchange. Since 2009, this forum has covered all the Bank's countries of operations besides Turkey, and will conceivably be

	- Conduct vertical market studies wherever the need arises, across all countries of operations.

3.2 Technical Co-operation

The use of TC funds should mainly centre around institution building and policy dialogue and only in specific cases be used for project preparation. The use of TC funds will be considered for:

- Warehouse Receipt Programmes in Russia and Serbia including legal assistance
- Specific TC use for thematic initiatives (Food Security Supply, Retail in Russia)
- Work relations with Ministries of Agriculture and public sector authorities (such as Grain Unions) building on the relationship with the private sector to foster policy dialogue
- Enhance the transition impact of investment projects or pre-investment assistance, such as due diligence and financial audits for ETC
- Business restructuring pre-equity investments
- Environmental and social audits for high risk sectors
- Promoting best practices in sustainability management and maximising environmental and social benefits e.g. as the proposed Agribusiness Sustainable Investment Facility

The new framework between the Bank and UN FAO aims to deepen the collaboration between both institutions and the Bank seeks to improve the investment environment in the Agribusiness sector in selected countries by (i) improving the Agribusiness policy environment in a number of selected areas/sectors in the Russian Federation, Ukraine, and Kazakhstan; and (ii) initiating policy discussions on the development of Turkmenistan's agriculture.

For the Russian Federation, Ukraine, Kazakhstan and Turkmenistan, the specific priority areas/sectors covered by the Assignment, derived from the conclusions of the consultations, are:

- Food Chains in Kazakhstan
- Public-Private Partnerships in Russia's Agribusiness Education System
- Grain Sector in Russia, Ukraine and Kazakhstan
- IFI Coordination in the Agribusiness/Agricultural Sector
- Review of Turkmenistan's Agricultural Sector

3.3 Cross-Sectoral Approach

Agribusiness is closely related to other important industry sectors and co-operation across sectors has been fruitful in the past. The Bank will promote a cross-sectoral approach even more and exploit synergies within the institution to tackle major bottlenecks along the food chain, such as in infrastructure and the access to finance.

A lack of appropriate infrastructure, distribution and logistics is a notorious bottleneck and will become an even more pressing issue as production output grows and larger amounts of agricultural commodities need to be stored, transported and eventually shipped for export. Only if the underlying infrastructure systems are in place can the region fully benefit from an increased production volume which needs to be translated into revenues through increased exports. Storage and transportation systems throughout the region are not yet ready for an increased agricultural output. In this context, projects the Bank will aim to support include investments in transport related fields such as port terminals, shipping facilities and other distribution hubs. The Bank will also aim to support much needed investments in the construction and maintenance of adequate storage facilities throughout the region, i.e. quality warehousing for agricultural commodities, cold storage and automated state-of-the-art food logistics.

Another focus area for the Bank is to continue to strengthen the cooperation between the Agribusiness sector and the Financial Institutions sector including microfinance to develop banking infrastructure and credit lines to SMEs in rural areas. An important approach is trade finance solutions such as EBRD guarantees issued in favour of international commercial banks through the Trade Facilitation Programme. Projects will be accompanied by sector specific technical cooperation where appropriate.

Lending against grain warehouse receipts where the Bank aims to be instrumental in a number of countries (Serbia, Russia, Ukraine) will include close co-operation with the Bank's Legal Transition team in the conception phase and the Financial Institutions sector when working with partner banks to develop appropriate lending schemes.

3.4 Co-Operation with other International Institutions

The EastAgri Network

EastAgri was launched in response to EBRD's second Agribusiness Operations Policy (2002), which called for broader cooperation with development institutions operating in the agricultural sector. It was founded in collaboration with the UN FAO and World Bank. Current core members of EastAgri are the EBRD, UN FAO, the World Bank and the European Commission. In total, the network has a membership of 24 institutions, including other international financial institutions (e.g. the International Fund for Agricultural Development and the International Finance Corporation), multilateral institutions (e.g. the Organisation for Economic Co-operation and Development) and private banks (e.g. Crédit Agricole and Rabobank).

The network initially covered the countries of the Central European Initiative and later extended to cover the Bank's Early Transition Countries and the Western Balkans. In 2009, it was further extended to include Russia, Kazakhstan, Belarus and Turkmenistan. (A full list of countries, along with further information about EastAgri's activities, can be found at the web site, www.EastAgri.org. So far, the network has received funding from donors, including the Central European Initiative, EBRD, the World Bank and the UN FAO.

The network functions as an informal platform with three communication channels: 1. a dedicated website, 2. annual meetings and 3. ad hoc thematic meetings and workshops. Topics covered in such meetings are of common interest to EastAgri members and include public investment, private sector investment, agricultural credit and advice on policy.

The main advantage of the EastAgri network is that it lets each of its founding members focus on their strength in addressing the issues facing the sector: the UN FAO, which has a clear advantage in analysis and research, publishes sectoral and industry studies on the web site; the World Bank, which has experience in land reform and cadastral issues, can use meetings as a forum for policy debate; and the Bank, which is a project driven institution, can use it to highlight private sector expertise (and in terms of land reform, post-privatisation concerns). As a melting pot for public-private debate, the EastAgri annual meeting is an outstanding forum.

Since the forum for discussion created by EastAgri has proved both effective and practical, the Bank will continue to focus the majority of its coordination activity in its direction. The 2010 annual meeting is entitled “Releasing the agricultural potential of the EastAgri region for enhanced world food security” and is due to take place in October 2010.

Further Engagement

Where other investment-related topics arise, the Bank will cooperate individually with other international (financial) institutions. One important future avenue for this is in translating the successful Brazilian system of using crops in the ground as collateral in financing operations in the region, in cooperation with the IFC. Combined policy dialogue will continue to engage public and private bodies, exploiting the combined experience and leverage of the Bank and IFC together.

The Bank will also welcome project cooperation with other development organisations, along the lines of its current project with the Deutsche Entwicklungsgesellschaft GmbH in Serbia. The UK Department for International Development is also considering participation in the Bank’s Tajik Agricultural Finance Facility. These opportunities for cooperation augment transition impact potential by pooling resources. With regards to the European Union, which plays a significant role in the sector, the Bank will seek to strengthen its cooperation with the European Commission to develop a synergetic approach, particularly in potential candidate and candidate countries for EU membership.

Finally, the Bank will continue to use its internal training programmes to encourage knowledge transfer by inviting representatives from international institutions active in the Agribusiness sector.

ANNEXES

Annex 1: Selected lessons from Agribusiness Evaluations 1996-2009

Transition impact from consumer-industry investments and market primacy. Successful reform of consumer-product enterprises, transition impact and returns from investments in this sphere depend as much on means for improved marketing as on rationalised production. Financing plans must reflect that the market reorientation needs can be as high as those for hardware improvement. Support to management and training must focus on marketing and sales. Board nominees must have marketing insight. Budgets must prioritise brand maintenance.

Conditioned adherence to good standards of corporate governance. The set of project agreements should seek to negotiate and define specific events which constitute a breach by the Client or a co-investor of basic governance requirements. Such specific events should trigger exits by the Bank from the investment by way of punitive puts of shares and/or acceleration of loans.

The need to professionalise the Bank's participation in the supervisory board. Experience suggests that an outside industry specialist as a representative for the Bank can exercise greater influence on corporate governance in a supervisory board than a staff member of the Bank with limited industry knowledge. This reduces the risk of mixing monitoring obligations for the Bank and responsibilities as board member towards the Company.

Seeking relevant financier experience of risks at appraisal of an investee company. Critical appraisal should seek to assess the reasons why other investors have declined to participate or exited a project or sector. Such efforts should make good use of the Bank's networks among institutional and other relevant investors, notably the IFC and other institutional financiers active in the region. In this operation, the IFC, with almost five years prior experience from Hortex, would probably have shared its knowledge and experience willingly had it been approached by the EBRD at its appraisal.

Expanding sales of a regional consumer's brand into new markets is very costly and has a high risk of failure. Expanding sales of a regional consumer's brand in food seasoning based on local cooking habits into large new markets with limited brand recognition is costly and has a high risk of failure considering the brand building budgets available to global food companies. This strategy also requires solid market research and potential product modifications to suit local taste preferences. Optimising sales in the domestic and regional markets appears most promising combined with maximising production efficiencies.

Sponsors adhering to good governance at home and demonstrating long-term engagement to the project region are more reliable partners in Bank sponsored projects. A sponsor that has demonstrated its commitment to good governance and by initiating consolidation of its group structure or by producing group IAS accounts, is likely to adhere to similar standards in a Bank financed project. Also, a sponsor with a considerable portfolio of investment in the region has already demonstrated its longer-term commitment.

Agro-business complexes and other "combinates" of the past need careful appraisal. Due diligence should observe risk and potential losses in complex and opaque structures. Painful and costly restructuring and redundancies will often be needed early on for old "combinates" under new market conditions. Due diligence in such cases should not only identify modernisation and reform investment needs but also candidates for necessary dis-investment of unprofitable and non-core activities. Disintegration will be a necessary reform element in many large enterprises from the old planned system. Such reform processes will need sufficient control yielded to competent management, unaffected by political influence. Substantial funding for the costs and losses associated with plant and staff redundancies must be an element of any realistic reform plan. Secured separate funding to mitigate the adverse social effects can be a requisite in cases of very large restructuring redundancies in localities where few alternative job opportunities exist.

The Bank should not finance private sector projects where the risks of failure need to be covered by a government guarantee. The Bank should strictly separate private sector operations from public guarantees. If the Bank is not convinced of the success potential of a project and is not prepared to take the project risk, it should abstain from financing these operations. A private sector project should therefore be structured in an independent way where all the risks are mitigated through project means.

In countries of early transition the due diligence for a private sector project also needs to cover the financial sector capabilities to provide short-term credit lines. When structuring a project, the Bank in its appraisal has to assess the willingness and capability of the financial market to provide short-term credits. If the financial sector is not sufficiently advanced the Bank should not take the risk to rely on the fast development of the banking sector to meet the project's short-term financing needs.

Introduce phased commitments where the performance of other participants in agriculture enhancement programs is necessary to achieve transition objectives. An ingredient of the environment of the current project is some uncertainty about the dedication of state authorities to the transfer of functions to the private sector. In these circumstances, phased commitments can be utilised to await the satisfaction of specific undertakings before progressing to a subsequent project phase. This mechanism can afford the Bank additional protection in the case of operations which could otherwise produce an unsatisfactory return in terms of transition impact if implemented without full performance of the undertakings.

Post-privatisation deal structuring in large Agribusiness companies to mitigate risks. Undertakings should be negotiated at the outset towards full privatisation of big Agribusiness firms in the sense that there should be no remaining direct or indirect ownership influence by the Government, such as via state-owned banks. Successful reform of big Agribusiness firms in countries with strong political farmer influence will also need strong sponsorship, financing and management. The Bank should therefore invest in such businesses primarily with strong strategic sponsors and mostly with debt to mitigate the risks financially as well as to transition impact as minority stakes have limited influence.

Pertinent risk assessment needs to be accompanied by appropriate action securing that identified risk mitigation solutions are implemented. Several of the risks in this respect were correctly identified at appraisal; however, the steps taken to mitigate risk have not been successful. The loss of the potential strategic partners for the agricultural producers meant that creating a sustainable market presence and customer relationships was left to TC inputs alone. Opening up western markets through promotion campaigns and specialised services has been an overwhelming task for the producers.

The loan documentation should only impose obligations on the parties if they are enforceable. In a situation where a project faces liquidity shortage time is of the essence and any possible court action would take much too long. It is therefore important that all financial support obligations are structured in a way that they are available without any question of doubt and at short notice.

The Bank should reserve the right to agree to the appointment of key personnel and ensure that experienced sector specialists are hired. Especially in those projects where the Bank was actively involved in project design and structuring, it is essential that the Bank makes sure that projects benefit from the right sector expertise and the people hired have the experience and professional sector background needed. The Bank should therefore reserve the right to agree to key personnel appointments.

The Bank should assist in the formation of constructive alliances. The Bank can, through close co-operation and continuous dialogue with its Client, assist in the identification of constructive alliance partners. Likewise, the Bank has extensive contacts with the industry leaders through other projects, and should use this leverage to foster constructive co-operative alliances for its Clients. Through such efforts the transition impact can be enhanced.

Large enterprise privatisation with no strategic partners means high potential risk. Strong justification is required for entry by the Bank in privatisation deals where conditions exclude entry of strategic partners. Justification should include several of the following factors, confirmed by due diligence: i) A strong management team with an insight into needs for reform, transparency and good corporate governance (generally excluding a dominance of managers from the past system); (ii) Strong products/services with obvious competitive advantage; (iii) Strong position on reasonably stable domestic markets with low political intervention or regulatory risk; (iv) Established profitable exports; (v) Information systems, accounts and audits at least approaching Western standards; (vi) No acute crisis, financially, or pending environmental or other liabilities; (vii) Simple, transparent organisation; (viii) Shedding of non-core and unprofitable lines of business is well underway; (ix) Structure and technology of the industry and returns to scale in marketing, development and manufacturing alike will reasonable enable the enterprise to co-exist and compete with local, regional or global competitors; (x) Re-structuring challenges ahead that do not involve fundamental enterprise and sector constraints calling for resources beyond reasonable reach without entry of a strong strategic investor.

Composition of the supervisory board is crucial in restructuring projects. In a restructuring project sufficient attention should be given not only to a reform minded management but also to ensure that the supervisory board reflects reasonably the actual ownership structure of the Company and is open to consider unpopular decisions such as reduction of staffing levels after due consideration of all relevant factors.

Encourage spin-offs instead of dry redundancies. When redundancies are inevitable, the creation of independent spin-off companies for the outsourcing of services should be encouraged. These new SME type companies established by the employees who were laid off, would supply its former employer at fixed prices for the duration of the contract but at the same time would also operate on the free market that they will integrate progressively.

Involve banking regulators in discussions at an early stage when designing new financing instruments with systemic impact. With its overview of national economies and sectoral issues within economies, the Bank is well-positioned to identify products and financing instruments that are capable of having a lasting transition impact at sectoral or national level. The Bank is also in a position to discuss with regulators the prudential implications of new products and instruments. Where appropriate the Bank should hold dialogue with regulators at the design stage to discuss features and issues of a product or program with a view to securing the most suitable prudential treatment for the instrument concerned.

The Bank should take a proactive approach in requiring sponsors to practice public disclosure and consultation. As well as initial consultations, sponsors should be encouraged to adopt a programme of regular discussions with local communities, environmental and other interested groups. Where appropriate the environmental action plan should include an outline of ongoing consultation procedures to be following by the sponsor.

Ring-fenced Agribusiness structures may not fully limit the Bank's exposure to environmental vulnerability arising from other operations of the client or sponsor. Where the policy of the sponsor is to develop integrated Agribusiness operations, environmental vulnerability may arise at any point in the chain of operations. When a plant, operation or business entity financed by the Bank is dependent upon raw materials sourced from an operation of the same sponsor, environmental due diligence should extend to all relevant points of the supply chain.

Importance of the Sponsor's strong environmental culture and business ethics. In project finance operations the Bank always requires high credit standards for its clients to secure the value of the Bank's investments. However, in respect of Transition Impact, this may not be sufficient and may need to be further enhanced through the exercise by the client of high standards in respect of the environment and business ethics. The demonstration effects stemming from this responsible company culture should not be underestimated.

Environmental due diligence requirement for repeat financing. A mandatory review of the completion status of the Environmental Action Plan should be part of the Bank's environmental due diligence for a follow-on investment when a repeat financing occurs. If any major issues remain unsolved under the current operation, those issues should be carried forward as specific conditions, the compliance of which can be monitored under the follow-on investment.

Adequate exposure reporting. From a credit control point of view, while maximum exposure under a facility is known at all times, it may not be the same for aggregate exposure to counterparties. It is important to ensure that the Bank's maximum credit limit to international traders or other counterparties with whom it conducts direct business includes the maximum amount of guarantee that was approved for conditional off takes or under other forms of credit comfort under programmes managed by third parties.

Systemic risk identification with particular traders. It would be desirable to monitor the Bank's indirect exposure under financed commodities. While transactions are always structured so as to eliminate market risks, systemic risks affecting specific commodities may have an impact on particular traders over exposed to such commodities and therefore indirectly on the Bank's counterparties.

Joining forces by a select group of warehouses is one way to enhance the Warehouse Receipts programme. The example of Kazakhstan where an indemnity fund has been successfully put in place in a record time following the enacting of WHR legislation shows that it may be preferable to have a "club" approach whereby the better or financially stronger warehouses initially join forces. In countries where implementation of an indemnity fund meets too many hurdles, it may be more practical and no more risky for the Bank to use collateral managers in the selection and monitoring of warehouses, irrespective of their certification by a government agency. Evidently, if obtainable, an insurance against fraud should also be sought. It should be recalled that there has not yet been any claim made against an indemnity fund.

This means that the ability of an indemnity fund to cover such risks as fraud is so far untested. Due diligence about, and selective approach of, warehouses are likely to be at least as important as the comfort of an indemnity fund.

Allocation of sufficient EBRD staff resources in the absence of a strong strategic partner. The allocation of EBRD local resident office staff and specialist team resources is crucial in an equity investment where the Bank does not have an interface in the form of an equity fund. The active involvement of Bank representatives in the Board is important in a small local company where major management changes need to be supported by all shareholders. In some cases the Bank may need to continue this role even after the investment by a new strategic shareholder.

Focus on labour relation issues at appraisal. In highly labour intensive industries such as food retail, it is prudent during due diligence to research possible disagreements from NGOs and unions to be prepared for any controversial protests.

Avoid controversy in the public eye. When a project might raise the risk of controversy and might become a target of complaints from NGOs, the Bank should involve external consultants to ensure that the project meets all the necessary environmental conditions.

Lasting transition impact on an agricultural sub-sector may require a sequence of operations. Initial processor focus may need to be broadened in subsequent stages to have a lasting transition impact on the wider agricultural sub-sector (tomato growing industry in this case). A longer-term Bank engagement may be crucial in a fast-changing industry since processor-induced changes in primary farming take time and require substantial working capital. Broader sector improvements could further enhance transition impacts.

Enhancing backward linkages in the Agribusiness sector cannot be left to the sponsors alone and should in selected projects be supported by TC and other operations by the Bank. The Bank should be more active in using targeted TC and other operations to support backward linkages both related to a specific processor-related Bank operation (e.g. food processor, drinks manufacturer etc.). This effort should ideally go beyond the Bank operation concerned and address entry barriers for all market participants with the intention to reduce such barriers to market entry and seek a broader transition impact as per the Bank's mandate. This may involve cooperation with government programmes and a more active involvement in organisations which would provide rural credit and training, etc. In this respect collaboration with other IFIs should be considered. In some cases the TC undertaken by sponsors may be supported and expanded to reach a broader group of farmers.

Review EBRD's risk-taking appetite in the agribusiness sector with the objective to support more initiatives which are addressing the key constraints faced by primary agriculture. The Bank's engagement in agribusiness has been very selective and in essence closer to the processor and distributor stages of agricultural products. Whilst the argument is valid that processors ultimately have a beneficial impact on primary agriculture, the case can be made that a portion of the Bank's agribusiness activities should target the higher risk primary agriculture in combination with a focus on rural credit, extension services and storage.

Assessing and mitigating transition impact risks in competition. EBRD should apply clear standards and sound judgement when assessing and mitigating market dominance and other risks to transition. The EU competition standards are useful guidelines in this regard, especially in countries aspiring to EU membership.

Importance of a technically (not just financially) strong sponsor in technically complex greenfield projects. In greenfield projects with a degree of technical complexity, where production and financial performance may become challenging in the early stages of production, it is important to identify a technically as well as financially strong sponsor.

Lack of transparency in business and FDI. IFIs should act as the catalyst of an active policy dialogue between all the stakeholders of an industrial sector including the public authorities when they attempt to identify the issues that hinder the development of the sector.

Annex 2: Assessment of Transition Challenges (CS/FO/09-11)

	Market Structure	Institutions/ Policies	Overall 2009	Overall 2005
CEB				
Croatia	Small	Medium	Small	Medium
Estonia	Small	Medium	Small	Small
Hungary	Small	Small	Small	Small
Latvia	Small	Medium	Small	Small
Lithuania	Small	Medium	Small	Small
Poland	Small	Small	Small	Medium
Slovak Republic	Small	Small	Small	Small
Slovenia	Small	Medium	Small	Small
SEE				
Albania	Medium	Large	Medium	Medium
Bosnia & Herzeg.	Medium	Large	Medium	Large
Bulgaria	Medium	Medium	Medium	Medium
FYR Macedonia	Medium	Large	Medium	Medium
Montenegro	Small	Large	Medium	N/A
Romania	Medium	Medium	Medium	Medium
Serbia	Medium	Medium	Medium	N/A
Turkey				
Turkey	Medium	Medium	Medium	N/A
EEC				
Armenia	Medium	Medium	Medium	Medium
Azerbaijan	Medium	Medium	Medium	Large
Belarus	Large	Medium	Large	Large
Georgia	Medium	Medium	Medium	Large
Moldova	Medium	Medium	Medium	Large
Ukraine	Medium	Medium	Medium	Large
Russia				
Russia	Medium	Medium	Medium	Large
CA				
Kazakhstan	Medium	Medium	Medium	Medium
Kyrgyz Republic	Medium	Medium	Medium	Medium
Mongolia	Medium	Medium	Medium	N/A
Tajikistan	Medium	Large	Large	Large
Turkmenistan	Large	Large	Large	Large
Uzbekistan	Medium	Large	Large	Large

Annex 3: Impact of the Global Financial and Economic Crisis

The Bank's countries of operations are amongst those worst affected by the global financial and economic crisis that began in Western financial centres in 2008 but deteriorated sharply from August 2009.

The first sign of the crisis was the sudden risk-adjustment and subsequent inertia by foreign lenders with significant exposures in Eastern Europe. Several foreign banks, who for almost two decades had built up significant activities in the Region (many of them have local subsidiaries) sought dramatically to reduce their exposures in the Bank's countries of operations. The EBRD experienced significant pressure from its long-time co-financing partners who generally became more reluctant to participate in new financings and sought ways to bring about early repayments of their loans or increase margins in light of higher country risk ratings and weaker financial performance.

The financial crisis also triggered an economic slow-down on the back of extreme credit constraints, falling asset values and consumer retrenchment, with local demand for products decreasing particularly towards the end of 2008, putting further pressure on private companies' revenues and operating profitability. Hard currency loans taken out before the crisis transpired to be particularly painful to many companies. Due to strong devaluation pressures starting in late 2007 through the beginning of 2009, where for instance the Ukrainian Hryvnya devalued over 50%, these companies experienced significant foreign exchange losses at the end of 2008 and faced refinancing problems in the mid- and long-term. This problem prevailed throughout the agribusiness value chain but was particularly problematic in the food retail sector, where margins are thin and the small suppliers experienced difficulties in sustaining their product supply without advanced payments. Other countries, namely those less integrated into the global financial and credit system – often early transition countries – were less negatively impacted by the effects of the financial crisis, though the significant fall in workers' remittances also caused domestic downturns.

Another phenomenon was the effect on the global food and commodity crisis. Food prices almost doubled between the end of 2006 and early 2008, on one hand triggering an array of investment proposals for primary agriculture particularly in Ukraine and Russia, but on the other hand pressurising the more vulnerable parts of the Region's population, up to whom food price increases were passed, amongst other rises in the cost of living. The historic rise in the oil price affected in particular the food processing and packaging sector, where energy cost is a significant factor both in production and transportation. While food prices peaked and fell as the financial crisis took hold and the oil price retreated, awareness of the problematic worldwide supply of primary agricultural products at affordable prices has remained high, with industrial, political and investor attention shifting to increasing current productivity levels and yield.

Finally, the financial and economic crisis triggered protectionist policies by some governments. Examples of such policies are temporary export bans on commodities, intervention programmes particularly in sub-sectors considered as strategic such as grain production, storage and trading, or laws prohibiting early repayment of loans from foreign lenders or preventing local banks to provide new hard currency to their clients who generate revenues in local currency. Analysis shows that many of these policies do not provide long-term benefits for consumers and can potentially have serious detrimental impacts for agricultural producers proving counterproductive for rural development.

In the Agribusiness sector, the EBRD responded to this crisis by stepping up its lending and facilitating shorter processing times mainly to existing clients running into financing difficulties, requiring prompt support and fast turnaround. The Bank supported a range of client types in 2009, from commodity traders with increased working capital needs to sustain their trading operations, to crisis related financial restructurings of healthy but overstretched local companies.

For a complete view of the Bank's crisis response programme, please see "EBRD Operational Response to the Crisis", BDS08-250.