

# ANNUAL EVALUATION REVIEW 2017



Evaluation Department April 2018



**European Bank**  
for Reconstruction and Development

The Evaluation Department (EvD) at the European Bank for Reconstruction and Development (EBRD) reports directly to the Board of Directors, and is independent from the Bank's Management. This independence ensures that EvD can perform two critical functions: reinforcing institutional accountability for the achievement of results; and providing objective analysis and relevant findings to inform operational choices and improve performance over time. The Department evaluates the performance of the Bank's completed projects and programmes relative to objectives.

This summary has been prepared by EvD under the authority of the Chief Evaluator. The views expressed herein do not necessarily reflect those of EBRD's Management or its Board of Directors. Responsible members of the relevant operations teams were invited to comment on the Annual Evaluation Review 2017 prior to internal publication. Any comments received will have been considered and incorporated at the discretion of EvD. While EvD considers Management's views in preparing its evaluations, it makes the final decisions about the content of its reports. Annual Evaluation Reviews are discussed by EBRD's Audit Committee and approved by the Board.

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## Contents

Contents	<i>i</i>
Figures	<i>ii</i>
Abbreviations	<i>ii</i>
Defined terms	<i>iii</i>
<b>Executive summary</b>	<b>1</b>
Major findings and recommendations from evaluations	3
Outlook for 2018	3
<b>The Evaluation Department's year in review</b>	<b>4</b>
Work programme delivery	5
Move from random to purposeful selection	6
Separating debt and equity	9
Knowledge management	9
Training	9
Departmental matters	10
<b>Results in 2017</b>	<b>12</b>
Results	13
Findings	14
Final observational finding	18
<b>Special topics: Additionality, Equity and Local Capital Markets</b>	<b>19</b>
Additionality in the EBRD: review of concept and application	20
Equity operations	21
EBRD support for the development of local capital markets	23
<b>Outlook for 2018: expectations, changes and advances</b>	<b>25</b>
Major studies for delivery in 2018	26
Studies commencing in 2018 with expected delivery in 2019	26
Evaluation evolution and enhancement	27
External evaluation	27
Improving methodologies and techniques through international engagement	27
<b>Annex: Management comments</b>	<b>29</b>

## Figures

Figure 1. 2017 EvD Highlights	7
Figure 2. International Engagement and Knowledge Sharing	11
Figure 3. Profile of Self-Evaluation Sample	14
Figure 4. Overall Project Performance Ratings 2017	15
Figure 5. EvD Category Project Performance Ratings 2017	15

## Abbreviations

<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EPG</b>	Economics, Policy and Governance
<b>EvD</b>	Evaluation Department
<b>IFI</b>	International financial institution
<b>LC2</b>	Local Currency and Capital Markets Development
<b>LCM</b>	Local capital market
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OPA</b>	Operation Performance Assessment
<b>SEMED</b>	Southern and Eastern Mediterranean
<b>SMEs</b>	Small- and medium-sized enterprises
<b>TOMS</b>	Transition Objectives Monitoring System

## Defined terms

### **Additionality**

Additionality is one of three key principles governing the operations of the Bank jointly with sound banking principles and transition impact. The notion of additionality is based on the statement in the Agreement Establishing the Bank – Article 13 (vii): the Bank shall not undertake any financing, or provide any facilities, when the applicant is able to obtain sufficient financing or facilities elsewhere on terms and conditions that the Bank considers reasonable.

### **Evaluability**

The extent to which the value generated or the expected results of a project are verifiable in a reliable and credible fashion

### **Ex-ante**

Expectations or forecasts calculated or existing before a particular event based on assumption and being essentially subjective and estimative

### **Ex-post**

Results rather than forecasts based on knowledge and retrospection and being essentially objective and factual

### **Impact**

The positive or negative long-term effects produced by an intervention, directly or indirectly, intended or unintended; an impact generally results from a series of causal factors of which the project is but one

### **Indicator**

A quantitative or qualitative factor or variable that provides a simple and reliable means to measure achievement, to reflect the changes connected to an intervention, or to help assess the performance of a specified entity

### **Outcome**

The short-term and medium-term effects consequent to delivering the intervention's outputs

### **Output**

The products, capital goods and services that result from an intervention – its deliverables

### **Result**

The output, outcome or impact (intended or unintended, positive or negative) of an activity or intervention

### **Transition impact**

The likely effects of a project on a client, sector or economy, which contribute to their transformation from central planning to well-functioning market-based structures. This also means not everything that is good about a project is necessarily transition impact.

### **Transition qualities**

The six qualities of a sustainable market economy -- competitive, well-governed, green, inclusive, resilient, and integrated -- that EBRD promotes through its activities in its countries of operations.





# Executive summary

This Annual Evaluation Review 2017, published by the Evaluation Department (EvD) of the European Bank for Reconstruction and Development (EBRD), summarises the Bank's evaluation activities, findings and results. It provides evidence-based operational insights, principally to the Bank's shareholders, Management and other stakeholders that contribute to the Bank's accountability for performance and continued institutional improvement.

Major thematic evaluations completed in 2017 produced important insights on the Bank's performance and results in a wide variety of sectors and contexts – from equity operations to local capital markets – and examined big-picture issues, such as the additionality concept. More than 140 self-evaluations by project teams in 2017 provided supporting data for themes emerging from the evaluations over the past few years. Together, EvD's thematic evaluations and independent project-level evaluations provide direct feedback for operations teams, and strategically useful insights and results for Board Directors and senior Management.

EvD's work programme is developed in close cooperation with the Audit Committee of the EBRD Board of Directors. After informal consultation, a draft work programme is submitted to the Audit Committee. Subsequent to those discussions, a final work programme is brought before the Audit Committee and then approved by the full Board. All EvD evaluations are distributed to the Board and Management. Major evaluations are presented to the Audit Committee and are available in full to Bank staff on the EBRD intranet. Audit Committee discussion, which involves an active exchange between Board members, EvD and (generally) Management, provides an essential institutional mechanism for presentation, absorption and uptake of evaluation findings and recommendations. Audit Committee discussions in 2017 provided valuable feedback and guidance to both EvD and Management. Following committee discussion, final circulation and removal of any sensitive or proprietary information, evaluations are posted on the EBRD website.

The Bank's Evaluation Policy<sup>1</sup> gives EvD primary line responsibility for the effective design and performance of the Bank's overall evaluation system in addition to delivery of high-quality evaluations. In 2017 this work included:

- contributions to formulating the new transition objectives monitoring system

- playing a leading role in the Bank's knowledge management initiative
- input to new sector strategies
- use of results frameworks at the project level
- collaboration with Management to report on uptake of EvD recommendations.

The year 2017 also saw major adaptations to further strengthen the strategic relevance and value of EvD's work within existing resource constraints. EvD, while maintaining its traditional accountability function, continuously evolves to provide learning and insights to a Bank facing new strategic challenges related to missions, markets and a changing larger organisational context in Europe. More practically, alterations to the EBRD organisational structure, transition concept and project approval processes mandate changes in the evaluation system. For example, EvD piloted and successfully implemented a switch from random to purposeful selection of projects for self-evaluation.

However, beyond adjusting the mechanics and methodology of evaluation, EvD has worked in consultation with the Audit Committee to offer more thematic and strategic evaluations designed to be useful to the Board and senior Management to provide support to important directional decisions. This is evidenced in 2017 studies, such as the Additionality Concept and Equity Operations. A focus has been placed on timing strategy evaluations to coincide with Board approval of new succeeding strategies. Furthermore, EvD has deliberately moved from single project operation evaluations to evaluations of a cluster of multiple related operations to enable comparison across projects; deeper understanding of client, country, or sector impact; and assessment of the EBRD's ambition, strategy implementation and progress in transition. Expected changes like the new Transition Objectives Monitoring System, the IT upgrade Project Monarch and the Single Results Matrix will demand additional adaptations by EvD. Furthermore, EvD conducted a self-assessment regarding its own products,

<sup>1</sup> [www.ebrd.com/what-we-do/evaluation-policy.html](http://www.ebrd.com/what-we-do/evaluation-policy.html)



operations and management as input for an external evaluation in 2018, and as foundation material for future enhancements.

## Major findings and recommendations from evaluations

Summaries of three important evaluations: Additionality Concept, Equity Operations and Local Capital Markets are found in Section 3. High-level findings and lessons from across the 2017 EvD Work Programme are presented in Section 2. The following themes are seen consistently across the body of evaluation work in 2017.

Looking across all the evaluation products, EvD saw a recurring dimension regarding whether the operations are in sync with the larger sector or programme strategy. Key issues, discussed in more detail in Section 2, are as follows.

- **Ensuring sufficient resources for operations during strategic development:** Several evaluations found a need for greater resources to meet the aspirations of both profitability and achieving transition. While there may be sufficient personnel and funds to execute a particular transaction, EvD has identified instances where resources may be insufficient at a programmatic level and need to be addressed during strategic development.
- **Greater delineation of accountability and responsibility is needed:** When developing strategies, in addition to identifying resources, there must be clear accountable and responsible parties for the development, planning, implementation and monitoring of the Bank's initiatives. The Additionality and Equity evaluations identified areas where lines of responsibility could be clearer.

- **Higher ambition requires greater leverage:** When comparing results at the project level with objectives at the strategic level, one of the most striking issues mentioned in multiple evaluations was the need to match ambition with leverage. In numerous cases, where the EBRD strives to achieve the most, the financial leverage is quite limited. Clearly, the EBRD needs to be ambitious in terms of additionality and transition impact in its projects. Yet despite best efforts to assert leverage, compelling or influencing clients to act in the prescribed manner proved challenging.

When aggregating the lessons learned, many themes emerged but a common theme was that volatile external factors necessitate flexibility and vigilance. This was expressed in the following three lessons:

- flexibility in agreement terms is crucial in volatile environments
- changes in regulatory regime and political environment affect outcomes
- monitoring and reporting require vigilance and proactivity by the EBRD.

## Outlook for 2018

EvD enters 2018 with considerable positive momentum and is well placed to build on the foundations of effective performance established over recent years. Important milestones for 2018 are:

- participating in an external evaluation
- introducing country strategy evaluation products
- developing modified self-selection of projects for self-evaluation
- embarking on a new set of major evaluations including delegated authority, the Sustainable Energy Initiative and policy dialogue in Southern and Eastern Mediterranean (SEMED) countries with a focus on technical cooperation
- providing inputs to corporate initiatives related to the new Transition Objectives Management System, sector strategies and knowledge management.



1

# The Evaluation Department's year in review

In 2017 EvD completed one of its most challenging and rewarding years. The year 2016 marked a change in the methodology of its performance rating system and, in 2017, the performance rating system was further refined and accompanied by a change from random to purposeful selection of projects for evaluation. Other highlights include major evaluations related to equity, local capital markets and additionality; consultations with and presentations to Management; and a self-assessment of EvD as preparation for an external evaluation in 2018. This section recaps EvD's activities, performance and achievements in 2017.

## The Evaluation Department's products

EvD's range of products contributes to institutional learning and accountability, and thus to superior institutional performance and results.

- **Thematic evaluations (special studies):** In-depth evaluations organised around a theme, strategy or sector, providing detailed analysis of design, structure and results. Their objective is to identify strategy and performance issues and provide timely, relevant and actionable recommendations for the Board of Directors and senior Management.
- **Operation evaluations:** Comprehensive evaluation of a single project or (more commonly) a group of thematically related projects based on deep research and field work. Design and execution are assessed and performance is evaluated against objectives and opportunities. Key findings and recommendations directed to both learning and accountability are provided to the Board and Management.
- **Project validations:** Desktop evaluation reports using self-evaluations produced by

Management and independent EvD analysis. Analysis and findings tend to focus on design, execution, operational results and strategic relevance. Individual evaluations may be clustered by sector or themes where possible, in order to present a wider and more useful body of evidence.

- **Corporate reports:** Reports about EvD's operation and activities submitted to the Board and/or Management, both for information purposes and as an instrument of EvD's own accountability.
- **Additional papers:** Synthesis papers of related previous evaluations, short information notes and brief reports on subjects of particular interest to the Board.

All original evaluation papers are commented on by the EBRD Management and shared with the Board Directors. Thematic evaluations and operation evaluations are also discussed in detail at Audit Committee meetings. The EBRD staff and Board Directors can access all products through the Evaluation Library.

## Work programme delivery

The year 2017, if not the most prolific in terms of evaluations produced, was one of the most impactful with evaluations resonating with the Board and Management. (See Figure 1 for 2017 highlights.) EvD presented the following studies, information notes and reports to the Audit Committee:

- **Equity Operations Thematic Evaluation:** A comprehensive evaluation of the EBRD's equity operations from 2005 to 2016.
- **Local Capital Markets Thematic Evaluation:** A thematic evaluation of the EBRD's Local

Currency and Capital Markets Development (LC2) strategy and activities undertaken in 2012-2015.

- **Additionality Concept Study:**\* Rather than an evaluation per se, this study is a rigorous examination of the additionality concept and how it is applied and utilised at the EBRD.
- **Petroleum Distribution Operation Evaluation:** An evaluation of a series of transactions with a large downstream energy client.
- **Telecoms Operation Evaluation:** An evaluation of multiple projects with a major telecom provider.

- **Corporate Governance in Project Evaluations** (presentation to the Audit Committee): A new product; a presentation of findings related to a topic, corporate governance, from a series of validations.
- **EvD Self-Assessment**:\* EvD produced a self-assessment as preparation for the external evaluation in 2018.
- **EvD Client Survey Findings**: EvD presented summary findings from a series of surveys and focus groups related to EvD performance.

The following corporate reports were also presented to the Audit Committee.

- **Annual Evaluation Review 2016**
- **Mid-term Status Update**
- **Evaluation Department Work Programme and Budget 2017-2019.**

\* - Completed in 2017, presented early 1Q2018

Additionally, in 2017 EvD provided a comprehensive review of 143 projects via the operation performance assessments (OPAs)/self-evaluations completed by Management, and validated 17<sup>2</sup> projects. Validations are independent desktop evaluations of individual projects performed by EvD.

There has been substantial progress on four major thematic evaluations identified in the 2017 Work Programme: Investment Climate Support Activities, Lending Through Financial Intermediaries and evaluations of the transport and energy sectors. All four evaluations are expected to be presented to the Audit Committee during the first half of 2018.

EvD recognises that fewer evaluations were delivered in 2017 than in the previous two years. This reduced delivery was due mainly to staffing challenges, explained in more detail under Departmental Matters (below), and also to the selection of several expansive, demanding evaluations in the 2017 Work Programme, which necessitate additional time for completion.

## Move from random to purposeful selection

From 2009 to 2016, when EvD selected projects for evaluation, it identified a stratified random, representative sample of sufficient size to establish a combined three-year rolling sample, performance rates at the 95 per cent confidence level with sampling error not exceeding  $\pm 5$  percentage points for key performance indicators. In 2017, EvD moved from stratified random sampling to purposeful sampling. The process for identifying projects ready for evaluation, based on the 'Good Practice Standards for Private Sector Evaluation', remained the same in 2017. Each year, unevaluated operations are reviewed to identify those that have reached early operating maturity. This is achieved when:

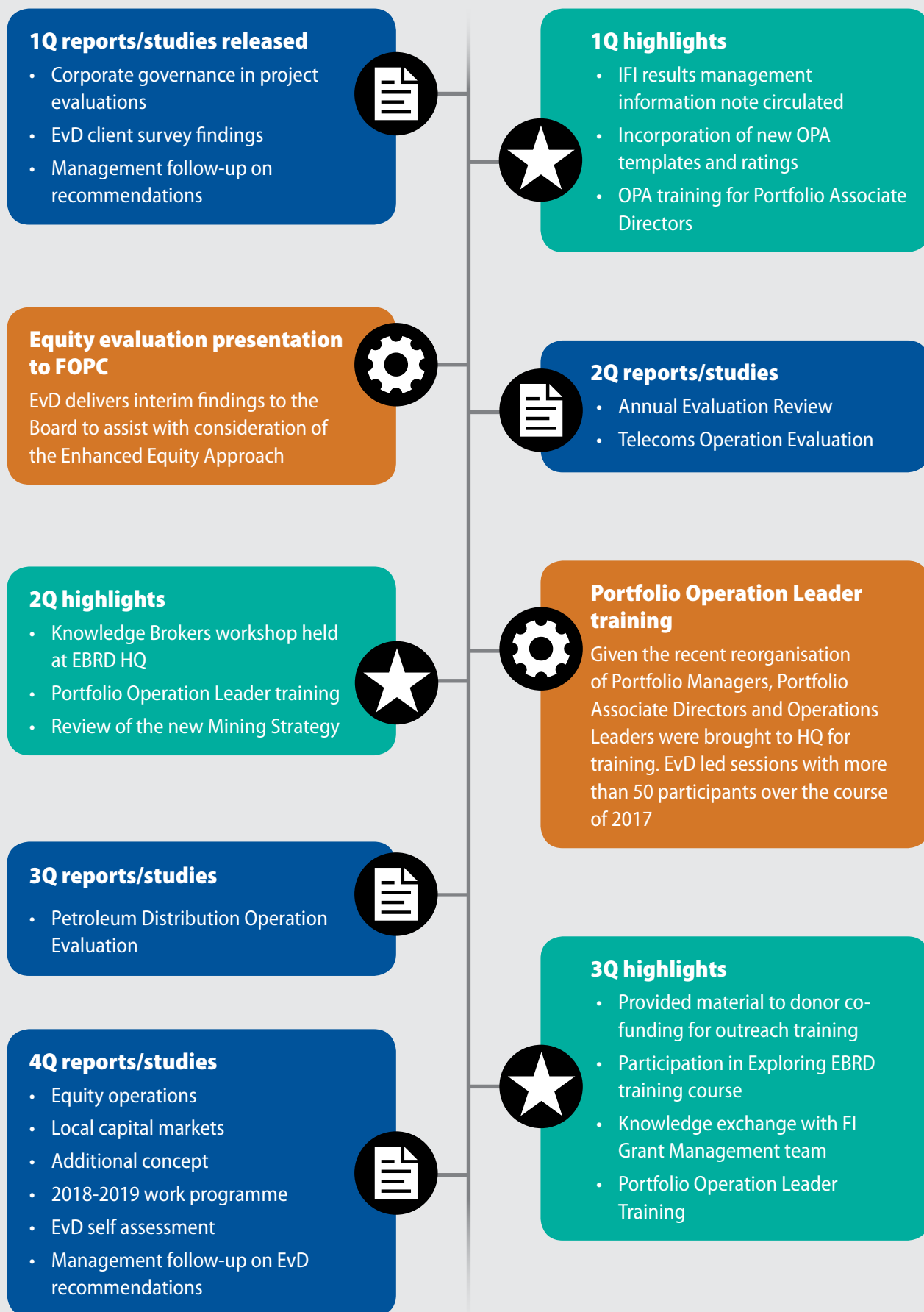
- the project financed has been substantially completed
- the project financed has generated at least 18 months of operating revenues for the company
- the EBRD has received at least one set of audited annual financial statements covering at least 12 months of operating revenues generated by the project.

The year 2016 not only brought the highest number of validations and self-evaluations generated in a single year but also the second year of evaluation results and ratings data produced by the new rating methodology and OPA template introduced in 2015. After reviewing the work completed in 2016, EvD came to several conclusions.

Firstly, many validations were not being fully utilised by stakeholders, in part because of the high number of validations and OPAs they needed to read, and in part because the random selection process had often identified projects that were less useful candidates for validation. Secondly, EvD is committed to pursuing more strategically timed evaluations in step with renewals of country, sector and other strategies, as directed by the Audit Committee. Selecting relevant project validations would provide critical data and analysis for the development of the larger and more widely distributed evaluations. Thus, the idea is to ensure there are relevant transport projects evaluated in a year when the transport sector strategy is being evaluated, or relevant projects in Mongolia when the Mongolia country strategy is being

2 In all, 19 projects were originally validated. After agreement with management because of reasons of sensitivity and propriety, the OPA for two projects with the same client was utilised thematically but the ratings are not included in the official sample.

**FIGURE 1. EVD HIGHLIGHTS 2017**



FOPC = Financial and Operations Policies Committee; IFI = international financial institutions; FI = financial institutions; OPA = operation performance assessment

evaluated. Finally, the amount of resources needed to continue evaluating in the same manner proved to be a burden on both Management and EvD. The rigour of the newer methodology, reductions and reorganisation of staff in the Banking Department, and the steady increase in the number of new projects approved each year made the prospect of staying with the existing system untenable. The year 2017 brought a greater than 10 per cent increase in the number of EBRD projects approved but a reduction in knowledgeable operations staff available to participate in self-evaluations and no additional budget to EvD.

It became clear to EvD that the self-evaluation process needed additional revision. A decision was made to reduce the number of validations and to purposefully select the evaluations for validation in accordance with specific criteria. EvD reduced the number of validations assigned from approximately 50-55 per year to 10-15. The reduction in the number of validations decreased the number of reports for the Board to read, evaluations for EvD to produce, and more detailed 'long form' OPAs for Management to produce; not only reducing burden but supporting the Operational Effectiveness and Efficiency programme and the initiative of the Board Efficiency and Effectiveness Working Group.

In order to maximise the utility of this smaller set of validations, EvD selected projects for validation based on specific criteria. Sample criteria include support for an upcoming thematic or operation evaluation, previously expressed Board interest, high transition impact and relevance to Bank strategic initiatives.

Also in 2017, EvD undertook some revisions to the evaluation project rating sub-criteria and OPA template based on analysis of results, Management feedback and evaluator assessment. This fine tuning was designed to reduce the burden of work on operations teams. The basic methodology and OPA template format remain intact.

The revised approach reflects the feedback from the client survey findings gathered in 2016 and presented to the Audit Committee in February 2017, in which stakeholders found cross-sectoral, synthetic findings more relevant than individual project findings and requested a reduced self-evaluation burden. The approach was fully vetted with the Management focal points and the Audit

Committee. The switch to purposeful selection was discussed by the Audit Committee in November and December 2016, and announced in the Annual Evaluation Review 2016, which was released publicly in June 2017.

There was frank discussion about the implications of utilising a purposefully selected sample of projects, which is generally perceived to be somewhat lower in methodological rigour than a randomly selected sample. In addition, EvD would no longer be able to present its project ratings as statistically representative of aggregate Bank performance. The use of a purposefully selected sample was confirmed because of the following points.

- Based on the change in the transition concept, new financial metrics and the adjustments in EvD rating methodology, there was a discontinuity in project ratings, and aggregate performance comparisons to previous years were no longer valid.
- Most stakeholders valued a more strategic and thematic approach to evaluation as long as there was confidence that sufficient project-level data and analysis was undertaken.
- Without an allocation of additional resources, the previous approach was no longer sustainable. Neither EvD nor Management had sufficient resources to increase the number of projects in the sample each year.
- Most of the other international financial institutions (IFIs) do not engage in evaluation of 100 per cent of projects with a randomly selected sample for validation. Those IFIs that do so have significantly larger evaluation departments and budgets and approve fewer projects per year.
- While not viewed to be as robust as random selection, purposeful selection is a methodologically appropriate form of selection according to the *Evaluation Cooperation Group's Big Book on Good Practice Standards*.

EvD believes the move to purposeful selection has borne fruit based on feedback from Board and Management, the quality of OPAs and validations received, and improved timing of larger evaluation reports. As country strategy evaluations begin to become a regular part of the EvD work programme, the value of purposeful selection will readily become more evident.

## Separating debt and equity

The year 2017 saw another change in EvD's approach to self-evaluation and validation. At Management's request, self-evaluations and subsequent validations of clients with concurrent active debt and equity transactions were treated separately. Previously, EvD and Management preferred to evaluate debt and equity transactions with the same client together, providing greater insight into client and bank performance and improved efficiency in reporting. However, greater focus on separating debt and equity with 'Chinese walls' mandated separate evaluations.

## Knowledge management

EvD increased its activity and contributions in the area of knowledge management in 2017. The Chief Evaluator and Deputy Chief Evaluator have been active participants in the Economics, Policy and Governance (EPG) Department-led working group on the new Transition Objectives Monitoring System. The Chief Evaluator and the principal author

of the additionality study will be participating in Management's working group on the additionality concept. In 2017, the Deputy Chief Evaluator served as the leader of the pilot State Owned Enterprises Community of Practice and contributed to the development and presentation of the second module of EPG's Policy Academy in February 2018.

EvD sponsored the Knowledge Brokers, a game-based workshop designed to help evaluators and analysts use the right information and the right format for presentation to decision makers. In addition to EvD staff, counterparts from Management attended the workshop.

## Training

EvD provides training to operations staff assigned to complete OPAs. In addition to the regular training held at the beginning of each evaluation cycle, EvD staff delivered OPA training sessions at resident offices in Albania, Egypt, Jordan, Kazakhstan, Kyrgyz Republic and Ukraine. EvD participates in the

## Knowledge brokering at the EBRD

A simulation exercise, in the form of a table-top game called the 'Knowledge Brokers' was delivered in June 2017 to a group of 25 evaluators and managers from across the Bank (including EPG, technical cooperation, Country Strategy Coordination and Results Management, Banking and Portfolio) with enthusiastic feedback from the participants. Combining social science research techniques and gamification learning, Knowledge Brokers has been delivered to the American Evaluation Association, United Nations Development Programme, Czech Ministry of Regional Development, HealthCanada and now the EBRD.

The focus of the game is to teach participants how to give decision-makers the right information in the right format while navigating a changing environment and managing limited resources. A full-day exercise, the game immersed participants in the life of an evaluation unit providing decision-makers with analysis and evidence for four projects similar to those in the EBRD's portfolio – from improving municipal public transport to raising the levels of employment among women. With differing project life cycles and urgency levels,



competing teams decided on the methods of research and evaluation, timeframe, delivery format and the channels of communications, grappling with expected and unexpected challenges such as the sudden loss of a team member, budget cuts or project deadline shifts. EvD purposely included Management counterparts in the exercise in order to both impart useful skills to those in relevant roles and to demonstrate to Management the decisions undertaken by EvD when conducting evaluations.

See: <http://knowledgebrokers.edu.pl>

portfolio associate director and operation leader training sponsored by Portfolio Management.

Other semi-regular training events for EvD include a training presentation on evaluation for EBRD's Banking Academy, a week-long training course for new bankers, 'Exploring EBRD': a familiarisation class for new joiners, and 'Project Monitoring': a prerequisite class for the Banking Academy.

## Departmental matters

### Current staff

Described in detail in Annual Evaluation Review 2016, EvD's multi-year organisational transformation to a flatter operational structure with the introduction of a Deputy Chief Evaluator, better gender balance and a more diverse skills mix paid dividends in 2017 as a wide variety of challenging studies were undertaken, less consulting expenditure was needed, and experienced but younger colleagues were placed in lead roles.

A serious issue for EvD in 2017 was sub-optimal staffing levels, which affected departmental output. Affecting both senior and principal-level evaluators, EvD suffered from nearly three person-years' work loss due to long-term leave for various circumstances, i.e. family, personal, medical, etc. Another evaluator will be leaving EvD in early 2018 to join the Banking Department. As discussed in the EvD self-assessment, lack of staff mobility has been a continuing issue for EvD. Optimistically, this inter-departmental relocation suggests improvements in staff mobility and reflects favourably on skills transferability and Bank knowledge gained from EvD experience.

EvD Management is sanguine regarding the prospects for 2018 staffing levels. One evaluator has returned to work and two others are due to return in 2018. At least one new position is planned and a consultant has been engaged for the first six months of 2018 to fill in for missing staff.

### Staff development

EvD sponsored two seminars for departmental staff, one on business writing skills and the other on public speaking. One staff member was a member of the Bank's first cohort of the Management Matters course for associate directors and directors. Another staff member participated in EBRD's pilot female leadership coaching programme and another of these is scheduled for 2018. EvD staff took full advantage of the course offerings provided by the EBRD.

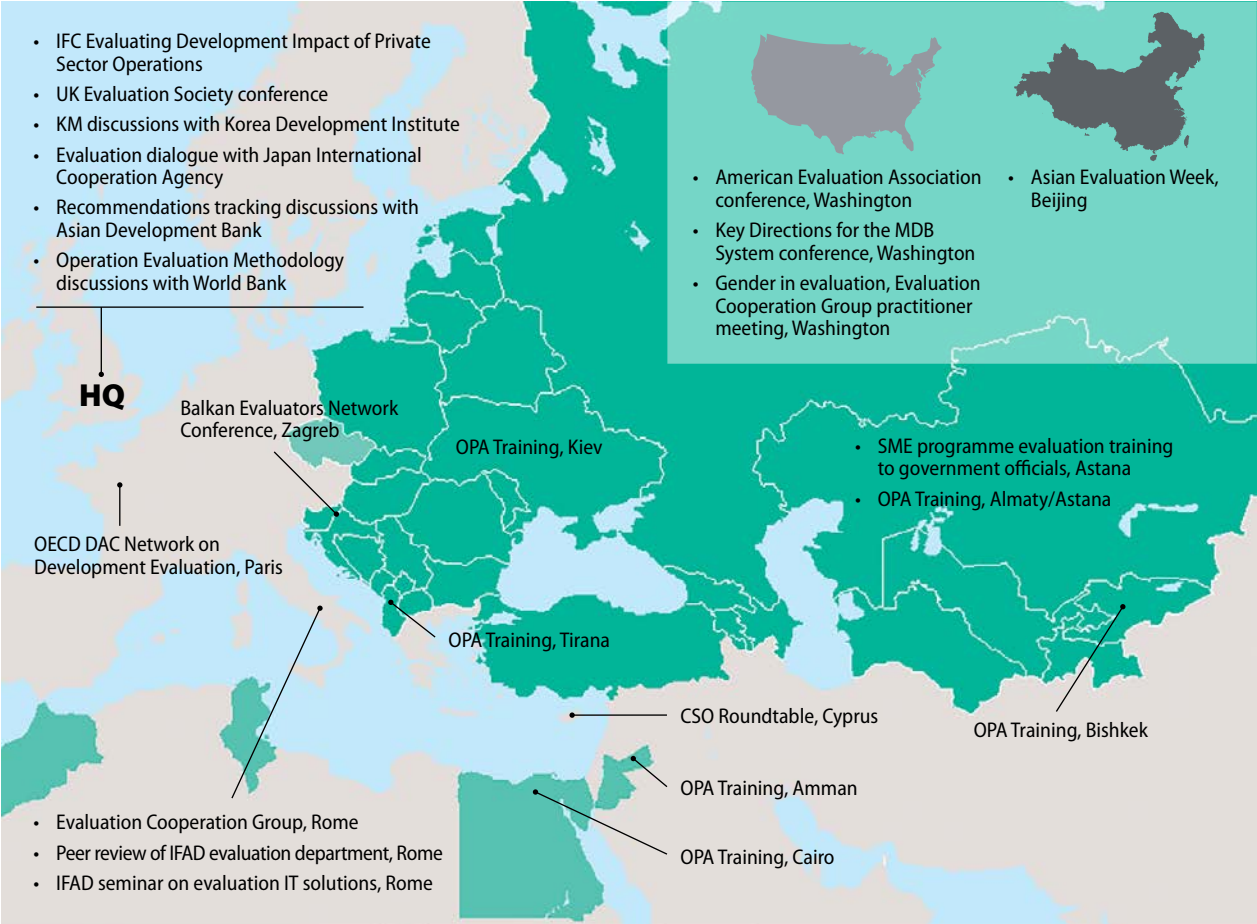
After its successful chairmanship of the Evaluation Cooperation Group in 2016, EvD remained fully engaged in the international evaluation community in 2017. In addition to attending the Evaluation Cooperation Group meetings, for which EvD prepared practice notes related to self-evaluation and external evaluation, EvD sent delegations to the European Evaluation Society, UK Evaluation Society, American Evaluation Association, International Finance Corporation Evaluating Development Impact in the Private Sector, Organisation for Economic Co-operation and Development (OECD) Evalnet, Asian Evaluation Week and Balkan Evaluators Network conferences to learn from and network with evaluation experts, and also presented at several of those conferences. Figure 2 illustrates EvD's international engagement and knowledge sharing activities conducted in 2017.

### Self-assessment of EvD

The EBRD's evaluation system will undergo an independent external evaluation in 2018. More details on the external evaluation may be found in Section 4: Outlook for 2018. In preparation for the external evaluation, EvD underwent a self-assessment of its objectives, performance, management and organisation in preparation for the external evaluation. The results of the self-assessment give an initial view from the EvD perspective on evaluation at EBRD and the issues presented and discussed are to be used to inform the larger external evaluation. The self-assessment included a questionnaire completed by EvD staff members and preliminary work completed by an external consultant. Developed over the second half of 2017, the self-assessment was presented to the Audit Committee in January 2018.



**FIGURE 2. INTERNATIONAL ENGAGEMENT AND KNOWLEDGE SHARING**



IFC = International Finance Corporation; KM = knowledge management; SME = small- and medium-sized enterprises; OPA = operation performance assessment; OECD DAC = Organisation for Economic Co-operation and Development - Development Assistance Committee; IFAD = International Fund for Agricultural Development; CSO = civil society organisation; MDB = multilateral development bank



# Results in 2017

EvD's objective is to transform the Annual Evaluation Review into a shorter document focused on recapping EvD's work, providing insight into the findings and learnings acquired during the preceding year, and informing readers about what is in store for the following year. This process began last year, moving the focus from the presentation of historical statistics to comparing findings across multiple evaluations.

## A watershed year in reporting

Based on the positive reception of the *Annual Evaluation Review 2016* and the context explained in Section 1 (that the change in the transition concept and the adjustments in EvD rating methodology and project sample selection resulted in a discontinuity in project ratings, and aggregate comparisons with previous years are no longer valid), in 2017 EvD moved forward in trying to integrate results from all of its evaluation products from the preceding year: reviews, validations, operation evaluations and thematic evaluations/special studies.

In addition, EvD is the sponsor of the Lessons Investigation Application at the EBRD. OPAs, validations and operation evaluations produce specific lessons learned at the project level, which are entered into the application. In past years, lessons learned from EvD were formally incorporated as part of the project cycle. Several years ago, the project approval requirement was eliminated but operations teams are strongly encouraged to consult the Lessons Investigation Application prior to creating their approval documents for the Operations Committee. Some lessons are developed by EvD staff, but most are developed by operations teams conforming to a specified template and then thoroughly reviewed by EvD staff. The *Annual Evaluation Review 2017* incorporates some of the highlights from the lessons learned in 2017.

## Results

### Evaluation cohort 2017

A total of 143 projects<sup>3</sup> were self-evaluated by Management, reviewed by EvD and then returned to Management for final edits and approval. In all, 154 lessons learned were derived from the self-evaluation process and entered into the Lessons Investigation Application. A profile of the projects evaluated appears in Figure 3.

3 In all, 143 projects were self-evaluated but a smaller number of OPAs were submitted. OPAs frequently cover multiple projects; i.e. framework projects or multiple projects with the same client might be evaluated in a single OPA.

A new feature in the 2017 OPA was a series of survey-type tick-box questions to facilitate EvD assessment of results across the entire population of projects evaluated.

Interesting results from the data received from Management include:

- 72 of the 143 projects indicated that the company/client achieved its intended operational objectives; 50 projects partly achieved the objectives<sup>4</sup>
- for debt transactions, 71 projects indicated that all committed funds were disbursed and on-time<sup>5</sup>
- for projects not validated, Management reported 39 projects achieved their transition objectives, 69 partly achieved them, and six reported they were not achieved (two did not respond).

EvD completed 17 project validations. These projects were assigned results frameworks and project performance ratings, provided supplemental lessons where appropriate and culminated in a report distributed to the Board and Management.

In terms of overall performance ratings,<sup>6</sup> (see Figure 4) none of the projects received the lowest rating, Highly Unsatisfactory. A total of 15 out of 17 ratings were Satisfactory or above.

Two projects were rated Marginal. While EvD and Management were in sync regarding projects being Satisfactory, generally Management rated projects higher than EvD. The most common overall rating among the OPAs was Good with nine occurrences (52 per cent) whereas EvD's most common overall rating was Satisfactory with eight occurrences (45 per cent).

EvD ratings under the current methodology are based on the OECD Development Assistance

4 Remainder indicated No, Not Applicable or did not respond.

5 Remainder indicated No, Not Applicable or did not respond.

6 Overall performance ratings have a six-point scale: Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Highly Unsatisfactory. Category ratings have a four-point scale: Outstanding, Standard, Below Standard, Deficient.

Committee criteria of relevance, effectiveness and efficiency. Additionality is a component of relevance. Effectiveness assesses contribution to both outcomes and impacts and provides insight into transition impact. Efficiency assesses financial performance of the client and investment return and could be used as a proxy for sound banking.

Looking at the individual category ratings (Figure 5), the majority of the cohort of projects was rated Standard or better. The additionality and effectiveness generally rated higher than efficiency because the financial performance of the client in a number of cases was Below Standard, meaning the client did not substantially achieve the projected financial indicators. While it would be difficult to identify a common reason for the Below Standard rating, each of the projects cited lower than forecast revenues due to unforeseen, or more impactful than foreseen, market or regulatory changes. Regulatory changes affecting the market and projects is one of the more common lessons learned from self-evaluations and is discussed in the Findings section below. As EvD continues to focus on providing more learning, for the first time, EvD synthesises findings and lessons from its entire body of work in 2017 in the next section.

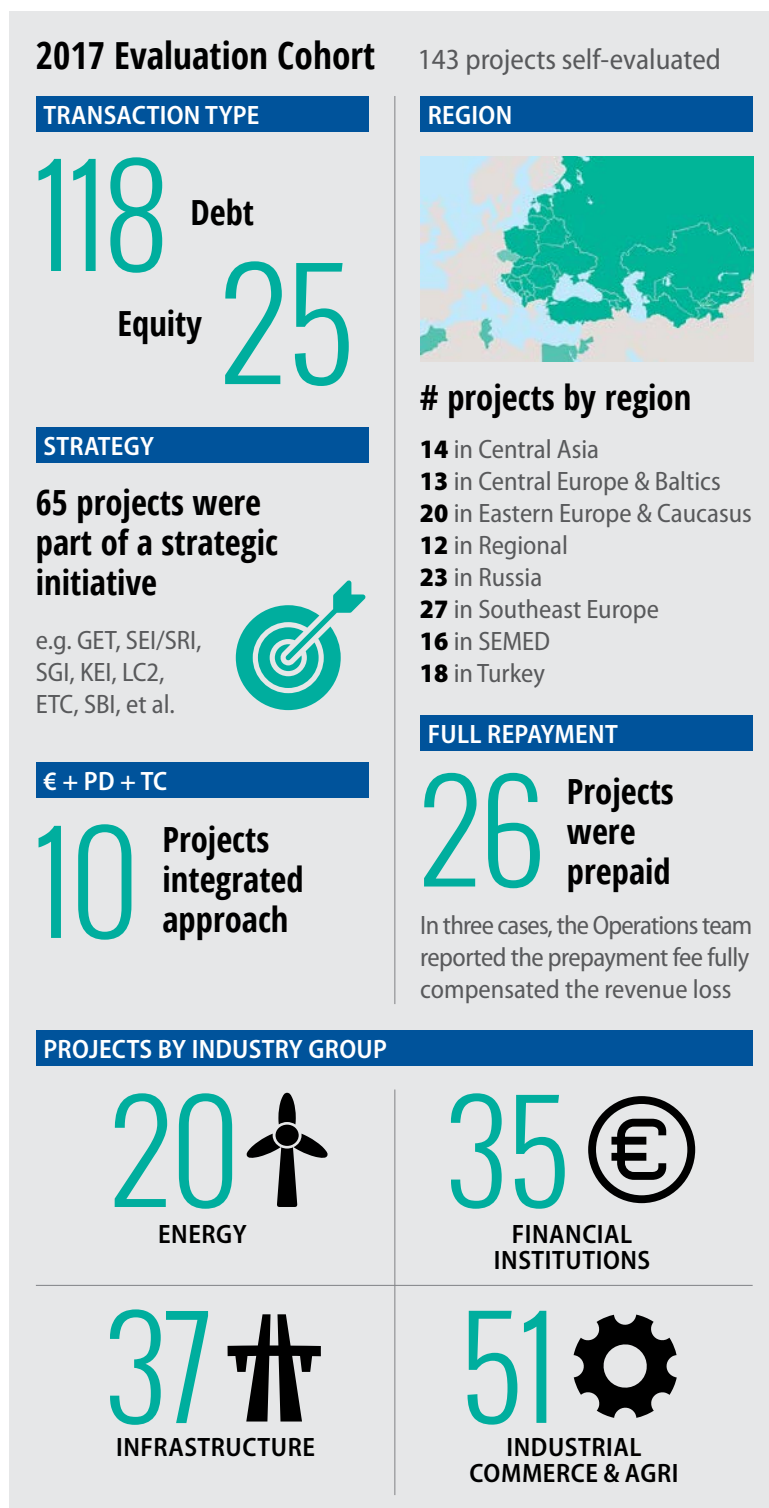
## Findings

### Comparing 2017 and 2016

The most prevalent finding in 2016 across all evaluations was related to a need for increased specification of appropriate results indicators at the time of project approval. While this need for results indicators was mentioned in evaluations in 2017, it was not as prevalent as in 2016. Without making judgements on performance in this area, EvD infers that ongoing progress in the areas of results frameworks, clarification of expected results for the differing

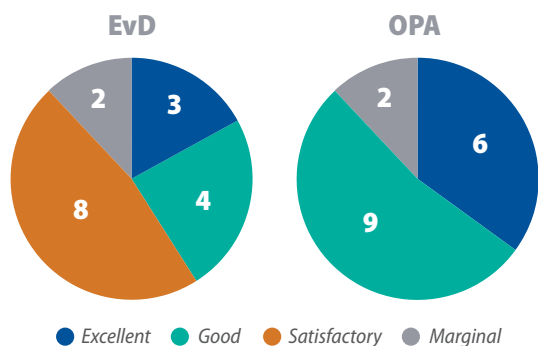
strategic planning tools, and enhancements to Board approval documents may be contributing to this improvement. Adoption of a single results matrix in the near future may further reduce the prevalence of this finding.

**FIGURE 3. PROFILE OF SELF-EVALUATION SAMPLE**

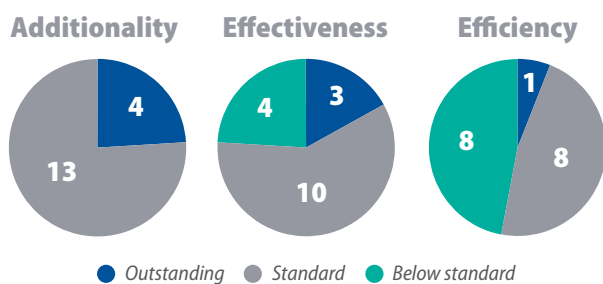


GET = Green Economy Transition; SEI = Sustainable Energy Investments; SRI = Sustainable Resource Initiative; SGI = Strategic Gender Initiative; KEI = Knowledge Economy Initiative; LC2 = Local Currency and Capital Markets Development; ETC = Early Transition Countries; SBI = Small Business Initiative; SEMED = Southern and Eastern Mediterranean; PD = Policy dialogue; TC = technical cooperation

**FIGURE 4. OVERALL PROJECT PERFORMANCE RATINGS 2017**



**FIGURE 5. EVD CATEGORY PROJECT PERFORMANCE RATINGS 2017**



Another finding from the *Annual Evaluation Review 2016* that was prevalent in 2017 was the importance of a committed sponsor. This finding focuses on the importance of a parent company or other sponsor being committed, not only to technical and financial support, but also to reform and improved performance in order to ensure success. Often, the borrower does not have the capacity for full implementation of the necessary conditions, covenants and activities, and thus support from the sponsor is required. One of the lessons from a manufacturing and services project emphasised the necessity of the full technical and financial support of a strong sponsor for greenfield projects in emerging markets. Another project lesson went further and stated that when working in challenging environments with significant risks of devaluation and economic challenges, it is important to work with experienced companies backed by large sponsors. And in the case where the sponsor might be weaker than expected, as in a power and energy transaction, it becomes critical to ring-fence the borrower from the sponsor. This is applicable in other sectors, as discussed in the *2016 Crisis Response for Greek Bank Subsidiaries in Southeast Europe* evaluation. That evaluation found that during the Greek financial crisis, Greek bank subsidiaries in Southeast Europe were adequately ring-fenced and

able to repay their loans, despite the high risk status of their parent banks.

While having a formidable sponsor provides additional capability and stability, another lesson was to not underestimate the operational challenges of dealing with a strong local sponsor. One interesting related finding in 2017 was in a Russian manufacturing project, where the Bank supported an important venture between two major companies. The mutual alignment of interests and modus operandi between the two sponsors were instrumental in the success of the project. Common to all these lessons was achieving a balance of sponsor capability and Bank influence and leverage alongside mutual alignment of interests among the borrower, sponsor and the Bank.

**Evaluation findings theme: ensuring operations are in sync with strategy**

In its country and sector strategies, the EBRD outlines numerous activities in which the Bank may participate. Evaluations in 2017 noted that in order to accomplish the goals named in the strategy effectively, there needs to be clearer guidance on priorities, responsibilities and resources.

**Ensuring sufficient resources for operations during strategic development**

Ensuring sufficient resourcing of EBRD teams proved an important high-level theme extracted from EvD’s 2017 work. Several evaluations found a need for greater resources to meet the aspirations of profitability and achieving transition. While there may be sufficient personnel and funds to execute a particular transaction, EvD has identified instances where resources may be insufficient at a programmatic level and need to be addressed during strategic development.

The LC2 evaluation pointed out that the LC2 team, which is working toward a key Bank-wide strategic initiative and a growing area of business, “. . . does not have a strategic resourcing plan, and its resources appear insufficient to meet its challenges and aspirations. The team relies heavily on external and often short-term staffing resources; consequently member turnover has been high.”

The Equity Operations evaluation found “the EBRD lacks sufficient staff with skills in equity and the aligned incentives needed to make the best use of its capital to support transition impact and financial

performance. The EBRD's levels of equity staff are no more than 50 per cent of industry norms, and reporting arrangements to the Board are poor."

The Telecoms Operation Evaluation offered, "EBRD is performing policy dialogue in the ICT sector on a needs- and commitment-only basis and given its resource limitations, it is streamlined towards pre-privatisation and post-privatisation support in the telecom sector and capacity building activities."

As the EBRD approaches the next round of corporate strategies, the Strategic Control Framework in particular, care must be taken to plan and ensure sufficient resourcing particularly since cost efficiency and zero budget growth have been emphasised in recent years. Achievement of top-level revenue numbers and transition scores indicate overall success but planning for future success in burgeoning areas like LC2 and Equity demand growth capital.

### ***Greater delineation of accountability and responsibility is needed***

Accordingly, when developing strategies, in addition to identifying resources, there must be clear accountable and responsible parties for the development, planning, implementation and monitoring of the Bank's initiatives. Accountability and responsibility were a theme that appeared in multiple evaluations at the organisational level and at the project level. In the additionality concept study, an important finding was there is no true accountable or responsible party for additionality at the EBRD. The Economics, Policy and Governance Department has basic responsibility for its definition. The Banking Department has responsibility for proposing additional projects at the approval phase but there is neither a formal indicator of additionality to be achieved at project inception nor a formal review of additionality similar to sound banking and transition impact. It has no formal place in the corporate scorecard or in many strategies.

The Equity Operations evaluation discussed how certain elements of the Bank's business belong to the Equity team and others belong to the Banking Department. The Enhanced Equity Approach recommended changes in the way that the Bank managed its equity investments leading to the EBRD Equity Group's increased control over the portfolio.

Despite these suggestions, the division of duties and responsibilities between the Equity team and the

Banking Department remains partial. For example, equity investments made under the Direct Financing Facility are still managed by the Banking Department under the supervision of the Small Business Investment Committee, rather than the Equity team that normally approves equity projects; this reduces clarity about responsibility for managing the equity portfolio and what is meant to be achieved.

Moving to the project level, in the Petroleum Distribution Operation Evaluation, road safety was a larger transition objective based on more finite project outputs and outcomes but with no clear responsibility delineated among the stakeholders for impact on road safety, progress beyond general awareness of road safety was not evident.

### ***Higher ambition requires greater leverage***

When comparing results at the project level with objectives at the strategic level, one of the most striking issues mentioned in multiple evaluations was the need to match ambition with leverage. Clearly, the EBRD needs to be ambitious in terms of additionality and transition impact in its projects. Yet despite best efforts to assert leverage, compelling or influencing clients to act in the prescribed manner proves challenging. In numerous cases where ambition was high, leverage was limited. In a bond project with a state-controlled enterprise, once funds were disbursed, it became difficult to convince the client to follow Bank rules and policies; procurement procedures for example. In an equity project, the client was unable to deliver an Initial Public Offering as expected and continued to invest in capital expenditures and buy back shares from other investors but did not deliver a Put option to the EBRD. In some cases, the Bank asks for reporting related to transition after repayment has been completed leaving limited leverage. One 2017 financial institutions validation offered that the monitoring reports, of little perceived value to the client itself, ceased after repayment.

One of the recommendations from the Petroleum Distribution Operation Evaluation was "client commitments to actions intended to generate transition impacts should be covenanted in repeat transactions" to maximise leverage, a recommendation echoing earlier evaluations such as *Transactions with State Owned Enterprises* and *Private Sector Participation in Municipal and Environmental Infrastructure Projects*, because similar transition objectives were proposed with successive deals.

EvD realises that ambition is part of the EBRD ethos and there is no easy solution for asserting leverage, especially being tasked with increasingly challenging transition objectives and seeking to work in difficult environments. Nonetheless, continued optimisation of strategic choice of instruments and embedding policy dialogue into project operations along with dedicated employment of tools, such as covenants and conditionalities, conditions precedent to disbursement, performance-based tranches and new streamlined reporting systems, should maximise the Bank's capacity to assert leverage.

### **Lessons theme: volatile external factors necessitate flexibility and vigilance**

As mentioned above, EvD analysed the lessons produced through the self-evaluation, validation and operation evaluation process. When analysing the lessons submitted in 2017, EvD found clusters of lessons pertaining to certain topics.

#### ***Flexibility in terms is crucial in volatile environments***

Perhaps the most prevalent lesson in 2017 was the need for the EBRD to be flexible with terms in volatile environments. Nine lessons across multiple industries emphasised that the EBRD should be prepared to amend terms post-signing because of financial crises, regulatory and market changes, or currency risk and pricing changes. Despite the potential for a lower return to the Bank, the flexibility to restructure terms after signing enables clients to address operational problems and to continue pursuing transition objectives. In most cases, bankers felt keeping the loan 'on the books' was better than the alternative. Suggestions for future projects included the following.

- Maintain close cooperation with Risk Management in order to proactively restructure transactions to pre-empt adverse results from volatile market conditions and respond quickly when necessary. In the case of equity transactions, the sponsors/majority shareholders may not have the appropriate sense of urgency and may not approach the EBRD in a timely fashion. Thus, the EBRD must be proactive.
- Adapt pricing to better reflect what is available in the market during difficult times.
- Create a flexible financial structure when working in a volatile environment including step-down adjustments depending on leverage and disbursements; utilising an adjustment

mechanism to disbursements based on upside and downside scenarios; and a deferred payment mechanism for an acquisition price, to be linked to the post-acquisition performance of the target.

From an evaluation perspective, this lesson is a complication because EvD assesses results based on objectives presented at project approval. While some circumstances may be out of the Bank's control, expectations for transition and financial return to the Bank are based on the Board documents at project approval. Nonetheless, EvD does realise that post-signing adjustments are invariably part of doing business in transition economies. Therefore, the departmental shift to emphasise higher-level evaluations at the country, sector, programme or cluster level reflects a broader view of actions taken and larger results achieved rather than individual project failures to meet original benchmarks due in large part to external factors.

#### ***Changes in regulatory regime and political environment affect outcomes***

Similarly, a common external factor-related theme was the susceptibility of project success to unexpected political and regulatory changes. While it appears obvious that changes in laws, regulations and governments will affect EBRD operations and should be considered 'a part of doing business', changes in the political and regulatory environment and having the capability to respond to those changes accounted for a considerable number of lessons, particularly from renewable energy projects, one of the EBRD's fastest growth segments. Important takeaways were that the EBRD should:

- be proactive when a government threatens to nationalise companies and update the relevant departments in the Bank
- understand when projects reliant upon government subsidies, levies or feed-in-tariffs are sustainable and develop downside scenarios should the subsidy be reduced or removed
- understand investment in highly regulated industries, e.g. utilities, carries significant regulatory risk.

#### ***Monitoring and reporting require vigilance and proactivity by the EBRD***

Vigilance and proactivity were deemed important for assuring quality monitoring and reporting. There were seven lessons – four lessons in financial

institutions, two in manufacturing and services, and one in municipal and environmental infrastructure – related to monitoring and reporting. In a variety of cases, reporting was not performed as anticipated because clients lacked interest in the reports or had insufficient capacity to prepare the reports to EBRD standards, or there was insufficient specificity in the loan agreement that documents needed to be submitted for disbursements. The impetus of the lessons was that the EBRD must:

- understand the client’s capacity and be vigilant in monitoring the client’s reporting consistently with the same staff or consultants
- ensure the client fully understands what is expected to complete the reports
- ensure clarity in the loan agreements and ensure the client has an incentive to report.

## Final observational finding

An interesting footnote to the analysis aiming to synthesise learning across evaluations was a perception by multiple evaluators that resident office staff tend to be more interested in and committed to lend support to EvD products. They are not only eager to support evaluations and provide data and insights, but also interested in the reports and findings with a strong desire to be notified about EvD progress and activities. The reasons may be since resident offices are likely to receive less ex-post analytic information, whether through formal or informal channels, EvD conclusions may be more valuable to them, or perhaps the findings discussed in EvD reports are more apparent in the field, or some combination of the two. EvD believes its contribution to learning in the resident offices is a strong validation of its mission and efforts.





# Special topics: Additionality, Equity and Local Capital Markets

EvD delivered three studies in 2017 that resounded with stakeholders and connected to ongoing dialogue about the EBRD strategy and future. These were the Additionality Concept review, Equity Operations evaluation and Local Capital Markets evaluation. Strategic discussions on the future of the Bank, graduation for advanced transition countries and high levels of liquidity in financial markets at the EBRD have brought the additionality concept into focus. EvD, rather than doing a traditional assessment of strategy, design and/or implementation, completed a review of additionality as a concept and how it is operationalised at the EBRD.

Equity operations were another major source of discussion after disappointing returns in previous years, consensus that equity facilitates transition impact and the adoption of an enhanced equity approach. EvD completed a comprehensive thematic evaluation of the EBRD's equity operations from 2005 to 2016. Finally, local capital market development is part of the LC2 strategic initiative and a key to longer-term expansion, not only for local businesses but also for the EBRD. *EBRD Support for the Development of Local Capital Markets* included an evaluation of the strategy, resourcing, cooperation with other IFIs and other elements of the Bank's work in local capital markets. This section contains a summary of each of these studies.

## **Additionality in the EBRD: review of concept and application**

### **Background**

Along with sound banking and transition impact, additionality is one of the EBRD's three foundational operating mandates. Dramatic shifts in global capital markets and in the circumstances and direction of member countries over the last ten years represent major strategic challenges to the Bank and how it can execute its demanding mandate.

Additionality is a general guiding principle adopted by all key multilateral and bilateral agencies operating in the area of private sector development. Understanding the multilateral emphasis on additionality, the changing context of the EBRD's countries of operations, and the recent intense reassessment of the transition impact concept, EvD carried out a thematic review of additionality in the EBRD in 2017 with the purpose of filling some gaps around additionality and contributing to emerging Board and Management efforts to develop a stronger and more satisfactory institutional framework.

In the EBRD and across the IFI system shareholders are demanding greater effectiveness in leveraging

more private capital flow into countries where it can improve development outcomes – that is, in being additional. A major cross-IFI effort has been launched to develop a harmonised approach to leveraging private sector resources and additionality among IFIs, with active EBRD participation. Internally, the EBRD launched a working group with the intention to develop a more standardised assessment of additionality at project level.

### **Concept**

The general principle is that IFI support for the private sector should contribute beyond what is already accessible or in some form that is otherwise absent from the market; it should not crowd out the private sector. The EBRD definition of additionality, stemming from the Agreement Establishing the Bank, is consistent with treatment in relevant inter-multilateral development bank agreements and with the approach of bilateral donors. This definition, however, is not one against which performance can be rigorously measured; assessment of additionality is always to some extent a judgement call. Later interpretations of additionality explicitly extended the concept to include non-financial aspects of the Bank's influence over the project; that is the improvements to the project's design and functioning. The difference between non-financial additionality and transition impact is conceptually sound, but in practice is not well understood or applied consistently.

### **Governance and operationalisation**

While responsibility for other mandate issues – transition and all elements of sound banking – is clearly specified, there is no specifically designated custodian or advocate for additionality in the Bank. The overall verdict on the additionality justification is effectively a tacit one, embedded in the collective Operations Committee decision to proceed with a project. There is no aggregate monitoring and reporting on additionality. Overall therefore, and

despite keen Board interest in the issue, additionality has not been subject to the same degree of Management accountability as either transition impact or sound banking.

Additionality in the EBRD is operationalised at project level. The justification of additionality for each project is often seen as less rigorous compared with other dimensions of the project document and not providing a good sense of the value of the additionality contribution. No specific requirements exist on the contribution of additionality for individual projects.

### **Drivers and constraints**

Financial additionality exists when finance is not offered by the private sector or not on reasonable terms. Some element is almost always claimed; cases where no financial additionality is asserted at project level are rare. With most loans, financial additionality rests on the provision of longer tenor than is available in the market, thereby making the judgment that the market could only provide finance on unreasonable terms. Claims of financial additionality are weakened when clients have strong market and financial standing and an evident ability to access finance, especially where no evidence is provided of above market pricing. Similarly, early pre-payments can indicate low financial additionality, as can cancellations of significant shares of originally approved/signed projects. Finally, where liquidity is high, projects with local financial intermediaries struggle to demonstrate additionality at the level of the client.

Commercial mobilisation, the attraction of private capital to the Bank's transactions, is an important component of financial additionality. The ability of the Bank to encourage other capital to support its transactions stems from its special attributes – the preferred creditor status and ability to mitigate political risk, or the knowledge of local markets and context, which provide comfort to potential investors and lower their perception of risk.

Non-financial additionality on the other hand is present mainly in Bank conditions that exceed what would normally be asked by alternative financiers. The fact that the client is willing to commit to Bank conditions that in principle come at a cost is evidence of additionality. Most commonly these are environmental and social standards, and aspects of corporate governance and business practices; for

public sector clients they also include sector reform and institution building.

It is important for conditions to show that they are truly additional, i.e. that these aspects of the project would not materialise if it was not for the presence of the EBRD in the transaction. A common example is application of environmental and social standards by a client already subject to European Union harmonised regulations. Ultimately, the credibility of conditions as a source of non-financial additionality rests on the Bank's ability and willingness to enforce their implementation, which relies in part on the Bank retaining financial additionality. There are examples of conditions being abandoned by early prepayment or where the Bank is a minority shareholder. For this reason, financial and non-financial additionality can be inter-dependent.

## **Equity operations**

### **Background**

Since its founding in 1991, the EBRD has employed equity investments as a way to catalyse co-investments and realise improvements in firm-level performance – both of which are approaches that the Bank uses to achieve its goal of transition impact. In 2017, EvD reviewed the Bank's equity portfolio approach, analysing the impact of the initiatives to improve equity performance and developments between 2005 and 2016.

In 2013, an EBRD report argued for the greater use of equity instruments to pursue the Bank's institutional objectives. Despite the many arguments in favour of pursuing this approach, the EBRD's returns on its equity investments have been low, and the Bank's current equity portfolio raises several concerns. For example, direct equity investments made between 2005 and 2014 returned 0 per cent; while the internal rate of return for vintages for 2014-2016 has seen losses.

In order to strengthen the Bank's equity performance, Management introduced the Enhanced Equity Approach, which was intended to elevate the strategic profile of equity within the EBRD and to improve the performance of the equity portfolio.

### **Equity approach and portfolio**

The EBRD's equity investments are limited to minority interests only, due to concerns about conflicts of interest in managing related policy and

debt interests. Beyond this, there are few policy constraints on the use of equity.

The Enhanced Equity Approach for direct equity, issued in 2016, brought a more focused and consolidated approach to equity. For example, it made important changes to the EBRD organisational structure to improve project design and portfolio management and establish a culture of value creation. But while this new approach touches on many of the key issues with equity performance, it does not provide the level of clarity needed given the scope and scale of the challenges, or provide a basis for improving performance in the future.

At the time of the evaluation review, the portfolio consisting of 210 direct equity investments and 122 private equity fund investments was primarily focused on the financial institutions sector, with limited exposure to infrastructure. But significantly, the direct equity portfolio was unbalanced, with a large number of small investments coupled with a small set of very large exposures; 34 per cent of the portfolio by value was allocated to projects exceeding €100 million in size.

In many respects, the EBRD's equity portfolio has performed below expectations:

- the equity portfolio generated unrealised losses of €675 million in 2014, €748 million in 2015, and €468 million in 2016
- direct equity generated a 0 per cent return on vintages from 2005 to 2014
- the internal rate of return for vintages was –2 per cent in 2014, –10 per cent in 2015, and –12 per cent in 2016.

Overall, private equity funds consistently outperformed direct equity investments by about 3 per cent per annum; this amount would increase if the EBRD management costs were taken into account.

### **Organisational arrangements for equity operations**

Due to the deteriorating financial performance of the EBRD's equity operations since 2004, the Enhanced Equity Approach recommended changes in the way that the Bank managed its equity investments. Overall, these would increase the EBRD Equity Group's control over the portfolio.

Despite these suggestions, the division of duties and responsibilities between the Equity team and the Banking Department remains partial. For example, equity investments made under the Direct Financing Facility are still managed by the Banking Department under the supervision of the Small Business Investment Committee, rather than the Equity team that normally approves equity projects; this reduces clarity about responsibility for managing the equity portfolio and what is meant to be achieved.

More widely, the EBRD lacks sufficient staff with skills in equity and the aligned incentives needed to make the best use of its capital to support transition impact and financial performance. The EBRD's levels of equity staff are no more than 50 per cent of industry norms, and reporting arrangements to the Board are poor.

### **Recommendations**

EvD made the following suggestions for improving the EBRD's equity performance.

- **Clarify institutional and resourcing arrangements for developing and managing the equity portfolio.** For example, the Equity Group should have unambiguous authority to manage all equity investments and approve new equity investments.
- **Prepare an independent external review of the existing portfolio, staff resources and operations.** This will help with efforts to restructure the EBRD equity portfolio, by identifying redundant investments that no longer contribute to transition impact objectives.
- **Prepare an independent review of alternative institutional arrangements to manage the EBRD equity portfolio.** These alternatives might include ring-fencing equity as a separate part of the Equity Group, or fully separating equity as a subsidiary.
- **Prepare an equity strategy for review and approval by the Board.** This should include: (a) clear objectives for the portfolio; (b) details on how market opportunities will be developed and integrated into country strategy programmes; (c) details on how the portfolio will be structured; and (d) a full set of financial statements and reports on the equity portfolio, to be provided on a regular basis.

## EBRD support for the development of local capital markets

### Background

Development of local capital markets (LCMs) was a core strategic objective of the EBRD at its inception in 1991. However, it was not until LC2 was launched in 2010 that it became an important operational objective in its own right. In 2012 the Bank established a dedicated LC2 team to improve implementation of the initiative. In 2013 LC2 was designated as one of the Bank's strategic initiatives and an LC2 strategy was approved.

Under this strategy the LC2's strategic priorities include legal and regulatory improvements, developing financial market infrastructure, supporting institutional investors, promoting improved transaction efficiency and expanding the Bank's range of products. The initiative has an ambitious operational plan for effective LCM engagement.

In 2016 the Bank's independent evaluation department launched an evaluation of LC2 activities from 2012 to 2015, reviewing them against the LC2 strategy, the Bank's needs and legal assessments, and country strategies for its countries of operation.

### Evaluation findings

Overall, there appears to be a disconnect between the Bank's high but undefined ambitions for transforming LCMs and its limited capacity (resources, priorities, organisation, collaboration with other organisations) to do so. If this is not addressed, the evaluators foresee few accomplishments in LCM development beyond those already achieved (reported below in summary). The evaluation presents a case for fundamental reassessment of the Bank's LCM development strategy.

- The LC2 strategy identifies appropriate areas of focus as broad activities and products but quantitative and qualitative outcomes and intended results for the main target countries are not well defined and not sufficiently specific.
- Useful early diagnostic work was done on country LCM needs and legal issues, but this was not initially widely incorporated into country strategies; greater alignment is needed across the range of Bank country documents and the LC2 strategy.

- Standard LC2 products (derivatives law reforms, covered bond law) have been efficiently implemented in several cases, but their range in terms of EBRD banking transactions is limited and they do not always directly target country priorities. However, their availability does promote hedging and creates a platform for financial market intermediaries, including the EBRD, to offer a greater range of local currency products.
- The impact of portfolio-type investments on LCMs has been largely limited to corporate bond markets in Poland and Romania where the Bank was an anchor investor; but there is limited evidence that this has lengthened their average maturities. Bond investments in Turkey were accompanied by policy dialogue to create a new bond index.
- Investments into stock exchanges have had positive effects on corporate governance, settlement connectivity and transparency, but improvements in secondary market liquidity have been patchy.
- Many technical cooperation projects achieved their targeted outputs, but they often lacked focus on the larger strategic priorities identified in needs assessments; relatively little technical cooperation went to larger countries seen as most ripe for LCM investments.
- While the dedicated LC2 team was created to improve organisational focus and processes to implement the strategy, pre-existing sector and regional reporting lines remained unchanged. Consequently, it is unclear how strategic and operational choices are made.

### Recommendations

- **The Bank should prepare a new LC2 strategy with much greater focus on LCM development.** The strategy should clearly articulate the Bank's strategic objectives and its envisaged role and operations. It should also incorporate:
  - alignment with the new 'transition' concept
  - inclusion of a results framework based on clear performance benchmarks for key target countries
  - clear definitions of LCM objectives, effects and instruments

- a template for treatment of LCMs in new country strategies.
  - **The Bank also requires a full resource and organisation plan to execute the new strategy**, including an organisational structure for decision-making, staff resources in headquarters and resident offices, and specifying the funding needed (and its sources) to support technical cooperation and policy dialogue, including rapid response interventions.
- 
- **New country strategies should identify whether LCMs will be a priority** for operational work and, if so, should specifically include treatment of LCM development needs and gaps.



# Outlook for 2018: expectations, changes and advances

EvD expects 2018 to be a year of substantial delivery on its core mandate as it acts as both the cornerstone and main driver of an effective and efficient evaluation system in the Bank. This section summarises a few selected areas of particular interest to the Board and Management.

The Department's 2017 Work Programme continued a significant shift in the composition of EvD's products and services. The intent was to prioritise evaluation work that provides both Board and Management with high-value analysis, findings, insights and recommendations on matters of direct strategic interest and relevance. Project evaluations are now done selectively, providing both accountability and learning as before, but also reflecting strategic judgement, thematic prioritisation and downstream utility. Both Board and Management have noted on multiple occasions that EvD should seek to provide high-value findings on strategic issues upstream of decision points wherever possible. The 2018 work programme will seek to advance this shift in composition further.

## Major studies for delivery in 2018

**Transport Sector Strategy Review:** An evaluation of operations under the current sector strategy to provide recommendations for Board and Management upstream of the revised sector strategy planned for 2018.

**Energy Sector Strategy Review:** An evaluation of operations under the current sector strategy to provide recommendations for the 2018 revised sector strategy, as above.

**Credit Lines:** An evaluation of approaches and operations using financial intermediation with partner banks, which is among the EBRD's most frequently utilised investments and a key delivery mechanism for Bank strategic objectives.

**Investment Climate Support Activities:** An evaluation of efforts to improve the investment climate via programmes such as the Legal Transition Team, Investment Climate and Governance Initiative.

**Infrastructure Project Preparation Facility:** An evaluation of the EBRD's facility to scale up private finance for infrastructure projects based on value-for-money principles.

**National Bank of Egypt Operations:** An operation evaluation of the Small- and Medium-sized Enterprise (SME) Loan, Women-in-Business Loan, and

Energy Efficiency Loan programmes with the state-owned National Bank of Egypt.

**Delegated Authority:** The EBRD has markedly increased its use of delegated authority for approval of projects in recent years. At the Board's request, EvD will look at the effects and implications of delegated authority, including experience with organisational reporting and project performance.

**Property and Tourism Strategy Review:** EvD assessed the design, structuring and available implementation data as they relate to the objectives of the current property and tourism sector strategy in preparation for the development of a new strategy.

**Hydropower in Georgia:** A long-term summative evaluation of the EBRD's efforts in the hydropower industry in Georgia looking at market, regulatory, design and financial influences.

**Poland Thematic Cluster Review:** An analysis of a portfolio of projects undertaken in Poland to derive findings related to additionality and areas of focus for transition impact.

## Studies commencing in 2018 with expected delivery in 2019

**Multi-country Strategy Reviews:** A review of selected themes across three to four country strategies scheduled for renewal in 2019. Themes are still to be determined, but the intent is relevance for the upcoming strategies and value for future country strategy design and implementation.

**Policy Dialogue Support in SEMED countries:** An evaluation of approaches and operations using financial intermediation with partner banks, which is among the EBRD's most frequently utilised investments and a key delivery mechanism for Bank strategic objectives.

**Sustainable Energy/Resources Initiative:** An evaluation of this important and wide ranging strategic initiative to reduce energy waste and greenhouse gas emissions as a precursor to a near-future evaluation on Green Economy Transition, the EBRD's fastest growing area of business.



**Women in Business:** An evaluation of a programme lending to female-owned SMEs supported by the Financial Institutions, Gender and Advice to Small Businesses teams.

**Legal Transition Programme:** EvD will evaluate selected elements of this flagship programme to support operations and policy dialogue in many areas.

**Evaluation of Stock Exchange Investments:** An operation evaluation of the EBRD investments in stock exchanges and bourses.

**Review of Mongolia Operations:** A cluster evaluation of projects in the mining sector in Mongolia and perhaps other sectors to be determined providing specific insights into achievements in Mongolia and more general preparation for country strategy work.

## Evaluation evolution and enhancement

The year 2018 will be important. As EvD adapts to changes in the organisation, it will need to retool how it selects projects for evaluation. The mainstreaming of the new Project Christopher Transition Impact System along with the new Transition Objectives Monitoring System (TOMS) will compel EvD to examine how it evaluates transition impact. Furthermore, country strategies have been crystallised as the focal point for measuring transition results and EvD will be analysing issues and themes across multiple countries to provide inputs into the development of the EBRD's new country strategies, and to establish effective methodologies and techniques for country strategy evaluation.

As with changes surrounding transition impact, the introduction of a single results matrix at project inception may provoke similar changes for assessing project results. Currently, EvD creates ex-post results frameworks based on project approval documentation. The introduction of a Management-supplied results matrix with relevant indicators is a welcome initiative but will undoubtedly necessitate changes in evaluation approaches.

Another influence on the structure of EvD's evaluation approach is the reorganisation of Portfolio Management. Portfolio Management is the key counterpart for the self-evaluation and validation

process. The separation of debt and equity combined with the decoupling of several industry groupings will require EvD to be sufficiently flexible to adapt to differences among Portfolio Management Units, yet sufficiently consistent and rigorous to ensure comparability and process efficiency across the organisation.

Finally, an external evaluation of EvD is scheduled for 2018, the results of which will inform further potential changes and enhancements to evaluation at the EBRD. The year 2018 represents an important launch point for reflection and adaptation on the evaluation approach, which will continue into 2019 and beyond as the IT systems upgrade and Project Monarch begins to come online. Ultimately, these changes may be manifest in the conduct of the evaluations themselves, the organisation and composition of the work programme, and the content of the Annual Evaluation Review.

## External evaluation

Under the leadership of the Audit Committee of the EBRD Board of Directors, the Bank's evaluation system in general – and EvD specifically – will be subject to an independent external evaluation in 2018. An independent consultant will be hired to conduct the evaluation and report directly to the Audit Committee. The evaluation is expected to include the scope and quality of evaluations, the self-evaluation system, uptake of recommendations from evaluations, EvD's performance, Management's participation in the evaluation process and relationships between EvD and the Bank's Management and Board.

## Improving methodologies and techniques through international engagement

EvD will continue to explore best practices in private sector and international development evaluation in 2018. The Chief Evaluator and Deputy Chief Evaluator plan to attend the 2018 Evaluation Cooperation Group meetings and EvD will be represented at the annual OECD Evalnet and European Evaluation Society meetings. EvD anticipates delivering a presentation on the additionality study and participating in a multi-IFI gender panel at the European Investment Bank headquarters in Luxembourg. It will also participate in the Wilton Park

programme, Revisiting Independence, Objectivity and the Critically Reflective Role of Evaluation for the Sustainable Development Goal Era, organised by the United Nations Development Programme. Papers

and presentations are anticipated for delivery in 2018 at the European Evaluation Society conference in Thessaloniki and the Aid and Trade conference in London.



# Annex: Management comments<sup>7</sup>

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<sup>7</sup> As submitted to EvD on 3 April 2018.

- Management thanks the Evaluation Department for its 2017 Annual Evaluation Report (AER), appreciating the continued delivery in the new format and the move toward more thematic and strategic evaluations, which provide insights beyond individual projects.
- Management appreciates the EvD products delivered in 2017 and looks forward to the planned delivery of major studies in 2018. Management also appreciates EvD's acknowledgement that the transition on results framework is an ongoing process, with the recently introduced single results matrix presenting another step towards its planned completion. Finally, Management values the important role of EvD in the Bank's efforts on creating Communities of Practice acting as a repository of institutional knowledge as well as the working group on TOMS.
- Management remains committed to addressing recommendations raised by EvD. Having provided detailed responses and extensive comments to the Special Studies that were subsequently discussed at the Audit Committee last year, Management will not comment on the common themes related to these special studies presented in the AER. Management prepares action plans to follow up on recommendations and provide updates on the progress to the Audit Committee every six months. The last update to the Audit Committee in October 2017 on the Management follow-up showed good progress in both addressing EvD recommendations as well as wider strategic themes to which these were related at the Bank.
- Management welcomes the EvD initiative for a new approach in selecting projects for self-evaluation from a stratified random sampling to purposeful selection, with the reduced number making it a more useful tool for management to absorb lessons derived, in line with the wider efforts to achieve operational effectiveness. This has increased the relevance of the results to the stakeholders and allowed them to stay focused by extracting meaningful insights and lessons and to reflect effectively on these in upcoming strategic and thematic documents. Changes to the OPA templates and rating sub-criteria further simplified the content requirements for Bank staff with more emphasis on learnings. The separation of project evaluations with simultaneous equity and debt is consistent with related changes at Management level.
- Management notes the lessons drawn from evaluations including flexibility in agreements due to volatility post-signing, changes in regulatory regime and political environment as well as the vigilance required by purposeful monitoring and reporting. Management remains alert during project implementation and the ongoing efforts for streamlined monitoring and reporting will facilitate further improvements in the process. The enhanced approach to policy dialogue creating and deepening existing channels of communication with relevant authorities and stakeholders enables a quicker and more effective response to changes in regulatory regimes or the political environment.
- Management also notes the summary of lessons drawn from self-evaluations, validations and operation evaluations for the first time in the AER. While they are insightful and valuable, these lessons are specific and operational in nature and their beneficiaries are staff members engaged in day-to-day operational activities. As such, Management does not comment on them individually. Instead, they will be utilised practically and as relevant on case-by-case bases. Together with contextual background, Management plans to reflect them in new transactions while carefully balancing sound banking principles, transition impact objectives and additionality.





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