Evaluation of Bank operations

Project evaluation is the assessment of the performance of completed projects and programmes through systematic analysis of their outputs or outcomes against expected or planned results. It also involves the evaluation of categories of operations and patterns of experience through thematic and sector-oriented studies.

The EBRD's Project Evaluation Department (PED) seeks to measure how closely the Bank's operations meet a broad range of objectives, thereby assessing the Bank's transition effectiveness. It looks for significant lessons to be learned from the EBRD's completed operations, and uses the lessons of other international financial institutions to help in shaping future operations. To learn from experience during the project cycle, it also tries to gain evaluation experience with ongoing projects and existing programmes.

The independence in which project evaluation activities are carried out supports objectivity and transparency.

Evaluating projects

The project evaluation process concentrates on operations one to two years after full disbursement has taken place. To date, the EBRD has prepared 97 Operation Performance Evaluation Reviews (OPERs) on private and public sector investment operations, comprising 39 per cent of the 248 operations ready for post-evaluation. It has also carried out 101 assessments of expanded monitoring reports (self-evaluation of projects by operation leaders – OLs) in order to validate the OL's findings. Through the OPERs and these assessments, a total of 198 projects have been covered, comprising 78 per cent of operations ready for evaluation. As of the end of 1999, the EBRD had committed funds to 496 projects, 40 per cent of which have been evaluated or assessed.

Apart from the OPERs on investment and public sector operations, the EBRD has also carried out evaluations of large technical co-operation (TC) operations, thematic and impact studies as well as mid-term reviews of Bank operations. In total, 142 evaluation reports have been produced since 1993.

Transition impact and the EBRD's overall transition effectiveness

In judging whether the EBRD has performed according to its mandate, PED focuses its post-evaluation exercises on the transition impact of projects in a particular sector and in the economy as a whole. Over the past few years, the Bank has made progress in enhancing the way in which the transition impact of a project is assessed and rated at the concept clearance stage (ex ante) and one to two years after disbursement (ex post). To evaluate transition impact, experienced staff undertake an analytical process, during which they apply a number of transition indicators[1] to each project. The findings on transition impact can then be used to assess the Bank's overall performance in this area.

The 1999 results reflect the performance of EBRD projects prepared in earlier years. Therefore, it is the underlying medium-term trend that is significant rather than the results of a particular year. Results up to the end of 1999 show that 75 per cent of operations evaluated in 1996-99 achieved a transition impact rating of "medium" or "high". This is a relatively good outcome in view of the young age of the evaluated portfolio and the challenging economic environment in the region. A total of 26 per cent of operations evaluated during this period were rated "high" on transition impact, which is identical to the results of 1996-98.[2]

Transition impact ratings of post-evaluated EBRD projects 1996-99

	Negative %	None %	Low %	Low-Negative %	Medium %	High %	Medium-High %	Total number of projects evaluated
1996	0	0	23	23	63	14	77	35
1997	0	6	25	31	42	28	70	36
1998	4	8	14	26	43	31	74	49
1999	4	10	8	22	52	26	78	50
1996-97	0	3	24	27	52	21	73	98
1996-98	2	4	20	26	48	26	74	120
1996-99	3	6	16	25	49	26	75	170

The assessment of projects indicates that transition impact could be improved in some cases. In this respect, it is important to note that the evaluated projects were primarily prepared during 1991-97 and that the EBRD has focused increasingly on transition impact since 1996. This change in focus, emphasising the need to select projects with a higher transition impact, is expected to result in better transition performance ratings in the future.

1 A set of seven transition indicators are applied to the company/client, industry/sector and the economy in general: competition, market expansion, private ownership, frameworks for markets, skills transfer, demonstration effects and standards for corporate governance. These indicators were developed by the EBRD's Office of the Chief Economist in cooperation with PED.

2 Transition ratings before this period were not sufficiently refined, and the checklist of transition indicators had not been fully developed.

Overall transition effectiveness of evaluated EBRD projects 1996-99

	Unsuccessful %	Partly successful %	Successful %	Highly successful %	Successful/ Highly successful %	Total number of projects evaluated
1996	14	31	43	11	54	35
1997	11	42	36	11	47	36
1998	22	20	53	4	57	49
1999	22	24	46	8	54	50
1996-97	13	37	39	11	50	98
1996-98	17	30	45	8	53	120
1996-99	18	28	45	8	53	170

The overall rating of the EBRD's operational performance, as presented in the table above, is described as the EBRD's overall "transition effectiveness" due to the high weight given to transition impact. However, the table also takes account of projects' performance ratings regarding "additionality", environmental performance, financial performance, fulfilment of objectives and the Bank's investment performance. It shows that the percentage of projects rated "successful" or higher remains at 53 per cent in both 1996-98 and 1996-99. However, due to the deterioration of the economic situation in the Bank's countries of operations, the percentage of "unsuccessful" projects increased from 13 per cent in 1996-97 to 18 per cent in 1996-99.

The projects analysed in the table above are a representative sample of the projects ready for evaluation. On the basis of this evaluation work, the portfolio has maintained an acceptable quality and the EBRD has successfully fulfilled its mandate since its inception. One of the areas in need of further improvement is the financial performance of projects, which should be achieved through greater progress in project appraisal.

The importance of past experience

Apart from ensuring that the EBRD has functioned according to its mandate (accountability), it is essential that the project evaluation process also generates important lessons from past operations. Through Bank-wide dissemination of these lessons, bankers are able to improve future operations (quality management). A substantial amount of staff time is allocated to disseminating evaluation findings to Bank staff as early as project appraisal and through "lessons learned" workshops. In this way, the lessons are properly shared and can be integrated into the design and structure of new projects.

Cooperation on evaluation among multilateral development banks (MDBs)

PED continued to cooperate closely with the evaluation departments of the other MDBs through the Evaluation Cooperation Group (ECG). This group was established in 1996 in response to the report of the Task Force on MDBs, which was created by the ministerial Development Committee. A key Task Force recommendation was that MDBs should harmonise "criteria, techniques, and practices for measuring results among evaluation units". Over the past years the ECG has helped to strengthen partnerships among MDB evaluators. The participants are the EBRD, the World Bank, the International Finance Corporation (IFC), the three other regional development banks (the Asian Development Bank, the African Development Bank and the Inter-American Development Bank) and the European Investment Bank. As a result, progress has been made in harmonising and improving evaluation methods for operations in both the public and private sector.

ECG members completed an "evaluation benchmarking" exercise in 1999, which helped to harmonise evaluation criteria. The establishment of "Good Practices Standards for Private Sector Evaluation" was a particular achievement of the ECG during the year. The ECG will continue to work on the remaining differences in practices, including certain areas of public sector evaluation and the evaluation of institutional development. The ECG will persist with its efforts to identify best practices, promote evaluation capacity development in countries of operations, make evaluation results comparable and translate evaluation findings into operational standards.

Thematic lessons from investment operations

In keeping with the EBRD's disclosure policy, the lessons presented below are drawn from both positive and negative aspects of EBRD projects during recent years. They are intended to help increase the overall quality of the Bank's future portfolio by enabling staff at all levels to learn both from successful and unsuccessful operations.

Examples of evaluated EBRD projects

Projects with a successful outcome

Credit line and subordinated loan to emerging private sector bank
In 1995 the EBRD extended a credit line accompanied by technical assistance to an emerging private bank in one of the Baltic states. A subordinated loan was subsequently granted in 1998. PED concluded that thorough project preparation and assessment of the bank had resulted in a strong management team and firm commitment to best practice in corporate governance. These qualities were encouraged by the EBRD by working closely with the bank, and this has enabled the institution to overcome several difficult periods in the development of the Baltic states' financial sector. The bank has developed into a strong institution with substantial foreign participation. In PED's view, the bank now has an important role in serving local businesses. Its success has boosted competition in the sector, enhancing the stability and sustainability of the whole banking system and advancing the transition process. The EBRD's involvement in this financial institution was instrumental in bringing about these positive developments.

Municipal and environmental infrastructure (MEI) operation
The EBRD has lent €10.2 million to finance water and waste-water investments over the past four years in Estonia. This has been provided through a state-guaranteed loan to water utility companies owned by 12 small municipalities. A privatised central water utilities company was selected to channel sub-loans for local implementation. Technical co-operation (TC) funding supported a twinning programme between a major Nordic city and the water utility companies, involving training at all levels. PED found that institutional reform is developing well and that this will eventually help Estonia's accession to the European Union. Environmental objectives were also adequately met. In addition, the EBRD's thorough project monitoring has been instrumental in bringing this multi-faceted operation to a successful conclusion.

Energy efficiency project
An energy efficiency project in central Europe involved the turnaround of a large heating installation and maintenance company at an early stage of post-privatisation into a profitable, market-oriented energy service company (ESCO). This project was successfully concluded with sponsor support from a pan-European group in utilities and services that had a clear strategy to expand into new Eastern markets. The EBRD provided financing for the ESCO, which focused initially on helping municipal and public buildings bring about energy efficiency improvements through conversion from oil to gas.

A "greenfield" bank for micro-enterprise loans
The EBRD is co-founder of a new bank for micro-enterprise loans in eastern Europe, which will lend mainly to small entrepreneurs in trade and services. Other sponsors include international and bilateral financiers and consultants, who initially managed the bank. A mid-term review by PED recently confirmed excellent start-up results after only two years of operations. It was concluded, however, that true sustainability requires increasing market exposure. The new bank had lent to almost 2,000 micro and small firms while repayment arrears were still under 1 per cent. Loan officers and branch managers were locally trained staff but senior management, supported by technical assistance, were expatriates. In PED's view, excellent lending productivity was helped by internal systems and training of high calibre. Grant-adjusted break-even was considered within reach. This could ultimately help to demonstrate to hesitant commercial banks that micro-lending could be profitable. TC-funded advice, significant equity capital and soft foreign loans had supported the new bank. PED believes that the remaining challenge for the bank is to become less reliant on such grant support. Deposit-taking is still at a pilot stage and needs a substantial investment in banking infrastructure in order to expand. In the medium to longer term more financial intermediation is needed to help the bank become self sufficient.

Projects with a less successful outcome

Restructuring of a large industrial complex
The EBRD provided a considerable loan to a large engineering complex in a "one-company town". With the company's sales falling as a result of the difficult economic climate, the EBRD's project aimed to provide the company with some breathing space. Deeper corporate reforms were expected to follow as a result of technical advice from Western industrial firms. The market downswing became protracted, however. Since the company was a dominant local employer, in common with many other "one-company towns" in the region, profound large-scale restructuring involving the break-up of the company into smaller components and down-scaling would have resulted in high levels of redundancy. This met strong political and social opposition, as no significant funding was in place to mitigate the social consequences. Consequently, large-scale restructuring was avoided, and the existing managers initiated a modest reduction in capacity without undertaking more radical reform. PED concluded that during the appraisal of this project the EBRD failed to identify some insurmountable social, political and managerial problems. In addition, the lack of a robust reform plan and the absence of a committed sponsor whose capital was at risk were identified by PED as significant drawbacks. A plan for mitigating the social effects of redundancies should have been drawn up since past experience has shown that without such a plan very large enterprises of this type in "one-company towns" are reluctant to undertake reforms.

Minority equity investment in large existing commercial bank
When the EBRD acquired a minority stake in a leading commercial bank in one of the largest transition economies, it was expected that the Bank's investment would lead to improved corporate governance through the EBRD's representation on the Supervisory Council. The project was also expected to attract additional financing and possible investment in the bank by other Western investors. However, the EBRD's involvement coincided with a decline in the bank's fortunes, and the EBRD was unable to influence developments. Four years later the bank's banking licence was withdrawn and the EBRD lost its entire investment. The PED concluded that:

- the EBRD's original assessment of the bank had placed too much emphasis on the bank's capital adequacy and on the high agency ratings and positive media reports; and
- risk mitigation measures had not been sufficiently direct, depending on coordination and cooperation with other projects that did not materialise as hoped, or had not been in line with wider EBRD objectives in this sector.

Banking sector in Russia

Corporate governance

Although fostering good corporate governance has been one of the most important objectives of many EBRD projects and a key element of the Bank's policy for the banking sector in Russia, a number of projects have fallen short of acceptable standards and have put the reputation of the Bank at risk. Ineffective institution-building has been both symptom and cause, especially in the sphere of financial institutions. In some projects in the Russian banking sector, the EBRD has had too little influence from the start to have any realistic prospect of having an impact on formal governance issues, especially when the Bank was only a creditor.

Basing strategy on thorough analytical and background knowledge of the banking system, its development and rationale

Analysis of several EBRD projects in the Russian financial sector reveal an apparent assumption that the new Russian banking sector would perform an intermediary role similar to that performed by banking sectors in established market economies. Not enough attention was paid to the strong influence on the Russian banking sector of the legacy of the planned economy and of the dramatic period of banking and enterprise reform that took place just before the fall of communism.

Interpretation of the signals of excessive government borrowing

The absence of normal credit operations in the real economy constitutes a high risk when the magnitude of government bonds clearly demonstrates the lack of an adequate tax and other revenue collection system and when the size of the investment in government paper by financial institutions becomes excessive. It is essential for the EBRD to have a thorough insight into the economy as a whole, as important macroeconomic signals can help to direct the Bank's investments towards areas of high transition impact.

Currency risk

The EBRD needs to re-evaluate its strategy for managing currency risk, showing greater concern for the needs of the economy of each country of operations, including a broader concern for local capital market trends and development. It is particularly unfortunate if recipients of Bank financing recycle funds into international financial markets to avoid currency risk, so reducing the impact of the EBRD's financing in the country's economy. Currency risk can be allayed through appreciation of the currencies of the countries of operations and by adopting a much longer timeframe for the Bank's lending operations than originally envisaged.

Controlling the use of an institution's funds

Notwithstanding the "fungibility" of a bank's financial resources, it is still essential that the EBRD makes every effort to have the firmest possible knowledge, control or assurances concerning how the Bank's funds are likely to be used when it invests in financial institutions. It is of key importance to make sure that no speculative activities are encouraged as a result of the Bank's financing. Given that international markets treat an EBRD investment in a financial institution (whether as lender or shareholder) as some form of risk mitigation, it is important to try to exert some control over any increased access to foreign financing that the Bank's interest in a financial institution may bring about.

Appraising minority positions in banks prior to their realisation

When taking a minority position in a financial institution with the aim of fostering good corporate governance, the EBRD must make sure that progress in this area has good prospects. The identification of fellow shareholders with common objectives and the detailing of these objectives in a shareholders' agreement are very important steps.

Restructuring large enterprises

Reform of large enterprises and mitigation of political and managerial constraints

The EBRD has learned that large-scale restructuring of large enterprises needs the full support of local authorities to help mitigate the social effects of redundancies. Without this support, such enterprises will be profoundly adverse to radical reform. Another requirement is the need for new competent turnaround management with full owner backing. Programmes must also be in place to mitigate the adverse social effects of redundancies. The EBRD will seek to collaborate with local authorities and financial institutions such as the World Bank on a few carefully selected operations that aim to demonstrate successful restructuring of large enterprises. Most of these projects are expected to have the support of new strategic industry sponsors.

Widespread barter and the efficiency of markets

Widespread barter in the economy will delay the transition process. Projects that support the reform of enterprises producing goods can be put at risk by barter. Market-based pricing and cost accounting and improved accounts/audits in terms of transparency and accountability are areas where the EBRD can improve standards. However, even these measures cannot deal with widespread barter. Consequently, it might be necessary for the Bank to avoid projects in sectors and industries with a high degree of barter, such as the commercial vehicle industry.

Supporting large-scale enterprise reform

Direct intervention by the EBRD to help with the reform of large-scale enterprises in Russia following privatisation will prove difficult under prevailing conditions. Western companies' incentive for direct investment will be low, at least in the short term. Currently, large enterprises are legally prevented from yielding majority control to foreign owners and management, even if they are in dire need of reform. The conditions for EBRD investment in large-scale enterprises should include:

- full backing from relevant central and local authorities based on prior dialogue and agreements;
- the yielding of control to competent turnaround management with commitment over time from a strategic investor or to reform-minded owners in long-term incentive-based management contracts; and
- agreed action plans, including ways of mitigating the social consequences of restructuring and the resulting redundancies.

Micro and small enterprise (MSE) financing

The EBRD's objectives in MSE financing

MSE projects should have clearly defined objectives to avoid uncertainty in the execution and monitoring of the project and any potential loss of efficiency. Each MSE operation should have a clearly defined target group and requires credit technology, sufficient resources, a number of agents and a series of targets. The fulfilment of these requirements will help to bring about effective deal structuring and monitoring. It will also help to phase-out the grant elements in TC and capital funding in line with appropriate time plans and in accordance with the EBRD's mandate.

A cautious approach to non-lending investments

Investments in systems and infrastructure in "greenfield" MSE banks may be justified on a limited pilot basis but not on a larger scale if based on subsidies or high margins in imperfect markets. Returns for offering accounts, transfers and retail banking services may justify owner or strategic alliances with commercial banks as an alternative to investment in self-contained banking systems and infrastructure.

Municipal and environmental infrastructure (MEI) operations

Economies of scale in financing small municipalities through strong domestic intermediaries

The provision of MEI financing to small municipalities via domestic intermediaries can benefit from economies of scale in project preparation and implementation management, resulting in a greater impact on the transition process.

MEI programmes and the selection of domestic financial institutions

Tendering or other forms of contracting with clear competitive elements should be used for the selection of financial intermediaries. The selected bank or institution should have a clear strategic orientation towards the municipal market and a capacity to serve municipalities and their utilities in a way that would be supportive of expanded domestic capital markets.

Water and waste-water investment financing for small municipalities

Channelling of financing to small local municipal utilities via a central intermediary can be an efficient way of fostering MEI investments and institutional change. Competitive selection of intermediaries will generally be preferable to negotiated contracting. EBRD projects should seek to link municipalities to the financial market and to market-based contracting for implementation support.

MEI programmes and performance monitoring at sub-borrower level

MEI programmes should introduce performance monitoring of sub-borrowers in a way that will encourage domestic intermediaries to continue this process, adapting the criteria to reflect domestic standards.