

DEVELOPMENT EFFECTIVENESS COMMITTEE

Chair's Summary of the Committee's Discussion on 27 June 2007

Special Evaluation Study (SES) on Private Sector Development and Operations: Harnessing Synergies with the Public Sector

1. The SES is the first of four related studies which provide a comprehensive assessment of ADB's private sector operations and its efforts to improve the business climate in DMCs.
2. The SES shows that PSOD's portfolio is profitable and its quality is satisfactory. The 92% project success rate for PSOD projects substantially exceeds the 64% success rate for public sector projects and the 80% standard that ADB uses as a benchmark defining satisfactory performance. Overall, ADB's Private Sector Development and Operations were rated "satisfactory". The rating was mainly due to a lack of synergy between the public and private sector areas.
3. ADB is uniquely placed to provide the required combination of services because its public and private sector operations are both under one roof, but the evaluation found that ADB had not yet fully developed the synergies between the public and private sector parts of ADB, which were not always working together as a team.
4. Despite strong growth in the size of PSOD's portfolio, many DMCs complain that ADB is not responding adequately to this demand. Responding to this demand however, requires changes in (i) ADB's organizational structure; (ii) the level and type of resources; and (iii) roles, products and responsibilities. This type of change will not be easy, since ADB has struggled to find ways of merging public and private sector operations for some time. It is a challenge to introduce a private sector culture into an organization like ADB that is dominated by a public sector culture.
5. In OED's view, some organizational changes are needed to fully exploit the public/private synergies. The SES only highlights this fact rather than providing any concrete solutions at this stage. OED agrees with the Management's response that organizational changes need to be taken up in the context of the review of the Long Term Strategic Framework (LTSF).
6. In sum, the two main findings of the report could be summarized as (i) the need for closer and more structured public-private synergies and (ii) the need to include close collaboration between public and private sectors in the CSP.
7. Director General, PSOD and Director, SPMS presented the Management's Response which agreed with the general findings and recommendations of the SES and raised a few concerns on the specific recommendations.
8. DG, PSOD noted that the dramatic shift in the Asia Pacific region over the last four decades, where it has changed from a capital deficient to a capital abundant region. In addition, societies have realized that the private sector is more apt at providing goods and services and that economic development needs to include private sector development. Thus private sector assistance is becoming an increasingly important role of ADB and all the MDBs. The increasing demand for private sector work from ADB's DMCs requires an internal paradigm shift towards private sector. However, current resource limitations constrain PSOD's capability to deliver in the face of an increasing portfolio. Director General, PSOD considered that a 92% success rate

is a very good result given PSOD's constraints. While the PSOD is supportive of the report and its overall thrust, the classification of the Department as "satisfactory" with a 92% rating was the subject of intense discussion with OED. The explanation provided by OED that this was as a result of circumstances outside of the PSOD's control was not considered a satisfactory explanation by PSOD.

9. While ADB's competitive advantage is to have both public and private sector areas under one roof, this was also a challenge, since many of ADB's procedures are based around public sector work. In comparing with other private sector focused organizations, it was noted that, for example, IFC has broken away from the public sector area of the World Bank, and in EBRD, the private sector prevails over any public sector interventions. Thus, in choosing a strategy which includes Public-Private Partnerships (PPP) as ADB's core product, PSOD has adopted a more difficult but also more comprehensive strategy.

10. There is currently no reward structure in place to stimulate public sector cooperation with the private sector area of ADB, since incentives are still focused on lending volume. While there are successful examples of close collaboration between PSOD and Regional Departments, such as in energy related projects, these occur thanks to positive working relationships between staff rather than as a result of any existing structure promoting cooperation. PSOD strongly advocated a reward structure that would facilitate closer cooperation.

11. DEC commented on the following key points, to which OED and the Management responded.

12. **Private Sector Development.** DEC agreed that indigenous private sector development (PSD) is essential, and the focus of private sector operations (PSO) should not be limited to encouraging foreign direct investment (FDI). PSOD agreed with this perspective, while at the same time noted that ADB should continue to be involved in promoting FDI in DMCs, as it can provide a catalyst for investment.

13. Similarly, ADB should not only focus on privatization but should also support governance issues in the corporitization process of state-owned enterprises (SOE). PSOD fully agrees adding that the ADB can play an invaluable role in such privatizations by leveraging off the risk management theme that underscored all PSOD operations. With respect to both SOEs and private sector companies, PSOD reminded DEC that it only works with sound companies in order to avoid undue financial risks.

14. DEC indicated that since the majority of DMCs agree with the importance of PSD, CPS and CAPEs should devote a section to PSD, providing a framework for the public and private sectors to work together effectively. Staff agreed to include PSD and PPPs in future reports.

15. A DEC member raised the issue of monitoring income generation resulting from PSOD activities. PSOD noted that results of PSOD operations must be profitable in order to attract others into transactions.

16. **Resource Issues.** DEC agreed that PSOD is both under-resourced and over-stretched. To support PSOD's requests for additional resources, it would be useful to illustrate the large volume of project requests. For example, it would be useful for DEC to see figures on PSOD's activities broken down by country and by sector, and to know which projects are rejected and why. PSOD agreed to provide the figures upon DEC's request. PSOD clarified that only one in every eight transactions is selected by PSOD, and that projects are rejected for reasons such as the project is not financially viable, it has limited development impact, or it is in a sector that PSOD has chosen not to work in. While not disagreeing, DG PSOD stated that he hesitated to

create more internal reports (unless so requested), favoring instead the evidence provided by the very rapid growth of private sector operations.

17. **Overall Institutional Framework.** DEC agreed that any changes regarding private sector operations should be addressed during the review of the LTSF. However, one DEC member expressed disappointment that Management would like to consider any organizational changes during the LTSF review. Director, SPPI reiterated that the LTSF was the appropriate framework to consider the organizational issues raised in OED's report.

18. A DEC member expressed concern over the satisfactory rating, and considered that improvements were required, particularly with regard to development impact of PSOD's interventions and PPP interventions. He agreed with the need for a culture change within ADB at the institutional and operational levels, but this change needs to be driven by Management. He recommended that Management responds to the DEC on this issue.

19. A DEC member noted that, while this SES is the first of four reports and its conclusions may only be preliminary, he would have like to read about how other organizations are doing private sector work, what models are used by others, and if others were achieving better outcomes, and if so, why. He agreed with the proposal for structural changes and revised operational plans, but indicated that these were not enough, and changes in culture, incentives and managing for results with maximum impact were required. He noted that resources and accountabilities need to be addressed first in order to deliver on development outcomes. He emphasized that Management could have been more proactive in its response to the report by providing some indication of a future direction or vision.

20. PSOD indicated that ADB has a model that works well, and other organizations such as AfDB and IADB would like to adopt the same model. As opposed to IFC and EBRD, ADB works with financial institutions on the ground, which helps keep costs under control and at the same time contributes to developing the financial sector in the country of intervention. DG PSOD considered the strategy adopted by the other MDBs less effective. Evidence to support this included the success enjoyed by PSOD, the low level of underperforming assets and the benchmark studies of both OED and CTL showing PSOD far ahead of the other private sector arms of other IFIs.

21. OED explained to DEC how IFC and IADB are set up in terms of public and private sector departments: IFC is based on a commercial bank model using a scorecard tool and with 50% of its staff in the field, and IADB is based on a development bank model but with a newly revised organizational structure.

22. A DEC member noted that other organizations such as IFC have large and well resourced offices in client countries such as PRC and India, while ADB has only one staff in each Resident Mission (RM). He noted that clients will not wait for ADB and will approach other institutions which can meet their demand. If ADB agrees that it wants to service the demand for private sector interventions, then resources need to be allocated to the RMs. The member also noted that PSOD is not a member of the steering committee on the review of the LTSF and found this inadequate if the synergy between public and private sector areas of ADB is to be improved.

23. **PSOD Portfolio.** A DEC member indicated that given the demand for private sector work, the one roof model ought to be attractive, and noted that the current PSOD portfolio showed innovative elements with some good results. In his view, ADB is more successful in delivering and completing projects than in terms of development impact.

24. Another DEC member raised the issue of the relationship between PSOD and the Office of Cofinancing Operations (OCO). DG, PSOD indicated that given their current structures, OCO was better positioned to focus on public sector work and PSOD should use its own syndicating capabilities.

25. The issues on the acceptable level of risk with regard to the non-sovereign portion of PSOD's portfolio, the harmonization of safeguards with IFC, and counterpart risks and conflicts of interest were also raised. A DEC member suggested that a balance scorecard for PSOD could be a useful tool for measuring achievements in the future.

26. Another DEC member indicated that the limitations with regard to risk may need to be reviewed to allow PSOD to enter into more projects. He also suggested that PSOD diversify into other areas such as SMEs, agriculture and clean energy, and that PSOD consider regional cooperation projects in future. DG, PSOD indicated that PSOD is already indirectly active in these areas through its funds activities and is considering some of these other areas.

27. Finally, DEC Chair indicated that DEC generally endorsed the key findings and recommendations of the SES. DEC would look forward to the completion of the other three related evaluations by OED, in order for DEC to have a comprehensive assessment of ADB's private sector operations.