

# IFC Management Response to IEG-IFC

## IFC in Ukraine: 1993–2006 An Independent Country Impact Review

(September 7, 2007)

### I. Introduction

1. IFC appreciates IEG-IFC's *Ukraine Country Impact Review (FY 1993–2006)*. The report presents a valuable and independent review of IFC activities starting from FY 1993 when Ukraine was in the early stages of transition to market economy and had just become an IFC shareholder. It provides timely and useful information for the preparation of a new country partnership strategy for Ukraine this year.

2. We welcome the report's independent finding that IFC activities achieved above-average overall development impact and investment outcome in Ukraine. We also note that the report found IFC's strategy in Ukraine to be appropriate and relevant to country conditions during the FY 1993–2006 review period. This period was particularly challenging, given that the country went through a protracted economic decline in the 1990s as the transition to a market economy proved complicated and structural reforms were slow in getting traction. Recognizing the difficult investment climate and to foster private sector opportunities, IFC focused on advisory work aimed largely at supporting privatization activities, strengthening small and medium enterprises (SMEs), and improving the business and regulatory environment. Amid these conditions, IFC undertook cautious efforts to develop its investment operations, but was constrained by limited opportunities. In hindsight, this sequencing of advisory and investment operations has worked out very well, as private sector opportunities increased and IFC's investment operations grew rapidly in recent years.

3. We are pleased to note that the report found that the results of IFC's advisory operations in Ukraine have been strong on all performance indicators, including development effectiveness and overall work quality. The report also found that success drivers include project strategic relevance, timeliness, and structure/framework. Programmatic activities, in particular, have had strong outcomes overall. The majority of projects from the early 1990s fall into this category and have led to significant impact on the ground as well as a series of follow-up operations that have built on this success and expertise.

4. We appreciate that the report found that evaluated mature IFC investment operations are performing relatively well in terms of investment and development outcomes. The report's analysis of projects that have not reached operating maturity suggests that these projects are poised to have good outcomes as well. IFC's focus on advisory services ahead of investment operations appears to have paid off, given the overall positive outcomes of our investment operations.

5. We recognize that there are opportunities to enhance our development impact further in Ukraine and this report is valuable in informing our strategy going forward. In addition, we agree with the overall direction of the report's recommendations.

## II. Responses to Specific Recommendations

**6. *Recommendation 1: IFC should develop and follow a more systematic medium-term (three- to five-year horizon) country approach to identifying investment opportunities in areas of high impact, country competitive advantage, and unmet demand in order to channel IFC investments into projects with the greatest potential development impact and demonstration effect.***

### **Management Response:**

7. We agree with the need to refine IFC's approach in identifying investment opportunities in Ukraine. As our operations in Ukraine grow and mature, we find ourselves better positioned to recognize and take advantage of emerging opportunities early on and to carve out a meaningful niche for ourselves in the market. Increases in resources and staff dedicated to Ukraine have allowed us to conduct in-depth research and mapping of specific sectors to pinpoint areas of unmet demand and potential competitiveness that are likely to generate the highest development outcomes, particularly demonstration effects.

8. IFC will continue to follow a systematic medium-term strategy for its operations in Ukraine. In the past, IFC has taken a long-term approach in Ukraine to ramp up its investment operations following successful implementation of a reform agenda, which included a mass privatization program. Because the reforms took longer to execute and the number of investment opportunities acceptable to IFC remained scarce, IFC continued to focus on advisory services to address some of the issues that made Ukraine unattractive to private investments.

9. IFC's engagement continues to be guided by the four-year country assistance strategies, prepared jointly with other World Bank Group institutions. In addition, IFC undertakes annual strategy and budget discussions to allow the country teams to alter and fine-tune their plans in the context of changing country conditions and internal institutional dynamics. These country-level discussions feed into IFC's strategic directions papers, which cover three-year periods.

**10. *Recommendation 2: IFC should seek to work in sequence and/or in parallel with IBRD to address remaining privatization priorities, especially large enterprises and infrastructure, with IBRD policy work and IFC post-privatization funding, and use existing joint mechanisms, such as the Sub-National Finance Department to promote public-private partnerships and provide funding to municipal utilities projects.***

### **Management Response:**

11. We agree with this recommendation to improve collaboration with IBRD in Ukraine. In recent years, our joint work has evolved from a somewhat limited engagement to meaningful strategic cooperation in a number of areas. For example, IFC's business enabling environment and corporate governance operations are closely linked with IBRD's Development Policy Loans (DPLs) and private sector development programs. In May of this year, it was agreed that the project manager of IFC's business enabling environment project in Ukraine will dedicate 20 percent of his time to IBRD, working on a broad range of IFC/IBRD coordination matters within his focus area. Apart from this, the country representatives of both institutions maintain regular contact, keeping the teams apprised of relevant developments. The ongoing work of the Ukraine Country Partnership Strategy has to date been a strong example of attempting to tackle the country's developmental challenges through a

coherent and systematic approach that takes advantage of the respective strengths and areas of expertise of each World Bank Group institution.

12. IFC is keen to pursue joint opportunities in Ukraine through the joint World Bank/IFC Sub-National Department, including investments in public-private partnerships and support for a range of municipal services. The newly available Partial Credit Guarantees from IFC in Ukraine opened the door for exploring some of these scenarios. Once IFC develops the necessary mechanisms to provide a broader range of local currency financing, the prospects for cooperation in this area will expand even further.

13. As for private participation in infrastructure, this sector remains a priority for IFC in Ukraine. Provided that future privatizations are carried out in a transparent fashion in line with international practices and that reliable clients emerge as a result, we would be glad to extend our assistance both through investment lending and advisory services, if needed. This is an area where IFC will appreciate IBRD's policy advisory work in advance of privatization.

***14. Recommendation 3 a: IFC should focus on strategic relevance of its advisory operations and replicate the demand-driven, multigenerational, and multidimensional design of its successful larger operations, using the latter to refine benchmarks for measuring performance of ongoing projects.***

**Management Response:**

15. IFC's advisory operations in Ukraine are carried out by the Private Enterprise Partnership–Europe and Central Asia (PEP-ECA), IFC's business advisory program in the countries of the former Soviet Union. PEP-ECA has recently decided to focus its advisory work in Ukraine on the following three proven areas of expertise that address key business constraints for the private sector:

- Continuation and expansion of business enabling environment work
- Continuation of corporate governance work, with a broad focus on the banking sector and on the more sophisticated topics, such as internal audit/internal control
- Significant expansion of access to finance work, currently conducted through leasing and housing finance, with plans to branch out into sustainability finance, rural finance, and agricultural insurance (based on lessons learned through agribusiness linkage programs).

16. IFC is using its experience with the successful demand-driven, multigenerational, and multidimensional larger operations in Ukraine to develop follow-up advisory projects that build on our achievements and focus on the next logical area of intervention. All of the above areas will be targeted through multidimensional approaches that include work with private sector players, as well as policy makers. The first two areas, in particular, are areas where IFC has had a long, multigenerational engagement in Ukraine.

17. Going forward, most investment-linked advisory work will center on the programmatic platforms outlined above by combining sector-level work with company-specific advisory services. The former will ensure maximum impact that goes beyond just one client, while the latter will be enhanced through the recently introduced pricing guidelines, which help secure client commitment to implementation.

**18. Recommendation 3 b: IFC needs to proactively develop and maintain regular contact with donors in its areas of engagement to help establish information exchange mechanisms, align priorities, improve distribution of labor, and avoid inconsistencies, as well as initiate tactical interaction at the outset of its multidonor operations to minimize discrepancies in approach and maximize cohesion and alignment of tactics among donors.**

**Management Response:**

19. Each project manager for advisory projects monitors the work carried out by other donors in Ukraine in his or her area. While the volume of funding channeled through IFC's advisory services is relatively modest in comparison with overall donor-funded operations in Ukraine, IFC has a visible niche in the area of private sector development. Within this area, significant efforts are dedicated to coordinate our work with other implementing agencies.

20. Project managers also actively engage with other donor-funded projects to collaborate on various events. For example, the Ukraine Corporate Development Project worked with the USAID-funded Consortium for Enhancement of Ukrainian Management Education to deliver a week-long course on corporate governance to university professors, while the Ukraine Leasing Development Project collaborated with USAID to establish the "Certified Leasing Professional" Program.

21. It should be noted that a new donor coordination initiative has recently been organized in Ukraine by the Ministry of Economy's Directorate for Coordination of International Technical Assistance, aiming to ensure maximum collaboration with minimum overlap in key areas. A donor conference was held earlier this year and various working groups (organized by topic) have met over the course of the year. The thematic working group meetings include various donor representatives who are active in that topic as well as government ministries involved in it. IFC has participated in a number of these meetings and has the responsibility as Lead Donor for the working group on "Enterprise Support."

22. PEP-ECA, in an effort to facilitate its fund raising, but also to ensure that our activities remain consistent with the work of other implementing agencies, has assigned the role of donor relationship manager to each of its senior operations managers. The intention is to create a "one stop" PEP-ECA point person for the donor, representing all PEP-ECA business lines and coordinating proposal preparation and any other issues. PEP-ECA donor relationship managers are regularly updated on all local interactions with the donor agencies and are copied on the donor reports. Regular meetings are held with local donor representatives where they discuss not only funding for PEP-ECA projects, but also learn about other donor initiatives in Ukraine.

**23. Recommendation 3 c: IFC should expand the proven model of creating partnerships between linkages projects seeking to develop agricultural suppliers and agribusiness investments, as well as aim to undertake financial markets projects that would provide local currency financing and/or guarantees to banks extending credit to such agricultural suppliers, in order to exploit synergies between investment and programmatic advisory operations.**

**Management Response:**

24. IFC is currently working on an agrifinance study that should give more insight into possibilities of improving access to finance for the agricultural sector. Results are expected by January 2008. In addition, we are currently looking for opportunities to replicate our highly successful linkages pro-

jects in Ukraine's agribusiness sector. For example, we are implementing an Agricultural Insurance Development Project with the aim of establishing a sustainable crop insurance program in Ukraine, which improves farmers' chances to get funds for agricultural input investments. The project provides opportunities for linking financial markets with agricultural suppliers.

25. The idea of financial markets projects that would provide local currency financing and/or guarantees to banks extending credit to such agricultural suppliers is appealing due to its potential for a very strong development impact for a potentially competitive, but highly vulnerable, part of Ukraine's economy. So far, this type of work has not materialized due to (a) the small number of financial institutions that qualify for IFC investments, (b) the reluctance of the Ukrainian banks to re-engage with agricultural producers after failed attempts in the 1990s that resulted in widespread defaults, and (c) until recently, the limited menu of IFC financing options that better match the needs of the sector, such as local currency financing. Despite these challenges, we will continue to monitor the situation closely.