MANAGEMENT RESPONSE TO THE SPECIAL EVALUATION STUDY ON PRIVATE EQUITY FUND OPERATIONS

On 15 August 2008, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of the Management:

I. General Comments

1. We welcome the Special Evaluation Study (SES) on Private Equity Fund (PEF) Operations. The SES provides a good overview of the PEF operations and contains a number of useful ideas for ADB's consideration.

2. While we agree that the return on the PEF investments has been lower than anticipated, the following two aspects need to be kept in view:

(i) ADB is not a profit maximizer—and should not be—given its emphasis on development. The Report itself acknowledges that development outcomes have been satisfactory. Hence any net positive return on capital should be seen as "satisfactory" also since this is adequate for ADB to continue its business. Otherwise, ADB stakeholders could get a wrong impression that our main goal is profit maximization.

(ii) The SES covers a period of 20 years, which is too long to draw meaningful conclusions. The objectives, sector focus, and methodology of funds selection had changed significantly from the end 1980s (when the first funds were invested in) to the years 2002-2005 when the bulk of the new investments in funds were made. Further, the investment climate in Asia has also fluctuated with a major currency crisis occurring in 1997, which was extremely disruptive to returns on funds.

3. We agree that PSOD's operations in general (and funds operations in particular) have been constrained by lack of staff resources. However, given the overall staff constraints facing ADB, this issue can only be tackled in a gradual manner, and in the context of ADB-wide priorities.

4. Many of the useful suggestions for improvements in processes are based on systems employed in larger organizations with bigger loan portfolios. For such processes to be implemented in PSOD, more staff resources would be required. Given staff constraints and the very healthy book that PSOD has (its infected loan portfolio is less than 1% of its portfolio), this will need to be further examined.

II. Specific Comments on the Recommendations

5. We in general agree with SES's recommendations. Indeed, many of the recommendations of the SES are being implemented.

6. **Strengthening Country Program.** We agree with this recommendation. We note that PSOD has participated in the Country Partnership Strategy process for all large DMCs and several small ones that have been identified as having potential for PSOD

operations. As compared with less than 20% five years ago, about 70% of all new PSOD financings (including PEFs) have strong links to the CPS.

7. **Preparation of an Operational Strategy for PEF.** We agree. PEF operational strategy is being aligned with PSOD's and ADB's overall operations. For example, in 2008, all PEF operations targeted clean energy and energy efficiency projects, and housing finance/mortgage, which are of thematic priority to ADB. PEFs are not being considered in countries where PSOD has a large direct involvement, except to finance thematic priority sectors.

8. **Upgrading PSOD's portfolio planning, management, and reporting.** We believe PSOD's portfolio planning, management, and reporting are adequate for its organization size and portfolio. More detailed and sophisticated forms of planning, monitoring, and reporting are perhaps better suited when our portfolio size increases, and will be considered when appropriate.

9. **Strengthening the risk-management systems for PEFs and clarifying organizational roles and responsibilities.** We agree in part. These can be considered subject to resource constraints. We note that roles and responsibilities of PSOD are clear and improvement in risk-management systems for PEFs is an on-going process.

10. **Allocating sufficient resources in the areas of budgeting and staff.** This has already been covered in para. 3 of this memo.