



SPECIAL STUDY

EBRD's Nominee Director Programme



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Abbreviations

CGAP	Client “Corporate Governance Action Plan” prepared by the EBRD Legal Transition Team
DFI	Development Finance Institution
EPG	Economics Policy and Governance group
EPMU	Equity Portfolio Monitoring Unit
EL	Equity Lead
FI	Financial Institutions group
ICA	Industry Commerce & Agribusiness
IPO	Initial Public Offering
LTT	Legal Transition Team
ND	EBRD Nominee Non-executive Director
OCCO	Office of the Chief Compliance Officer
OL	Operation Leader
PE	Private Equity
SA	Subscription Agreement
SHA	Shareholders’ Agreement
TI	Transition Impact
TIMS/TOMS	Transition Impact Monitoring System / Transition Objective Monitoring System
VCP	Value Creation Plan agreed between the EBRD operations team and the client
VCL	Value Creation Leader

Definitions

Corporate Governance Action Plan (CGAP)	The Corporate Governance Screening Tool is used as part of due diligence on investee companies and for those with flagged corporate governance issues, a questionnaire is sent to the client for completion. LTT analyses the responses according to a corporate governance matrix, and prepares a Corporate Governance Memo and Action Plan. The CGAP is shared with, discussed and agreed by the project team and then covenanted as part of the investment agreement. EPG is responsible for monitoring the CGAP items as part of transition monitoring. The OL and OAD are responsible for checking the company completes actions in the CGAP on time.
Value Creation Plan (VCP)	The Value Creation Plan is an action plan initially coming from the investee company. It is agreed with the Bank at FRM stage. It is updated by the Company’s board with input from EBRD’s Nominee Director. A value creation plan reflects EBRD’s and the company’s latest thinking on value creation opportunities in the investee company with clear, measurable and objective milestones. It is not a covenant but critical items can be covenanted. Its areas of focus include: 100 days planning, operational excellence, top line growth, strategy and exit planning.

Executive summary

The EBRD has used Nominee directors (NDs) since its inception: as a key element of its direct equity investments, as an instrument of transition impact, and to represent EBRD's interests as a minority shareholder. The ongoing importance of the equity investment tool for transition is set out in the Strategic Capital Framework 2021-2025. Equity investments are likely to increase in importance in the post—pandemic period. Today 49 percent of the number of the Bank's equity investments have an ND seat. NDs, as non-executive directors, perform an advisory and oversight function on investee boards with duties to both the company and its shareholders. Unlike independent directors selected by the investee boards for their independence from management and shareholders, EBRD nomination of an ND is a right often negotiated by EBRD as a minority shareholder, allowing selection of nominees with interests broadly aligned to the EBRD, whilst expecting them to fulfil the director duty of acting in the company's best interests.

This study is EvD's first review of the Nominee Director programme for direct equity investments. EvD reviewed the programme based on questions and criteria discussed and agreed in advance with Management, covering purpose, structure and evolution, administrative and operational issues, including objective setting, knowledge management and recruitment. Using available evidence, EvD assessed some of the results from use of NDs.

The study used an extensive EBRD document and wider literature review, and prepared 14 case studies representing multiple sectors and company types. EvD interviewed operation leaders and NDs in each of the case studies, along with a wide range of staff across the Bank, including from Economics Policy and Governance Group (EPG), Legal Transition Team (LTT), Office of the Chief Compliance Officer (OCCO) and Equity Portfolio Monitoring Unit (EPMU). EvD also surveyed current NDs and EBRD operations staff managing direct equity investments with ND roles.

The main findings and observations are below, followed by a summary of specific recommendations for Board and Management to consider.

Main Findings

Purpose structure and evolution of use of nominee directors

- ✓ The right to a non-executive board seat is a frequently negotiated part of the EBRD's agreement to commit to a minority shareholding in an investee company.
- ✓ The purpose of NDs has evolved from an initial emphasis on monitoring financial risks to, since 2013, alignment with and supporting implementation of client Value Creation Plans (VCPs), which set out objectives for transition and financial success.

- Whilst equity investments remain a strategic priority for the EBRD, there is no clear articulation of strategy, policy or approach as to EBRD’s goals for use of NDs or their role in achieving direct equity objectives. The 2016/17 Enhanced Equity Approach made very limited mention of EBRD’s NDs.
- Guidance for NDs is found in on the Equity Group page, on OCCO’s Nominee Director page, in the Operation Manual 17.4, and in a general guidance note on application of equity policies, but without an overall policy statement.
- ✓ The EBRD considers use of an ND to set standards in an investee company as evidence of non-financial additionality (as per to 2018 additionality guidelines).
- The new transition methodology only references NDs in relation to the ‘Well-Governed’ objective, with their inclusion in Corporate Governance Action Plans (CGAPs) increasing the transition score. Transition reporting is silent on ND contribution to other qualities (competitive, resilient, green or inclusive).
- The Bank does not treat its ND engagement and accumulated experience as a distinctive corporate asset or source of value. It does not actively mine these experiences for unique insights and use them to help bankers with new deals.
- ✓ Past-experience is an important element used in the training course for prospective NDs, with scope for expansion.
- The Legal Transition Team’s Corporate Governance Sector Assessments, often the basis for an expected ND contribution, generally receive limited attention in Country Strategies and Delivery Reviews.
- ✓ The ND practices of other DFIs vary; IFC’s use is similar to EBRD, with NDs overseeing investee development plans, sharing information, and providing direct representation in ‘closely held’ companies.

Administrative and Operational Matters

- ✓ **The operational framework** for NDs is detailed, covering key aspects related to appointment, responsibilities and use of NDs, and is regularly updated by OCCO and the Equity team.
- **Recruitment:** There is a heavy bias at EBRD towards internally selected ND candidates: 58% of current NDs (as at December 2020) are current members of staff, whilst the equivalent at IFC is approximately 33% (IFC estimate). Female appointees hold 38% of ND roles at EBRD, compared with 47% at IFC.
- The candidate selection process is not elaborated in procedures and guidance, leading to a more narrow pool of candidates and little clarity on goals for recruiting wider talent (for diversity, specific market expertise etc).
- FI and Equity Group staff manage the EBRD candidate databases however almost half of survey respondents found inaccessible, not useful or out of date.
- Whilst some efforts have been made over the last 3 years to reach out to board networks, (eg one for women in the UK and to host an event at the EBRD), these efforts have been minimal, ad-hoc, and lacking an overall strategy. The Equity team should consider creating or building lasting connections with other board

network organisations across its COOs, and to develop new ones where there are gaps, including networks for female NDs, actively promoting new roles to attract diverse talent.

- There are no financial incentives for internal NDs to take an ND role or perform, or formal recognition internally, in terms of time and effort spent alongside the EBRD role. Most take positions to develop their careers or out of personal interest. According to OCCO, there is no intention to add financial incentives due to further conflict of interest concerns. These present limitations to expectations on internal NDs to perform.
- External ND fees are rarely supplemented to meet market rates, making it difficult to attract the best talent
- **Briefing and objective setting** for NDs is the responsibility of the individual operation leaders appointing NDs; EvD found these practices to be inconsistent. There was no documentary evidence that operation teams routinely share a consistent package of briefing materials as standard practice with specific key priorities for the ND, although objectives are discussed during on-boarding.
- ND records held in the Livelink information system are incomplete. While documents covering ND recruitment appointment and some board notes may be found, there is a lack of record-keeping on ND objective setting, monitoring, reporting, assessment and learning needs.
- **Learning:** OLs and NDs participating in annual workshops consistently expressed a wish for more learning from past-experience.
- **Expenditure:** Spending on the ND programme has gone down slightly over the last four years with a drop in 2020 due to reduced travel during the pandemic. Increased investment in the ND programme could strengthen transition and value creation outcomes for direct equity investments, a stated priority in the Strategic Capital Framework 2021-2025.

Effectiveness and Emerging Results

- The EBRD does not specifically track, aggregate or report on results from the use of NDs. This study presents some results pieced together by EvD from interviews and project files including board notes.
- ✓ In case studies where VCPs, CGAPs and transition objectives were well defined and implemented, projects tended to show successful implementation, with a high IRR. NDs were able to contribute significantly to success throughout their tenure.
- ✓ Fifty percent of NDs surveyed had been a member of the audit, HR, remuneration, strategy or other committees, and 14/55 were committee chairs, indicating many are taking a proactive role on investee boards.
- In three of the four case studies with NDs showing underperformance, CGAPs and VCPs were missing or not included in the Shareholder/Subscription Agreement (see section 4.2). This may merit further investigation about the

correlation between performance and use of CGAPs and VCPs across the direct equity portfolio.

- Case studies of projects with NDs varied widely by specific project features, impacting heavily on the extent of the EBRD ND's influence. This shows potential for learning from experience.
- **Equity Client Board Effectiveness Initiative:** In 2017 the Equity team commissioned Compass, an independent consultancy firm, to look into client board effectiveness. The final report showed a correlation between effective board governance practices and investee company financial performance.

Recommendations

From the findings above, EvD makes the following recommendations. Implementing these recommendations are likely to require additional budget and resources, which would need to be defined more specifically by the Equity Group in developing its chosen courses of action.

1. Develop an Equity Policy, Strategy or Approach covering key priorities for use of EBRD NDs across the Bank' wide range of direct equity investments. Present a 3-5 year vision for the programme, making clear how NDs will be selected, used, and input tracked, reported on and assessed to ensure the programme has a basis on which to develop. Link the strategy/approach to updated operational guidance, duties, principles, rules and procedures. Provide details on how to ensure a diverse and high-capability pool of candidates, through use of board networks, and development of supporting knowledge management platforms and information systems.
2. Update and standardise objective setting, monitoring, reporting and assessing ND inputs and defining incentives. Provide and keep record of briefing packs for NDs upon appointment, and track ND contributions to EBRD objectives. Require OLs to regularly report on ND contributions to VCPs and CGAPs through strengthened annual ND assessments, final assessment and de-brief on conclusion of the assignments. Use this as input for the wider project self-assessment.
3. Mine the ND experience as a valuable and distinctive corporate asset for insights to inform new projects, and to expand on existing orientation material for new NDs. A new Strategy/Approach should pay particular attention to these issues. Develop specific training modules for OLs managing NDs based on experiences sourced through activities such as a formal "After Service" interview/de-brief/survey and shared through systematic use of case studies in equity workshops.
4. Recruitment/retention of NDs, particularly from outside the EBRD orbit, merits a more systematic and ambitious approach. This could tap into and establish board networks across the COOs, along the lines of IFC's approach. Consider a formal mentoring programme for suitable internal mid-level staff. Review current incentive levels for both internal and external NDs.

1. Introduction

The EBRD has had an ND programme in place since it started investing in direct equity in 1991. Today, 49% of all current direct equity projects have an EBRD ND role, worth an initial investment total of €1.94bn.¹ There were 100 ND roles in 94 projects as at December 2020 (including those exited in 2020).² Of the roles:³

- thirty-eight percent were held by females.
- forty-two percent were held by external nominees.
- forty-eight percent of externally recruited NDs were ex-staff.
- seven projects had more than one ND seat (one had three seats, six had two seats).
- Of the 92 projects with EBRD ND roles, 33% were FI projects, 60% ICA projects and 7% in Sustainable Infrastructure.

Projects with NDs are located throughout the EBRD's countries of operations, with fewer in the Caucasus, Central Asia and SEMED, in line with the overall direct equity portfolio.⁴ This study looks at the relevance of the programme to the EBRD's mandate and discusses observable results. It also reviews the processes around recruitment, objective setting, management, reporting, information sharing and knowledge management.

Box 1: Methodology

EvD used the following methods to conduct the study:

- A review of Bank documents including strategies and policies, operational guidance, rules and procedures relating to NDs and external sources including a DFI guidebook, and literature on boards.
- Interviews with: staff leading ND programmes at IFC, FMO and PROPARCO for their experience, and with senior partners/managers who worked at private equity firms; EBRD internal and external NDs; and, EBRD staff involved in running the programme (equity leads, value creation leads, operation leaders, EPMU, OCCO, LTT and EPG and the consultant delivering training to NDs).
- Fourteen case studies with document review, and staff and ND interviews.
- Survey of current and recent NDs, and staff managing them with 95 responses (out of 186 recipients, or 51%).

¹ Data provided to EvD by EPMU

² Ibid.

³ Ibid.

⁴ Ibid.

2. Purpose, structure and evolution of the EBRD's use of nominee directors

2.1 Summary

- ✓ The right to a non-executive board seat is a frequently negotiated part of the EBRD's agreement to commit to a minority shareholding in an investee company.
- ✓ The purpose of NDs has evolved from an initial emphasis on monitoring financial risks to, since 2013, alignment with and supporting implementation of client Value Creation Plans (VCPs), which set out objectives for transition and financial success.
 - Whilst equity investments remain a strategic priority for the EBRD, there is no clear articulation of strategy, policy or approach as to EBRD's goals for use of NDs or their role in achieving direct equity objectives. The 2016/17 Enhanced Equity Approach made very limited mention of EBRD's NDs.
 - Guidance for NDs is found in on the Equity Group page, on OCCO's Nominee Director page, in the Operation Manual 17.4, and in a general guidance note on application of equity policies, but without an overall policy statement.
- ✓ The EBRD considers use of an ND to set standards in an investee company as evidence of non-financial additionality (as per to 2018 additionality guidelines).
 - The new transition methodology only references NDs in relation to the 'Well-Governed' objective, with their inclusion in Corporate Governance Action Plans (CGAPs) increasing the transition score. Transition reporting is silent on ND contribution to other qualities (competitive, resilient, green or inclusive).
 - The Bank does not treat its ND engagement and accumulated experience as a distinctive corporate asset or source of value. It does not actively mine these experiences for unique insights and use them to help bankers with new deals.
- ✓ Past-experience is an important element used in the training course for prospective NDs, with scope for expansion.
 - The Legal Transition Team's Corporate Governance Sector Assessments, often the basis for an expected ND contribution, generally receive limited attention in Country Strategies and Delivery Reviews.
- ✓ The ND practices of other DFIs vary; IFC's use is similar to EBRD, with NDs overseeing investee development plans, sharing information, and providing direct representation in 'closely held' companies.

2.2 Implications of the EBRD mandate for use of nominee directors

Use of EBRD NDs in direct equity investments does not receive explicit treatment in the 1990 *Agreement Establishing the Bank*. The Agreement establishes the overall purpose of fostering transition towards open market oriented economies and promoting private

and entrepreneurial initiative through methods of operating which include equity investment in private and state-owned enterprises.⁵

The Agreement also imposes limitations on equity investment that restricts the way in which NDs are used. It firmly states that the amount of any equity investment *should not be a controlling interest* and that the Bank shall not assume direct responsibility for managing any enterprise it invests in, *except* in the event of threatened or actual default, insolvency or other situations jeopardizing the Bank's investment.⁶ As part of its minority shareholding, EBRD is often able to negotiate the right to nominate one or possibly two non-executive board directors. As per company law in most common law jurisdictions, nominee directors' primary responsibility is to *act in the best interests of the company* as per directors' fiduciary duties in corporate governance best practice standards. This leaves NDs vulnerable to conflicts of interest if they try to represent the shareholder interests above the company's interests. EBRD's only influence is over the choice (selection or deselection) of the nominee, and to share EBRD objectives with the nominee with which they may or may not agree. This is the limitation in how EBRD may use the nominee director role to achieve objectives.

In practice, whilst the EBRD takes a direct interest of no more than 5% to 35% equity share, this can often be in a situation where there are few or no other minority shareholders, otherwise known as a *closed company* situation. Here the EBRD ND works with the majority shareholder and may express its interests as a shareholder with greater influence than if multiple other minority shareholders were present. This may be particularly common in founder owner companies, acquisition financing and in holding companies.

2.3 Function of nominee directors

Broad responsibilities of NDs are to deliver advisory and oversight functions as part of risk management and checks on the executive.⁷ As part of good corporate governance, they are accountable to both the company and shareholders.⁸ Areas of focus include strategy, risk oversight, financial integrity checks, ensuring legal compliance, approval of major transactions, representing all shareholders' interests, executive appointments and remuneration, establishing core values.⁹ (see Endnotes for more).ⁱ

EBRD NDs can be distinguished from independent directors in that whilst both, above all, have a primary fiduciary duty to act in the best interests of the company they serve, EBRD NDs, also, where consistent with their primary duties, usually share in the objectives of the EBRD in investing in the project as agreed with the client. The nominee seat exists due to rights obtained in the shareholder agreement due to the EBRD's minority shareholding, a *de facto* representative seat. EBRD seeks nominees who are likeminded with the EBRD and the client at the outset. Where EBRD's objectives conflict with the client's best interests, NDs, according to their fiduciary duties, will vote against the EBRD's interests, as they see fit. Mutually aligned objectives for the client to implement in the VCP and CGAP are enshrined in the subscription agreement (where

⁵ Agreement Establishing the EBRD Article 1, Purpose; Article 2, Functions; Article 11, Methods of Operation 2 a) and b)

⁶ Agreement Establishing the EBRD, Article 12, Limitations on Ordinary Operations, Para 2

⁷ Larcker D. and Tayan B., *Board of Directors Duties and Liabilities* Corporate Governance Research Initiative, Stanford Graduate Business School.

⁸ OECD (2015), *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris, <https://doi.org/10.1787/9789264236882-en>.

⁹ Larcker D. and Tayan B., *Op Cit*.

relevant) and these may also form an agreed basis for the ND's input and oversight. EBRD shares with the ND specific objectives requiring their input in advance.¹⁰ VCPs and CGAPs exist in a constantly evolving business environment and are likely to need amendment over time, to ensure interests remain aligned with the client wherever possible. The EBRD, with agreed minority shareholder rights, often has a right to a level of information sharing from the investee company which the ND is expected to provide to the EBRD operations team (subject to local laws) for monitoring of the investment. An independent director however, who is not an EBRD nominee, is not subject to the same requirements.

2.4 Evolution of use of EBRD nominee directors

Over time the purpose and role of EBRD NDs has evolved from an emphasis on monitoring financial risks to focus more on broader transition objectives. The 1991 policy framework for EBRD operations approved by the Board states the purpose of equity investments was to enable the Bank to become a catalyst, and significant enough to ensure proper oversight, without taking a majority position.¹¹

- *Monitoring* was placed fairly, squarely front and centre as the main rationale for representation on the investee company's board.
- *Provision of constructive advice* constituted a second element with goals being strengthening management and operations, attracting other investors and facilitating exit after a reasonable period, subject to market conditions, and without jeopardising the interests of other shareholders.

The guidelines caution that the EBRD should not be treated less favourably than other shareholders, and to attract investors, must try to develop a more liquid market for sale of equity through development of capital markets.¹²

Guidance for board representation in 1994 went a step further by identifying six specific issues to assess with respect to using an ND.¹³ These included the following:

- **Corporate governance improvements:** Whether there is a need to develop and strengthen corporate culture, contribute to the establishment of appropriate corporate governance and hence strengthen the transition impact of the project.
- **Facilitating investor dialogue/independent arbiter role:** Whether there is or may be a need to facilitate the dialogue between the various investors in the company.
- **Improvement of strategy:** Whether there is a need to improve the medium or long-term strategy of the company.
- **Technical advice:** Whether, in specific industries such as financial institutions, the management of the company needs to be provided with sophisticated **technical guidance.**

¹⁰ See section 3.3.3 on VCPs and 3.3.4 on CGAPs

¹¹ BDS91-7 (Final) *Operational Policies – General Introduction* p 16

¹² *Ibid.*, p 16.

¹³ CS/FO/94-9 FOPC *Guidelines for Board Representation in Companies with EBRD Equity Investment* p1-2

CS/FO/99-2 FOPC *Board or Committee members nominated by the Bank for Banking Operations* p 2

- **Information gathering/ Monitoring:** Whether a position on the board or committee of the company will provide useful information or contacts in respect of certain industries, regions or countries, and/or will have the opportunity to expand knowledge and experience in a specific area.
- **Risk mitigation:** Whether a position on the board or committee of the company will enhance the protection of the Bank's investment: this may be of particular interest where the Bank's investment in the company is of significant size or presents risks that can be mitigated through improved corporate governance

The EBRD reviewed the general purpose of NDs in 2010, at a Board Information Session in a review and update of the Rules and Procedures for Nominee Directors.¹⁴ Purpose and value of NDs would be assessed on a case by case basis, looking in particular at whether they could i) advance transition objectives, ii) improve corporate governance, iii) provide constructive advice, expertise or support or iv) facilitate better dialogue between investors. This tracks broadly with the previous stated goals, with more specific mention of *working towards the transition objectives*, but leaves out mention of monitoring and risk mitigation. In practice, priority goals would vary in individual equity investments according to the investee company's specific needs.

In 2013, EBRD introduced VCPs for equity investments, which were to be shared with NDs to ensure alignment of goals.¹⁵ These were to be mainstreamed in the Enhanced Equity Approach of 2016. The Operations Manual Chapter 17 specifies that NDs are tasked with ensuring these were implemented by the client, and that they remain appropriate.

2.5 Equity strategy and policy covering the nominee director programme

One of the features of an efficiently run ND programme is an overall strategic statement of objectives to improve the programme over the next 3-5 years. This could be accompanied by a robust and easily understood policy with operational guidelines or rules and procedures for using EBRD NDs in varying direct equity scenarios according to best practices.

On a broader level, EBRD's ongoing commitment to equity investment and its importance to transition is clear in the latest Strategic Capital Framework 2021-2025. It highlights the likely increasing importance of this tool in the post pandemic era.¹⁶

The main specific strategic document elaborating on the Bank's use of equity is set out in the 2016/17 Enhanced Equity Approach with Phase 1 focussing on development of an equity culture and Phase 2 growth of the EBRD's equity business. It emphasises the importance of quality over volume, the high correlation between transition and equity returns, and the importance of having the right resources for value creation. It seeks to improve the quality of equity investments, to ensure their additionality and contribution to transition. EBRD's role is to be 'a meaningful minority investor with a majority owner mind-set' in direct equity investments, targeting from 5-35% ownership share with a 4-7

¹⁴ SGS10-180 *Review and Update of EBRD Rules and Procedures relating to appointment of EBRD nominee directors to boards of investee companies* p6-7.

¹⁵ See section 3.3.3 below for more

¹⁶ BDS20-030 (Final) Report of the Board of Directors to the Board of Governors: Strategic and Capital Framework 2021-2025 p45

year timeframe (longer for infrastructure).¹⁷ EBRD NDs would play a key role in achieving high levels of corporate governance.¹⁸ In practice though, as set out in the 2017 revised Operations Manual, they are also to play a key role in ensuring implementation of value creation.¹⁹ As part of the approach, VCPs were to become instrumental to all direct equity investments, to be monitored by the Value Creation Unit (see Chapter 3.5.2 below).

EBRD investee company board representation is currently described in the guidance notes on applying 'equity policies', and mentioned as an equity specific issue, but there is in fact no published EBRD 'Equity Policy'.²⁰ This wording should be amended or updated as it is misleading. The Operations Manual contains basic information around steps to developing a case for an ND in a project, and obtaining approval and dealing with conflicts of interest (see Chapter 3).²¹ OCCOs Rules and Procedures (discussed in Chapter 3.2.1) currently form the centrepiece that drives the ND programme, but this means that it appears the Equity team is mostly focussed on watching for conflicts of interest rather than simultaneously implementing an elaborated policy and any specific strategy designed to maximise use of EBRD NDs for success in equity investments.

2.6 Relevance to transition and country strategies

2.6.1 Relevance to transition mandate

The transition objectives most relevant to use of NDs deserve some attention as the definitions have evolved with a significant shift to the new transition qualities in 2017. A closer look at the EBRD's transition impact qualities, past and present, reveals the relevance of ND work at the corporate level to a large number of them, albeit indirectly in a non-executive function.

ND contribution under the old transition methodology: The initial seven transition impacts established in 1999 were categorised under three themes: i) contribution to structure and extent of markets, ii) institutions and policies that support markets and market based behaviour patterns, iii) skills and innovation.²² Use of NDs at the wider end of the interpretation could better enable the Bank to further four of the seven transition impacts in specific projects: i) promote competition, ii) skills transfer, iii) demonstration effects of new behaviours and activities and iv) standards setting for corporate governance and business conduct. No direct correlation has been attempted however between using the ND in specific project and project outputs or outcomes, other than the mere fact of the existence of an EBRD ND role has been cited as an indicator to achieve standard setting for corporate governance, or as part of the CGAP. Going further than this presents the issue that the ND owes his or her first duty to the investee company's best interests at company law, not the EBRD, and thus cannot be held to account over whether they succeeded in precipitating achievement of other EBRD project objectives.

¹⁷ Ibid. p 10

¹⁸ CS/FO/17-06 *Enhanced Equity Approach*, February 2017 p 9

¹⁹ *EBRD Operations Manual*, Chapter 17 Equity, Section 6 Monitoring 17.6.2 Revision November 2017

²⁰ EBRD Intranet: *Policies and Operational Guidelines*, [Equity Notes](#)

²¹ EBRD Intranet: *Operations Manual- 17.4 Investee company board nomination and representation*

²² CS/FO/97-3 FOPC *Transition Impact of Projects* see 'Qualitative Aspects of Transition Impact of Projects: A Checklist'

Nevertheless the work of the ND in doing so where interests are fully aligned should be acknowledged in results reporting, to highlight their contribution, importance and efforts.

Updated transition methodology: Following the recommendations of the 2009-10 Besley report which reviewed the EBRD's transition concept and framework identifying a need for greater internal consistency in assessment and consideration of outcomes, in 2016 the EBRD issued a revised transition concept around 6 qualities for a well-functioning market economy: competitive, well-governed, resilient, integrated, inclusive and green.²³ According to the paper *Guidance for Operationalising the Transition Impact Qualities* discussed at the Board Information Session held in 2017, 'the updated transition impact methodology offers a simpler and streamlined way of identifying, building and assessing transition in projects. This methodology lends itself naturally to greater automation, which will lead to increased standardisation and efficiency.'

Gaps in reporting on attribution of NDs to achievement of transition objectives:

According to the new transition quality pre-assessment tool for projects, use of NDs is included as one of the objectives for well-governed, with the ND's primary purpose being to monitor implementation of the CGAP.²⁴ During initial Assessment of Transition Qualities for a project, therefore, if an ND is to be appointed alongside a CGAP, the overall expected transition score will rise. ND specific input due to their particular skill set or experience when acting as board director is not incorporated explicitly in the tool outside the parameters of well-governed corporate governance.²⁵ This is an obvious limitation, as specific advisory work by the ND can advance other transition objectives for example in the area of advising an investee company to enhance competitiveness, or to be more resilient due their financial expertise. They may also have specific relevant knowledge and experience impacting on achievement of green or inclusion objectives. None of this will be captured or attributed in the outcomes in the newly revised transition reporting system, as it was not part of the ex-ante assessment and will not be monitored in any way.

The reason put forth for this gap in attribution links back to the inability to hold a ND to specific EBRD objectives due to the fiduciary nature of their responsibilities to above all act in the best interests of the company. As mentioned, previously, where interests are aligned, this need not be an issue. Ways to track their invaluable contribution to transition at the company level could be further explored.

The revised transition qualities feed into results reporting on country strategies. This leads to a look at how strategies articulate the well-governed quality and how results reporting reflects the ND role.

2.6.2 *Well-governed transition quality and the role of corporate governance*

The Transition Report 2019-20 was dedicated to the issue of governance, with one of the areas discussed being firm level (or corporate) governance.²⁶ Improved firm level

²³ WS15-04 Transition Concept see *Discussion Note for Board Workshop November 2015 from review panel members Tim Besley, Sergei Guriev and Beata Javorcik* (p1)
SGS17-114 Add 2 Information Session *Transition Impact Methodology: Project Christopher – Guidance Paper on Operationalising the TI Qualities* p 1

²⁴ EPG *Pre-assessment of Transition Qualities tool- Excel Spreadsheet: Corporate Governance Questions and Objectives*

²⁵ EvD interview with P Krasny EPG.

²⁶ *Transition Report 2019-20* <https://www.ebrd.com/transition-report> p4

governance can lead not only to improved productivity, growth and value but also greater energy efficiency and green management. This requires managers who prioritise such investment. One of the EBRD's key tools to improve firm level governance is use of NDs who often play an instrumental role in setting up board committees or advising on improvements in areas such as strategy, risk, audit and HR, as set out in CGAPs.

The report also found that governance is stronger in multi-national companies and where competition is strong, and highlights the importance of strong governance at national level to influence corporate level owners to delegate the executive function to professional managers.²⁷ Good corporate governance enables the owners and executive function to be better aligned, where supervisory board and executive are separate. Through use of NDs, EBRD can help investee companies attract foreign investment and compete on a regional or international scale.

The EBRD Legal Transition Team periodically carries out country Corporate Governance Sector Assessments that identify key gaps and weaknesses in the EBRD's countries of operations. The assessments look at the quality of legislation and practices in five areas of corporate governance: structure and functioning of firms' boards; transparency and disclosure; internal controls; rights of shareholders; and stakeholders and institutions. The latest assessment carried out in 2016-17 made five major findings from a review of the 10 largest listed companies in each jurisdiction:

- non-financial disclosure of listed companies tended to be weak, with little information on corporate governance including boards and subcommittees;
- lack of clarity in many countries on composition and responsibilities of boards;
- little attention to board diversity;
- roles and required characteristics of independent directors were not typically well defined
- there was a need in many countries to improve internal control systems (risk management internal audit, compliance, board audit and risk committees).²⁸

The review in the assessments of the largest listed companies is a good indication of the probable state of corporate governance in unlisted companies. It also shows how, with a two-pronged approach at national and firm level through investments and advice, including through NDs, the EBRD could help transform the landscape.

These corporate governance gaps however receive only cursory treatment in country strategies during the assessment of transition qualities and setting of 5 year Policy Priority Objectives. Some objectives may cover corporate governance concerns. Some of these may be selected for annual policy milestones carried out by the LTT, and progress monitored by the Country Strategy and Results Management team. Due to the limited number of PPOs, potential for prioritising corporate governance gaps in the results architecture appears not fully utilised to the extent possible. Much work on the ground goes on without adequate recognition or thorough aggregation at country level.

²⁷ Ibid. see Chapter 3: Firm Level Governance p 60

²⁸ Ibid see Chapter 3: Firm Level Governance, p 63

2.6.3 *Relevance of corporate governance and use of nominee directors to country strategies*

Country Strategies include the well-governed transition quality as a target. For example, the most recent Country Strategy for Hungary points out the weakness in corporate governance structures:

“The corporate governance legislation and practices have room for improvement. Governance is assessed as weak in the structure and functioning of the boards, registration of shareholders, and very weak in the board composition, board effectiveness, responsibility and gender diversity at board level.”

In response to this gap the strategy merely states: “The Bank will continue to focus on developing capital markets and on opportunities to deploy equity and innovative investment products.” There is no elaboration of the link between use of equity and corporate governance weaknesses.

The Country Strategy Delivery Reviews include an indication of progress on the well-governed quality, particularly from the country strategy results frameworks on implementation of a CGAP. They do not mention the contribution of NDs.

2.6.4 *Contribution of nominee directors to indicators in transition objective monitoring system*

The new Transition Objective Monitoring System in Monarch tracks a number of pre-selected indicators, some of which partially reflect the use of NDs. The relevant indicators that can be selected for individual projects are set out below:

Well Governed Indicators Relevant to work of a nominee director	Equivalent Sector and Country Strategy Indicator
Representative appointed to the Board of the beneficiary firm as targeted	Number of beneficiary firms appointing representative to the Board as targeted
Improved Standards (CSR, GRI, IFRS, GAAP)	Number of clients with improved standards
Corporate Governance Action Plan (CGAP) approved	Number of CGAPs approved
Actions in CGAP implemented	Number of clients implementing a CGAP
Corporate Governance improved: <ul style="list-style-type: none"> – Commitment to CG – Control Environment and Processes – Rights of Minority Shareholders 	Number of clients exhibiting: <ul style="list-style-type: none"> – Commitment to CG with EBRD assistance – Control Environment and Processes with EBRD assistance – Rights of Minority Shareholders with EBRD assistance

The ND’s contribution to well-governed indicators: The indicators do not reflect the extent to which an EBRD ND contributed to CGAP implementation or general corporate governance improvements where no CGAP exists. As an ND with voting rights and ability to advise, propose and encourage, presumably the influence of the ND and role in decision making could be transformative, but this contribution is not specifically captured in the indicator ‘Actions in CGAP implemented’, although it may be inferred (see Chapter 3.5.3 for discussion of CGAPs).

The indicator 'Representative appointed to the board of the beneficiary firm' accounts for an EBRD ND (where EBRD contracts with its nominee). There is no separate indicator for where EBRD negotiates for independent director seats (where the non-executive director is not an EBRD nominee and not contracted directly by the EBRD). This is significant because the EBRD ND is a clear and direct EBRD contribution overseen by EBRD to the investee company whereas negotiation in the shareholders' agreement for addition of independents on the board does not reflect specific EBRD influence or contribution beyond a formality of initial board composition. The level of EBRD influence shows the extent to which results could be attributed to EBRD work.

2.7 Use of NDs at other DFIs

EBRD's main current counterparts on the corporate governance side who are also involved in the handling of NDs are IFC, FMO and PROPARCO. EIB has ceased its use of direct equity investments and NDs, focussing now on funds.

In 2008 the Corporate Governance Development Framework was signed by around 30 DFIs with the intention of integrating corporate governance into the investment process. Currently, benchmarking exercises on the use of NDs is handled by a working group known as the Nominee Director Policy Committee, headed by FMO. In 2015 EIB conducted a benchmarking exercise across IFIs and discovered that practices in use of NDs varied widely, so called on the working group to put together a guidebook for DFIs nominating members to the boards of investee companies.²⁹

According to the 2016 guidebook, the DFI purpose of having NDs is, in addition to other targets, i) to add value by filling gaps on the board (skills or knowledge), ii) for DFI investment monitoring and iii) for the DFI to learn more about the country industry region and to develop new business opportunities.³⁰ Alignment of expectations between DFI and investee is considered fundamental to avoid conflict and misperceptions. It reiterates the ND's fiduciary duty to the company and all its shareholders (and stakeholders), and not one particular shareholder, and the duty of confidentiality.

EvD learnt from interviews that IFC has a large programme for NDs and the duties are similar and subject to some of the same limitations to those discussed within the EBRD.³¹ IFC NDs have a first duty to act in the best interests of the company, and the shareholders, and they provide oversight for the growth or restructuring strategy. The investee company development plan is embedded from the outset, in a similar way that EBRD strives to use Value Creation Plans. In striking the right emphasis on company interests and shareholder interests, IFC recognises the concept of closely held companies with a small group of shareholders, and early stage companies where management and shareholders are the same (owner run) where a more direct representation is required to achieve mutual goals. Often investee companies with IFC agree to information sharing via the ND.

At FMO, no information flows back from the ND at all, they only have a high-level objective reported on annually. In specific cases there may be agreement to share information, but these are the exception. Corporate governance assessments at due diligence will identify gaps on the board, and they will nominate someone and define the

²⁹EvD interview with M Steindel, Leader ND Programme FMO

³⁰ [Corporate Governance Development Framework: 2016 Guidenbook for DFIs on nominating members to the boards of investee companies](#)

³¹ EvD interview with IFC Head of Nominee Director Support Center November 2020

objectives accordingly. FMO exercises great caution on not being in breach of local laws that often limit information sharing. Part of the reason for the high level of caution is that they do not have the same number of regional offices or legal support as larger DFIs.

2.8 Additionality

The appointment of an EBRD ND as part of an equity investment is often cited as a source of additionality in project approval documents. In 2018, following an EvD study, the EBRD introduced an updated approach to additionality, to ensure that the EBRD is making a contribution beyond what is available in the market without crowding out the private sector.³² The support EBRD brings should typically not be offered by commercial sources of finance, in keeping with the EBRD's Agreement Establishing the Bank Article 13. In other words, the EBRD 'should complement or supplement existing financing possibilities.' There are two types of additionality – financial and non-financial.

Non-financial additionality inputs relevant to ND input cover standard setting and capacity building: helping the client for example to improve corporate governance, environmental standards, energy efficiency audits, gender and inclusion policies procurement, and financial reporting standards. EBRD may be providing expertise or knowledge that help the client reach objectives.

Of direct equity projects board approved in the last 10 years with an EBRD board nominee role included, EvD found around 40% claim it was evidence of additionality, either as an attribute or a specific project conditionality.³³ EBRD's minority shareholding, together with the right to an ND board seat is expected to facilitate the implementation of corporate governance improvements in the investee company. In the other 60% of projects with an ND, this feature was not used to support additionality at Board approval as negotiations for a board seat were still underway and the subscription agreement not yet signed.

New EPG guidelines issued in August 2020 include a non-financial additionality source of 'Standard Setting' and client use of EBRD expertise, which may be evidenced by the right to appoint a member to a supervisory board. The guidelines do not elaborate on whether mere anticipation of a board seat at signing is adequate evidence.

The use of an EBRD nominee on the board has the potential to greatly increase the additionality, above what may be possible in an equity project without, as it puts a specific type of skill and experience that can promote transition beyond what might be expected from private sector investors at the very heart of the investee company. Whether or not this expected additionality materialises depends on the contribution of the ND, not currently assessed by the EBRD.

³² SGS18-329 EBRD's Enhanced Approach to Additionality – A quick reference guide July 2018 p1

³³ EvD search of additionality rationale in Board approval documents of projects with a nominee director approved over the last 10 years.

3. Administrative and operational matters

3.1 Summary

- ✓ **The operational framework** for NDs is detailed, covering key aspects related to appointment, responsibilities and use of NDs, and is regularly updated by OCCO and the Equity team.
- **Recruitment:** There is a heavy bias at EBRD towards internally selected ND candidates: 58% of current NDs (as at December 2020) are current members of staff, whilst the equivalent at IFC is approximately 33% (IFC estimate). Female appointees hold 38% of ND roles at EBRD, compared with 47% at IFC.
- The candidate selection process is not elaborated in procedures and guidance, leading to a more narrow pool of candidates and little clarity on goals for recruiting wider talent (for diversity, specific market expertise etc).
- FI and Equity Group staff manage the EBRD candidate databases however almost half of survey respondents found inaccessible, not useful or out of date.
- Whilst some efforts have been made over the last 3 years to reach out to board networks (eg one for women in the UK and to host an event at the EBRD), these efforts have been minimal, ad-hoc, and lacking an overall strategy. The Equity team should consider creating or building lasting connections with other board network organisations across its COOs, and to develop new ones where there are gaps, including networks for female NDs, actively promoting new roles to attract diverse talent.
- There are no financial incentives for internal NDs to take an ND role or perform, or formal recognition internally, in terms of time and effort spent alongside the EBRD role. Most take positions to develop their careers or out of personal interest. According to OCCO, there is no intention to add financial incentives due to further conflict of interest concerns. These present limitations to expectations on internal NDs to perform.
- External ND fees are rarely supplemented to meet market rates, making it difficult to attract the best talent
- **Briefing and objective setting** for NDs is the responsibility of the individual operation leaders appointing NDs; EvD found these practices to be inconsistent. There was no documentary evidence that operation teams routinely share a consistent package of briefing materials as standard practice with specific key priorities for the ND, although objectives are discussed during on-boarding.
- ND records held in the Livelink information system are incomplete. While documents covering ND recruitment appointment and some board notes may be found, there is a lack of record-keeping on ND objective setting, monitoring, reporting, assessment and learning needs.
- **Learning:** OLs and NDs participating in annual workshops consistently expressed a wish for more learning from past-experience.

- **Expenditure:** Spending on the ND programme has gone down slightly over the last 4 years with a drop in 2020 due to reduced travel during the pandemic. Increased investment in the ND programme could strengthen transition and value creation outcomes for direct equity investments, a stated priority in the Strategic Capital Framework 2021-2025.

3.2 Operational framework: guidelines, rules and procedures

3.2.1 Operations Manual 7.4

The Operations Manual Chapter 17 covers all aspects of equity investment operations from approval to exit and Subsection 17.4 specifically covers *Investee Company Board Nomination and Representation*. It contains basic information around steps to developing a case for an ND in a project, obtaining approval and dealing with conflicts of interest.³⁴ It provides links to OCCOs Rules and Procedures relating to selection and appointment of NDs, Candidate Approval forms, a checklist and an Aide Memoire for OLs on the subject. More information on Equity Specific Issues includes information on the importance of the Shareholders' Agreement to mitigate risk in addition to a board seat. It sets out the responsibility of the Country/Sector teams for deal origination and Equity Team and Equity Network lead for implementation matters, including NDs:

“The [Equity] Team shall .. be involved in establishing ongoing formal and ad hoc training programmes for the Equity product and for Board nominees, shall be responsible for establishing and maintaining a pool of potential external Board nominees for the Bank’s investments and shall further be responsible for the Bank’s budget for due diligence and external nominees”

3.2.2 Operational Guidelines

Alongside the Operations Manual, Operational Guidelines are published on the intranet to accompany EBRD policies. As stated in Chapter 2.6, no equity policy exists, but Operational Guidelines contain equity notes, including the Equity Specific Issues note discussed above and a General Guidance Note on Application of Equity Policies. This includes a segment on board representation, explaining the general ND role of acting in the best interests of the company and mitigating risks.³⁵

3.2.3 ND Rules and Procedures

The ND Rules and Procedures, prepared by a member of OGC seconded to OCCO, were put together to address compliance and legal issues related to NDs. They reflect best practices for a DFI ND programme, addressing legitimate conflict of interest and sharing of information concerns. They cover rules for ND selection, approval, ND exercise of duties, and similar procedures for members of equity funds. They do not cover an overall strategy for using EBRD NDs in equity investments and do not cover issues around results reporting. The Rules and Procedures should be supplementary to an overall statement of intent, strategy or policy about the way the EBRD intends to use NDs including in typical EBRD direct equity investment scenarios.

³⁴ EBRD Intranet: *Operations Manual- 17.4 Investee company board nomination and representation*

³⁵ <https://intranet.ebrd.com/Operations/Equity-Specific-Issues-.pdf>
General guidance note on application of equity policies

The Rules and Procedures have evolved over time since 1999, being reviewed and updated in 2010 when volume of equity investments had grown substantially, and again in 2016 and 2017. They are closely aligned with those at IFC, and reflect many of the main areas of concern covered in a 2016 guidebook for DFIs Nominating Members to Boards of Investee Companies, produced by a DFI Corporate Governance Working Group (which included DEG, FMO, IFC and PROPARCO).³⁶

The 2017 update included more specificity around the expectations of assessment of ND performance and briefing and objective setting materials, or if the ND could act as chairperson of the board.³⁷ The update was prompted by frequent questions from NDs over the years. This indeed provides some clarification, however, as discussed in the next section, EvD found no evidence of briefing and objective setting materials being systematically prepared and shared with NDs, no evidence of performance assessments, nor of external NDs serving as chairs under the amended procedures.

Although OCCO remains closely involved in the nomination of new NDs, in order to address any compliance and/or conflict of interest related issues, EPMU is taking over the role of providing final sign-off on all selected candidates for direct equity board representation and will continue to provide final sign off for funds committee membership. EPMU checks that all the requirements have been met, and that any exceptions have been duly covered according to the rules and procedures. OCCO may become closely involved when exceptions under the rules are required, for example when an operation team member is put forward for an ND role, to ensure the exception is valid. The above will be reflected in the revised ND Rules to be finalised in 2021³⁸

OCCO fields many queries from both internal and external NDs who have questions about how to interpret the rules, on conflicts of interest, integrity issues or on sharing of information. Generally, OCCO will intervene if there is a reputational issue. In Q2 2020, OCCO fielded 14 such requests, revealing the complex nature of many situations NDs are confronted with in the course of their duties. OCCO indicated that some requests could have been handled by banking staff.³⁹ Despite a steady flow of queries around application of the Rules and Procedures, they did not flag any major unaddressed compliance issues related to use of NDs.

Update to Rules and Procedures in 2019: A more recent change to the Rules and Procedures brought in prevents MDs, Equity Directors, Directors or Deputy Directors who are sector heads or regional heads or RO heads from becoming internal NDs. This decision was taken to address the issue of decision makers who are internal NDs being involved in approval of new projects related to the investee company on whose board they sit, or with that company's competitors, putting them in a position of conflict of interest and potential breach of the Bank's Code of Conduct.⁴⁰

³⁶ See *Guidebook for Development Finance Institutions on Nominating Members to the Boards of Investee Companies* 2016 Working Group for CG Development Framework.

³⁷ Intranet post [New Rules and Procedures on Nominee Directors have come into force](#) 18/4/17

³⁸ Rules and Procedures 4.2.3

³⁹ EvD interview with OCCO September 2020

⁴⁰ Equity Committee Memo *Internal NDs: Proposal to address potential conflict of interest concerns* 9/10/19 & 24/1/20 & Rules and Procedures on Conflicts of interest 4.2.1

3.3 Briefing and objective setting

3.3.1 Objectives

The Rules and Procedures for NDs Section 4.1 covers 'Briefing and objective setting', stating that upon nomination, the ND should receive briefing materials including:

[The scope of the ND's role, a description of the Bank's general objectives and areas of particular importance for engagement to address the Bank's intended transition impact and value creation goals; information on the company's structure EBRD's position as shareholder and voting rights, copies of previous ND reports if applicable; and reporting expected.]'

ND objectives, as covered in the Rules and Procedures 4.1 are:

'A description of the Bank's general objectives and areas of particular importance for ND engagement to address the Bank's intended transition impact and value creation goals'

They are specific to the client's needs and intended investment purpose and exist in addition to the usual fiduciary duties which take priority. They are found in specific project documentation and are often also provided verbally. Project specific documents include: VCPs, CGAPs, Shareholder/Subscription Agreements, FRM and Board approval documents, from conversations with the OL/EL the Chair of the client's board, and in some cases the client during due diligence. Each investee company has different requirements that play a part in defining the ND's objectives. The Internal and External Candidate Approval forms also set out expected focus areas for the ND in the specific investment. The ND uses professional judgment and experience to decide what is in the best interests of the company meaning when implementing objectives.

Some of those interviewed by EvD felt that objectives or areas of priority could change throughout the project and should not be set in stone, and flexibility was needed in the approach as business strategies were constantly changing according to the market.

The Equity team also expressed sensitivity around identifying objectives due to concern these may conflict with the ND's fiduciary duty to act in the best interests of the company. Whilst recognising this need for flexibility, a record of general objectives and priority areas for engagement should be updated when changes are made, subject to the Bank's rules around changes to operations.

Currently, briefing and objective setting for NDs is not explicitly linked to ND assessments, project and transition monitoring and reporting or to the project self-evaluation system. This is due to concerns around their fiduciary duties to the client potentially clashing with EBRD priorities. However, rather than seeing this as a direct accountability exercise, during implementation and ex-poste, ND reporting of input and contributions towards achieving EBRD objectives could be more clearly defined, tracked and included as part of the Bank's regular reporting to ensure they are acknowledged and credited for their work. This need not impinge on their fiduciary duty to act in the best interests of the company, which is a universally understood priority. See Endnotes for more. ⁱⁱ

3.3.2 *General duties and principles at the EBRD*

ND general duties are set out in a general guidance note on Equity Specific Issues, the Duties and Guiding Principles for NDs attached to the Terms of Reference (for external NDs), the Rules and Procedures for NDs, and the EBRD training (see Endnotes for detailsⁱⁱⁱ). ND duties are subject to local law, the company charter and by international good practice standards. Of NDs surveyed, 65% had already had experience as an ND and knew the duties in a general sense. Internally appointed NDs receive this guidance at the compulsory two-day training for EBRD NDs.

3.3.3 *Value Creation Plans*

A VCP reflects the EBRD's and investee company's latest thinking on value creation opportunities in the investee company with clear, measurable and objective milestones. 'The VCP is a live document which evolves through the investment project cycle as priorities and opportunities for value creation change'.⁴¹

VCPs have been around in the EBRD since 2013, with the goal of establishing clear KPIs and targets prior to final approval. The Equity Lead/Value Creation Lead is responsible for the content and quality, which typically incorporates project transition objectives, set in collaboration with the assigned economist from EPG and indicators for financial success. Wherever possible they form part of the legal agreements with the investee company along with requirements for regular client reporting of information for monitoring purposes. VCPs are supposed to be shared with the EBRD ND and investee board to ensure objectives were aligned.⁴²

According to the 2016 Enhanced Approach to Equity, VCPs were to be mainstreamed within the equity portfolio. The Operations Manual Chapter 17 clearly states:

"As part of the FRM, a value creation plan should be prepared and agreed with the company, and it is important that this is implemented and monitored, so that any corrective or additional action needed, can be undertaken."

The Operations Manual also states EBRD NDs would also be tasked with ensuring implementation:

'EBRD will usually have the right to nominate a director (see Section 17.4) who will often be an additional link between company management and the EBRD OL, **and will typically be tasked with ensuring that management does implement the agreed VCPs and KPIs and that these remain appropriate.** The Operation Leader or Equity Lead should assess annually the contribution of the Nominee Director to the company, and be in regular contact during the year as needed'

This gives NDs a key role in ensuring VCPs as carried out (for more see Endnote ^{iv}).

EvD found the following in relation to use of VCPs and NDs:

- From the survey, 13 out of 52 NDs (25%) had seen the Value Creation Plan, which is supposed to be agreed with the client and included in the approval

⁴¹ Equity Group Intranet explanation of VCPs : <https://intranet.ebrd.com/home/departments-and-groups/client-services-group/banking/equity/post-investment-stage>

⁴² Guell, A *Value Creation Plans for Equity Investments* Corporate Equity, Feb 2013 <https://intranet.ebrd.com/Equity-group/value-creation-plan.pdf>

documents (Final Review Memorandum). VCPs contain the basic key objectives and should be systematically included in briefing packs for all NDs on appointment.

- A perception among some NDs and staff EvD interviewed, was that VCPs are inflexible and impractical in rapidly changing economic environments, leading to their abandonment in some cases.⁴³ This clearly is not the intention, but maybe requires some further explanation and training for those involved in direct equity work to ensure this tool is better utilised.
- Final reporting on VCPs was limited to what was available in credit reviews and transition monitoring reviews without any specific elaboration on ND contribution.

3.3.4 *Corporate Governance Action Plans*

As board members, NDs play a critical role in implementation of CGAPs. EBRD conducts corporate governance reviews of investee companies and develops CGAPs because “Good corporate governance is essential for companies wishing to access external capital and for countries aiming to stimulate private sector investments. If companies are well run, they will prosper.”⁴⁴ Part of the Legal Transition Programme’s mission since 1996 has been to help develop a legal environment that supports private sector commercial and financial transactions by working with investee companies and authorities.⁴⁵ CGAPs for investee companies are intended to address gaps and weaknesses discovered in the corporate governance review conducted by the Legal Transition Team during due diligence.⁴⁶ Where the client agrees, they are included in the Subscription/Shareholders’ Agreement. EPG contributes to CGAPs and includes specific actions from it as TI benchmarks in the TI monitoring plan. See endnote.^v

EvD found the following in relation to CGAPs and NDs:

- Of the case studies reviewed by EvD, over half (eight out of 14) had CGAPs included as part of the project. Where CGAPs were not included in Shareholders’/Subscription Agreements or set out specifically in transition monitoring matrices they were also not evident in Projectlink files.
- EvD found no evidence of CGAPs being systematically shared with NDs, although in some cases NDs had a role in developing them. According to the guidance, OLs are responsible for monitoring implementation by the client, and EPG records progress in TI monitoring. No mention is made of the ND’s role here, and EvD saw no evidence of CGAP final assessments, apart from what was available in the final transition monitoring reviews (see Endnote ^{vi} for more).

3.3.5 *EBRD shareholder rights, protections and objectives*

Potential impact of an EBRD ND depends on the rights and protections in the Shareholders’/Subscription Agreement as the starting point. Cases where rights and protections were limited, or where commitment to implementation of action plans was absent can lead to confusion and derailment of the investment objectives. Where rights

⁴³ EvD interview with nominee directors

⁴⁴ See EBRD.com [Legal Reform: Corporate Governance](#)

⁴⁵ SGS96-174 Legal Transition Programme 1996 p1 & 6

⁴⁶ Operations Manual 9.5 Appraisal: [Corporate Governance Review Guidance](#)

and expectations were not clearly defined in the Shareholders' Agreement or shared with the ND, the ND had very little clarity on the basis of the EBRD's equity relationship with the client and their own position in relation to that. This is an issue in some of the equity investments held beyond anticipated timeframes and with circumstances well beyond EBRD influence.⁴⁷

Rights and protections may include for example veto rights on material changes, minority shareholder rights, membership of the board to include an EBRD ND or multiple NDs, observer, independent directors, put options, conduct of business, implementation of VCPs and CGAPs, business plans, environmental and social action plans and sharing of information.

3.4 Knowledge management, information sharing, monitoring and reporting

3.4.1 Methods of communication between the ND and EBRD

Strong communication between the ND and EBRD is an important marker of EBRD making efficient use of NDs to manage equity investments. During the equity investment, NDs communicate with the Operation Leader via phone/teleconference calls, emails, live meetings and through board notes. According to those surveyed by EvD, these methods are of equal importance. Forty-one percent of OLs/ELs indicated that they communicated with the ND on a monthly basis, 27% had quarterly communications and 30% on an ad hoc basis. OLs/ELs indicated they were able to reach the ND when needed and that they were satisfied they had received full summaries of key issues after each board meeting, giving them the information needed to address any issues.⁴⁸ The primary tool for information sharing by the ND are the board reports.

3.4.2 ND board reports and information sharing

NDs are required to submit board report to the OL within seven days of each board meeting following a template covering current issues and progress.⁴⁹ Board meetings typically take place quarterly, but vary depending on the issues facing the company. Reporting may be restricted in cases where local laws place limits on this, or where the rights of minority shareholders may be impacted, or where information may constitute inside information for trading purposes.

EvD found that ND reports were usually received by the OLs/ELs but were of varying quality and not always filed in the project files. Fifty percent of survey respondents agreed that they were very important for communicating with the EBRD team. Seventy-six percent of NDs who completed the survey claimed they submitted the board report to the EBRD after each board meeting. Twenty percent of NDs only felt the need to submit a board report when there was something significant to report. For more see Endnotes.^{vii}

Information from ND board reports is used by the OL in management of the investment, in preparation of Credit Analysis and PMM reporting, and to resolve issues with the client and with the ND. In most cases, the OL had a strong line of communication with the ND, and NDs described communication with the operations team as good. However the

⁴⁷ Examples include Enforta and Borsa Istanbul

⁴⁸ See Survey Results Appendix 3

⁴⁹ Rules and Procedures for NDs 4.3.1

reports are not linked to the assessment of ND performance, nor is there evidence of them being actively used in the project self-evaluation process (for OPAs, or lessons), or for knowledge sharing.

3.4.3 *Training and annual workshop*

Training: Training is a requirement for both internal NDs (2 days) and external NDs (half a day).⁵⁰ Past-experience is an important element used in the training course for prospective NDs, within the limited time available. The course provider has deep experience in delivering ND training programmes and a strong understanding of the unique issues faced by NDs in EBRD's COOs. All EvD survey respondents who had been in an ND role attended the training and rated it good (*four* on a five-point scale). Only a small portion (16%) of NDs had previously attended a specific externally provided ND training course, indicating the criticality of the EBRD's training course to EBRD NDs.

Annual Workshop: All NDs are encouraged to attend the Annual Workshop (Nominee Director and LPAC Annual Workshop).⁵¹ This workshop was in the past limited to NDs but now involves the Bank's entire equity business with over 160 participants.

Almost all survey respondents who had been an ND (94%) had attended the workshop. Survey respondents rated the ND workshop as *four* on a five-point scale for usefulness, indicating general satisfaction. However, a significant number indicated that there was demand for more emphasis and more time on specific areas.

- Fifty percent of respondents wanted to see more opportunities for sharing of learning experience, more information and professional advice.
- Thirty-eight percent wanted more seminars on specific topics, 32% wanted more opportunities for networking.
- Twenty-eight percent wanted more market and equity business information, 28% wanted more keynote speakers.

This demand indicates the popularity of the workshop and is a great opportunity for the Equity Group to provide more offerings and to work on building the attractiveness of EBRD as a good shareholder to work with as an ND. The desire for more knowledge sharing, learning, information and professional advice reflects the current weaknesses with knowledge management and learning within the Bank.

3.4.4 *OL/EL management of the ND position*

One of the indicators of an efficient use of the EBRD NDs is that OLs/ELs are clear about their role in managing them. According to the EvD survey of OLs/ELs managing NDs, 80% of respondents took ad hoc advice from colleagues to learn how to go about this and 40% of respondents used online guidance. Only seven percent had any formal training. Twenty-four percent received no advice whatsoever. EPMU manages an intranet page providing basic information about on-boarding new NDs and a brief 'OLs' Aide memoire relating to NDs', which is circulated to OLs via email on ND appointment.⁵²

⁵⁰ Rules and Procedures Relating to Selection and Appointment of NDs and Members of Equity Fund Committees 3.6.1

⁵¹ Ibid. 3.6.2

⁵² [Nominee directors Intranet page](#)

One respondent mentioned that the ICA equity network had a talk on the OL-ND relationship, and others cited the ND training itself, which they attended.

Box 2 Demand for knowledge sharing - OL/EL management of EBRD NDs

When OL/EL survey respondents were asked what types of learning and resources would be useful to them to better manage the ND role, respondents indicated that regular seminars to share experiences and discuss case studies would be most useful (59% of respondents). They also indicated online learning module (46%), external training (51%) and mentoring for members of the equity network (41%) would be useful.⁵³

To address these gaps, OLs should be offered regular sessions on managing NDs, which provide basic information and training on expectations and duties of the OL, and the opportunity to share experiences and case studies. The main duties and guidelines could be rolled into an online learning module covering various investee company board and ND situations, followed by live seminars with presentations of project case studies.

3.4.5 *Ex-poste review and ND assessments*

NDs are supposed to be assessed by OLs annually according to the Rules and Procedures 4.4, a change introduced in 2017.⁵⁴ One of the duties outlined in the 'OLs' Aide Memoire relating to NDs' is to gather informal feedback and review all other relevant information in order to assess the ND's contribution and performance.⁵⁵ This assessment provides a formal opportunity for issues to be resolved, and briefing and objectives to be communicated.

- For external NDs, prior to annual contract renewal, EPMU asks VCLs for a couple of sentences of feedback.
- For internal NDs, the process is unclear, with no written assessments evident amongst the case studies reviewed.
- The format and areas covered by the assessment are not clear, as there is no template.
- EvD heard that if an OL or the investee company finds an ND unsatisfactory, the OL will replace them. From interviews, EvD did not hear any issues around terminating an EBRD ND from their position when the need arose.

The lack however of any official documentation on the assessment or review of ND performance is a gap in the reporting on a substantial resource deployed by the Bank in equity investments. One cannot systematically describe the performance or contribution of an EBRD ND in a project nor differentiate them or aggregate their input towards CGAPs. There is no scoring system, and there is no final full write up of outputs from the ND's period in office. Such a performance review of NDs from the EBRD perspective could be usefully linked to the candidate database to keep record of those that have performed exceptionally well.

⁵³ EvD survey of NDs and OLs December 2020

⁵⁴ Intranet Article: [New rules and procedures on Nominee Directors have come into force](#) 18/4/17

⁵⁵ Aide Memoire for OLs, see [Operations Manual 17.4.4 Investee Company Board Nomination and Representation – Further Information](#)

After an ND finishes in a role, an ex-poste review or summary of their key achievements and contributions, and appraisal of their performance should be written up and made available to future OLs considering their appointment. Information about ND contributions from the ND assessments should also feed into the transition monitoring system on achievement of objectives.

Currently, experiences with NDs are not shared with other staff in any official sense, although there is clear demand for more sharing of experiences internally, as indicated by 60% of OLs answering the survey.⁵⁶ ND contribution does not translate into a final review of the CGAPs or VCPs and this does not feed into the transition impact/objective monitoring system (or TIMS or TOMS).

3.4.6 *ND records management and information systems*

One of the indicators of an efficient ND programme is that information is easily available from Bank systems, of quality, and accurate when compared with other information sources. Candidate databases are currently held separately from the rest of ND data records. EPMU, though its involvement in the approvals process, retains data on appointed NDs for the centralised ND database. Information though is generally limited to a basic set of data around the identity and term of the ND, there is no reporting retained on performance, committee membership or progress on CGAPs or VCPs. This is regarded the domain of the project teams. See Endnotes for more.^{viii}

Need for one data management platform with multiple user interfaces: Candidate databases, the actual ND database and reporting on ND performance could be usefully linked via a central data platform so that feedback can be considered when future appointments are made. Performance reporting could record key ND inputs around CGAP and VCP, committee membership, and other key contributions. Project teams could enter this annual assessment directly into an integrated system, to improve overall information and reporting on the ND programme.

3.5 **Recruitment**

OLs select EBRD NDs to suit the requirements of the investee company. Whether or not the EBRD ND is internally recruited among existing EBRD staff members or whether an external person is chosen depends on the specific circumstances of the project. The case studies highlight this through a wide range of situations.⁵⁷ The EBRD aims to ensure its hiring of NDs reflect the inclusion policy. There has been an intention to balance the internal candidates with external candidates, however progress has been limited due to the way the Bank prefers to appoint NDs in specific situations and seeks to influence outcomes of value creation and return on investment.

3.5.1 *Main responsibility for recruitment*

OLs/ELs and Value Creation Leads are primarily responsible for recruitment of NDs, and proposed candidates are usually identified prior to finalisation of the FRM, following the Nominee Director Rules and Procedures.⁵⁸ EPMU oversees administration of the process.^{ix} Final approval is granted by the candidate's line manager for internals,

⁵⁶ EvD survey of OLs and NDs, December 2020

⁵⁷ Case studies included 4 internals, 5 externals and 5 ex EBRD with 11 closely held companies, 2 fragmented ownership and 1 sovereign

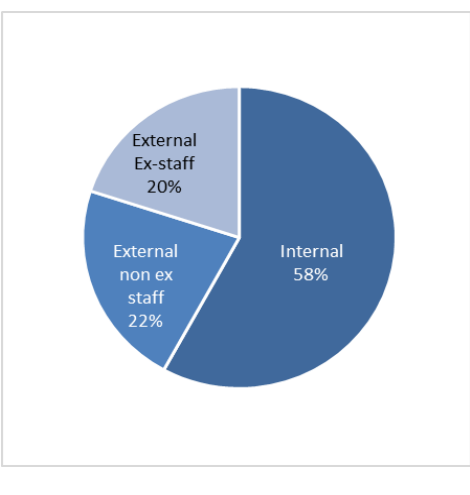
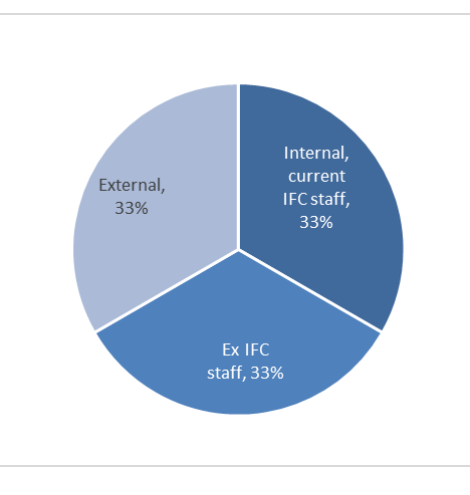
⁵⁸ See Operations Manual 17.4 Equity Investee Company Board Nomination and Representation

authorising director, Equity MD and OCCO.⁵⁹ Due to time pressures, OLs are unlikely to advertise and will take a more direct approach to candidates with the right profile for a shortlist. Individuals chosen for a shortlist may come from a recommendation by word of mouth, someone they already worked with who is available, or they may request ideas from individuals managing the ND candidate databases held by FI or the Equity team. Candidates for these databases are forwarded by Equity and Value Creation Leads.⁶⁰

In keeping with the Bank’s mission to increase the diversity in the pool of candidates, OLs are to choose from a shortlist of at least three individuals including at least one from the candidate databases recommended by one of the outreach staff responsible for identifying candidates. EPMU sends a contract request (or contract extension request) for external nominees to the Procurement Operations and Delivery Department (PODD) for contract preparation.

3.5.2 Internal/ external composition of active EBRD NDs

The 2016/17 Enhanced Equity Approach states that the Bank intends to access global talent for the ND programme, to balance the universe of internal/external candidates; to improve the gender balance; and to target specific skill sets.⁶¹ The composition of EBRD ND positions in December 2020 was 20% external ex-EBRD, 22% external non ex-staff and 58% internal.⁶² IFC, by contrast, has a large ND programme with around one third internally recruited, one third externally recruited and one-third ex staff.⁶³ This difference is partially explained by IFC having a dedicated outward looking Nominee Director Support Centre which taps into external board networks in multiple countries, and proactively seeks candidates for the database at events throughout the year.

EBRD ND Composition for direct equity investments 2020*	Indicative IFC ND composition for direct equity investments 2020*																
 <table border="1"> <caption>EBRD ND Composition for direct equity investments 2020*</caption> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Internal</td> <td>58%</td> </tr> <tr> <td>External non ex staff</td> <td>22%</td> </tr> <tr> <td>External Ex-staff</td> <td>20%</td> </tr> </tbody> </table>	Category	Percentage	Internal	58%	External non ex staff	22%	External Ex-staff	20%	 <table border="1"> <caption>Indicative IFC ND composition for direct equity investments 2020*</caption> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Internal, current IFC staff</td> <td>33%</td> </tr> <tr> <td>Ex IFC staff</td> <td>33%</td> </tr> <tr> <td>External</td> <td>33%</td> </tr> </tbody> </table>	Category	Percentage	Internal, current IFC staff	33%	Ex IFC staff	33%	External	33%
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<p>EBRD’s figures as at December 2020; IFC’s estimate as at November 2020</p>																	

Diversifying the pool of candidates is the key to increasing diversity and skills amongst serving EBRD NDs. Final choices of NDs are ultimately made on a case-by-case basis according to the investee company’s need, the relationship with the client, and the investment objectives with the best person for the job taking the role. There should never

⁵⁹ ND Rules and Procedures 3.2

⁶⁰ EvD interviews with case study OLs managing NDs

⁶¹ CSFO1706 *Enhanced Equity Approach* February 2017 p18

⁶² Figures provided by EPMU as at December 2020

⁶³ Estimate provided by IFC in interview with EvD, November 2020

be a situation though, where the right type of candidate is unavailable. Having a strong pool of diverse candidates to draw on is critical to obtaining a balance.

Since the EBRD ND programme began in 1999, the EBRD has relied on a mixture of internally and externally recruited NDs, with internal staff and ex EBRD staff dominating the positions right to the present (see charts above, Current Composition of NDs).

- Results from the case studies show that internally recruited NDs can help produce highly successful outcomes.
- Recruiting external NDs however can expand the Bank's capacity and bring a wealth of experience and skills that EBRD staff cannot. Often, multiple NDs are used over the investment lifetime, as ND requirements evolve. For further discussion, see Endnote.^x

3.5.3 *ND recruitment practices at IFC*

At IFC, early stage companies generally have internal IFC staff taking the ND role whilst for listed companies they are banned, as at the EBRD.⁶⁴ IFC conducts directorship assessments for each project to define what they want to do with the ND role and the type of person they need to source. The *Nominee Director Support Centre* manages the recruitment process. They draw on board networks and proactively recruit by reaching out to potential candidates at conferences and meetings throughout the year, and in the countries of operations and they do not tend to use search firms. They have successfully increased the proportion of female NDs to 47%.⁶⁵ IFC maintains a database of candidates and are working on revamping their systems to support this. The database contains individuals who have been recommended by word of mouth, much the same as the EBRD. Shortlists are built by identifying candidates through both the database and the external networks.

3.5.4 *EBRD candidate databases*

EBRD holds two Microsoft Excel databases with ND candidates: one is held by FI due to the specific knowledge and skills required for many heavily regulated FI projects; the other is held by the Equity Group and contains candidates across a range of sectors and regions. Candidates for these databases are put forward by word of mouth, and typically interviewed by a panel before being added. Allocated staff members are the gatekeepers and will deal with requests for candidates on a case-by-case basis.⁶⁶ EvD found the following:

- Survey results indicate that of those using the candidate databases, 44% found the equity database less than useful or not useful. Thirty-six percent of users of the FI database found it less or not useful, staff commenting said they did not know candidate databases existed, or could not access them. If they could, they said that the pool of candidates is not deep enough or up to date, and that the data lacked structure.

⁶⁴ EvD interview with IFC Head of CG Programme and EBRD Rules and Procedures for NDs 2.2.2.3

⁶⁵ EvD interview with IFC Head of CG Programme

⁶⁶ EvD interviews with FI database owner September 2020 and OLs, ELs and VCPs of cases studies

- There is no formal integration of this data with the rest of the Bank’s systems, and limitations exist around accessibility, user friendliness and search capabilities. See Endnotes for suggestions for improvement.^{xi}

3.5.5 *ND recruitment at private equity and venture capital firms*

The experience of some private sector PE firms and venture capitalists in hiring NDs is of value when considering the best approach due to their niche expertise in handling direct equity investments and strong performance. EvD spoke with representatives from three firms, two of which take only a minority shareholding when they invest. These firms have a strong tendency to try to secure more than one ND role, and use internal staff, specifically the deal originator (or OL equivalent) as they consider the relationship with the client absolutely central to the equity investment. All three had a preference of using staff or people they have worked in the past or knew to minimise risks when selecting new NDs. Two had built up networks of candidates with good track records, and one also managed a preferred supplier relationship with a global search firm. For more information see Endnotes.^{xii}

3.5.6 *External Board Networks*

As part of efforts to expand recruitment and increase participation of women in ND roles, EBRD reached out to the Professional Boards Forum in the UK, attending networking events between 2017-2019, and circulating notices of new roles to potential candidates. Following this, EBRD held an event for women interested in board roles.⁶⁷

Beyond these initiatives, there was no evidence of EBRD drawing on other regional or country board networks in COOs to find candidates, or of seeking to found or develop professional networks in COOs, including board networks focussing on recruitment of more women. This could be explored as part of capacity building in COOs. Potential NDs joining such networks can obtain advice, attend events, find further training, explore new roles, and keep up to date on new developments.

Board networks are a way to diversify recruitment and tap into new talent (eg, Professional Boards Forum, Global Network of Director Institutes, Institute of Directors UK, Women on Boards UK, Australia, partnering with pwc, Thomas Reuters and Standard Bank etc).⁶⁸ The EBRD invites NDs to an annual forum, but this is not the same as NDs having a live network that they can turn to throughout the year. There is also potential for EBRD to build its own which can be searched by OLs looking for candidates.

3.6 **Incentives**

Internal EBRD NDs: Motivation for EBRD staff to take an ND role was frequently career development (65%), out of personal interest (54%), because they already had a relationship with the client, making it relatively easy (54%), or because they were specifically asked to because of their profile, experience or expertise (46%). They expressed however a strong feeling of not being rewarded by the Bank for their efforts (72%). Most also indicated that they disagreed that they were recognised for this additional work (75%).⁶⁹

⁶⁷ Information provided to EvD by Equity Group, April 2021

⁶⁸ See Womenonboards.net

⁶⁹ EvD survey of NDs, December 2020

External EBRD NDs: The investee companies typically pays ND fees which are assigned to the EBRD.⁷⁰ This fee is then paid on to external EBRD NDs as part of their EBRD contract. External EBRD ND contracts generally include a travel allowance for attendance at the EBRD training in London HQ and for attendance at board meetings. EBRD supplemented some fees to retain a specific ND who commanded market rates for taking the position.

- External ND survey respondents indicated that they were *broadly satisfied* with the fee arrangement in the EBRD contract (63%).⁷¹
- A few external recruits thought that the contract did not adequately cover travel expenses to the EBRD HQ. Of the 30 respondents, 3 were paid fees and out of pocket expenses directly by the company (accepting a £0 contract from the EBRD). See Endnotes for comments.^{xiii}

Overall time spent: In the survey, external and internal ND respondents were asked how much time they spent on fulfilling their duties as an EBRD ND. 61% spent over 1 month of the working year on a single ND role. The requirements of the investee company boards, and level of ND input varies considerably, case by case. Some were dealing with serious problems requiring more engagement, in other cases, COVID had reduced travel time but increased work, and some were spending evenings and weekends in addition to a day job.⁷²

Internally recruited NDs may therefore spend one or more months of the working year or more on an ND role without receiving any additional specific rewards or formal recognition. Given the importance of internal NDs to the management of the EBRD's equity investments, and their high representation as a percentage of all NDs (61% as of November 2020), some sort of official recognition /incentive should be carefully taken into consideration as part of the EBRD system for rewards and compensation.

3.7 Expenditure

EMPU shared with EvD the budget and expenditure for the ND programme over the last four years. The budget has remained at €2,150,000 to cover contract commitments including recoverable and non-recoverable external ND fees and travel expenses, the workshop and associated costs.⁷³ By YE 2020, commitments stood around €1.8m, while actual costs (invoiced amounts after recoverable fees and expenses) reached just €791,881 (includes non-recoverable fees, a limited amount of travel from early 2020, and communications expenses, but not the workshop, which was cancelled due to COVID). The ND training budget is funded by HR, The Nominee Director and LPAC workshop is paid from the Equity budget in pre-pandemic years cost €28,500. No part of the current budget is allocated specifically for recruitment activities, for development of IT systems to support the ND programme or for learning and knowledge management.

Table 1: Total ND costs 2017-2020⁷⁴

	2017	2018	2019	2020
Total ND costs	€1,658,223	€915,651	€1,106,716	€791,881

⁷⁰ in accordance with the SHA/SA and Rules and Procedures for NDs 4.5.1

⁷¹ EvD survey of NDs, December 2020

⁷² Ibid.

⁷³ Data from EPMU December 2020

⁷⁴ Data from EPMU 2020

Once the Equity team has established the priorities for developing the ND programme, the existing budget could be reviewed for its adequacy to resource items for programme enhancement, along with the overall equity staff budget. It may be that outreach activities for recruitment, and development of knowledge/ learning materials (online, virtual or live) requires extra or reallocated headcount and budget. The issue of incentives for internal EBRD NDs within the existing compensation benefits and rewards system should also be addressed.

4. Effectiveness and emerging results

4.1 Summary

- The EBRD does not specifically track, aggregate or report on results from the use of NDs. This study presents some results pieced together by EvD from interviews and project files including board notes.
- ✓ In case studies where VCPs, CGAPs and transition objectives were well defined and implemented, projects tended to show successful implementation, with a high IRR. NDs were able to contribute significantly to success throughout their tenure.
- ✓ Fifty percent of NDs surveyed had been a member of the audit, HR, remuneration, strategy or other committees, and 14/55 were committee chairs, indicating many are taking a proactive role on investee boards.
- In three of the four case studies with NDs showing underperformance, CGAPs and VCPs were missing or not included in the Shareholder/Subscription Agreement (see section 4.2). This may merit further investigation about the correlation between performance and use of CGAPs and VCPs across the direct equity portfolio.
- Case studies of projects with NDs varied widely by specific project features, impacting heavily on the extent of the EBRD ND's influence. This shows potential for learning from experience.
- Equity Client Board Effectiveness Initiative: In 2017 the Equity team commissioned Compass, an independent consultancy firm, to look into client board effectiveness. The final report showed a correlation between effective board governance practices and investee company financial performance.

4.2 Emerging results from case studies

- Where VCPs, CGAPs and transition objectives were well defined and implemented, case study projects tended to be successful with a high IRR. NDs were able to contribute significantly to success throughout their tenure.
- In underperforming case study projects, CGAPs and VCPs were missing or not included in the Shareholder/Subscription Agreement

This study looked at the results of seven realised projects and seven current investments to discover more about how the specific contribution of NDs may have resulted in change to address gaps identified at board approval either as part of a specific CGAP, VCP or identified as a transition objective (see table Appendix 2).

Case study projects achieving a higher internal rate of return (or IRR to date) had explicit VCPs with the client, they tended to have explicitly set out CGAPs that were implemented, and had a high number of corporate governance TIMS benchmarks achieved.⁷⁵ In these projects, the impact of the EBRD ND was high, with evidence of

⁷⁵ See Appendix 2 Summary of case studies

their proactive participation, work on corporate governance improvements and strong liaison with the EBRD operations team.⁷⁶

Successful input from EBRD NDs in high performing projects included for example the ND participating in development of the CGAP, taking the lead on the board in setting up committees and chairing the audit committee, and cases where there were multiple EBRD NDs influencing the company's governance (see Box 2 below).

In the four underperforming cases that did not produce expected returns or reforms, three had no VCPs or CGAPs at all. One had a large number of corporate governance benchmarks set out in TIMS, but none in the Shareholder Agreement, and another actually had a CGAP but only an observer role, and accordingly no influence over the board.⁷⁷ Although the sample size is small, and it was not possible for EvD to look across the entire past portfolio for this study, these findings highlight the importance of securing agreement on CGAPs, VCPs and an EBRD nominee board role in the Shareholder/Subscription Agreements prior to signing.

Box 3 ND success stories

Example 1 – Regional agribusiness project

EBRD invested in equity in a regional agribusiness group with operations in eastern Europe, for equipment, infrastructure, working capital and corporate governance improvements as the main major project objectives. Over the Bank's holding period of more than three years, the client made significant improvements in its corporate governance practices with EBRD's continued support. The supervisory board did not exist before the EBRD investment.

The client had requested two EBRD NDs, because the majority shareholder/founder wanted EBRD advice and had explicitly requested this.⁷⁸ The externally selected EBRD ND had strong corporate governance experience and had previously been an EBRD ND whilst the internal EBRD ND had a strong relationship with the client so trust was very high. Another significant success factor was that the EBRD ND developed the CGAP from the outset, meaning they fully supported it during implementation. The client's strong trust of the EBRD ND meant that the ND could discuss succession planning for the company. The relationship paid off when negotiating the exit, as the EBRD ND's strong relationship with the owner ensured the process was smooth.

Example 2 – Financial institution projects

- In one now exited FI project with a local bank in the Caucasus, the EBRD invested in equity to fund an acquisition and growth, resulting in a high actual IRR. The EBRD nominated two different NDs over the investment period, the first was an external candidate where the personality fit was not optimal, leading to a second nominee who was a current EBRD staff member and experienced ND. This was someone who was able establish strong communication with the client in the country and was able to liaise with the

⁷⁶ EvD interviews with NDs, OLs and board notes

⁷⁷ EvD interview with OLs, NDs & from Projectlink files

⁷⁸ EvD interview with OL and Plink files

Central Bank on an outstanding issue regarding the owner/founder involvement in the company.⁷⁹

- The other project is with a bank operating subsidiaries in south-eastern Europe which was reprivatized after the financial crisis to a private equity firm and the EBRD (for 20% share). It involved three EBRD NDs at three different levels, holding, group and subsidiary levels.⁸⁰ A key objective was restructuring in preparation for an IPO, and part of that was a full corporate governance review that was included in the shareholders agreement.
 - Overall the project was a success as the company achieved an IPO, and EBRD sold the majority of its holding. A key success factor was EBRD's partnership with the majority shareholder, a strong PE firm, with shared objectives.⁸¹
 - The internally selected EBRD nominee at the holding company level worked in an oversight function closely with the majority shareholder PE fund, playing a key role in overseeing a review conducted by external advisors and legal firms and ensuring key requirements for the IPO were met.
 - The EBRD ND at group level was a former EBRD senior staff member who provided operational experience and knowledge of the region.
 - At one of the subsidiaries, EBRD's ND was selected for their strong credibility and knowledge of financial markets who was able to help rebuild relationships and trust with the regulator after the financial crisis.
 - Overall, due to the overriding control and influence of the PE fund, the influence of the NDs in this example could be considered medium compared with other case studies reviewed here.

Example 3 - Infrastructure project

In a ports infrastructure project with the world's largest operator in a COO, EBRD invested for a 10% stake for expansion, IPO and corporate governance improvements. It resulted in an IPO and the highly experienced EBRD ND was a senior EBRD staff member with strong influence. Whilst all corporate governance objectives were met, the issue was more around the timing of communications between the ND and the EBRD and the optics and fairness of such a staff member (and MD) going on to become an independent ND for the company after leaving the EBRD.⁸²

For more examples (M&S and ICT) see Endnote.^{xiv}

4.3 Case study findings by project feature

Case studies of projects with NDs varied widely by specific project features, impacting heavily on the extent of the EBRD ND's influence.

⁷⁹ EvD interview with OL, ND, & Projectlink files

⁸⁰ Interview with NDs, OL and Projectlink files

⁸¹ Ibid.

⁸² EvD interview with OL, ND& Projectlink files

- Where companies are listed and over decisions to IPO, EBRD influence is much more limited, although the ND plays a significant role in advising on preparation for the IPO.
- In closely held and founder owned companies, the EBRD ND has a stronger and more direct voice vis a vis the majority shareholder, and often makes a significant contribution where the relationship is strong.
- EBRD is particularly competent at advising on corporate governance improvements, and can play a complimentary role to other DFIs in co-investments
- In the right environment, external NDs can provide specific technical expertise and experience that internal NDs cannot, but if the fundamentals are wrong they will lack influence

4.3.1 *Preparation for IPOs and use of NDs*

IPOs are often an objective in equity investments, with many containing an ambitious corporate governance programme to meet regulatory requirements. Whilst the ND plays an important role in overseeing implementation of CGAP reforms required for an IPO, IPOs are ultimately determined by market circumstances and majority shareholder wishes. Ten out of the 14 case study projects cited an IPO as a key objective, four went on to achieve it to date, each of which had a strong EBRD ND proactively advising the company to meet targets.⁸³ In another project the investee company was acquired by a listed company. For the remaining five, adverse market or political conditions made an IPO unlikely, leaving the projects with some or no improvements in corporate governance. One of the most highly successful equity investments reviewed by EvD did not IPO but resulted in a highly successful staged exit in part to a new institutional investor, and in part back to the original shareholders.

4.3.2 *Listed companies*

In cases where the investee company successfully went through an IPO, the EBRD either exits and the EBRD ND resigns, or the EBRD retains its holding and EBRD ND seat. If the seat is retained it must be filled by an externally selected nominee or become independent.⁸⁴ The external nominee is then subject to strict controls on sharing inside information due to the Bank's ability to trade the securities and breaches may lead to serious conflicts of interest.⁸⁵ The role therefore becomes more that of an independent non-executive director. Listed companies are more likely to have achieved a strong standard of corporate governance and would therefore usually not benefit from an EBRD ND in the same way as unlisted companies in earlier stages of development.

- In one case the company ownership was fragmented prior to listing. The external EBRD ND was able to influence the board through his skill and experience, making a strong contribution to business development.⁸⁶ The company was eventually listed and the EBRD ND became independent.

⁸³ Various case studies

⁸⁴ See *Rules and Procedures* Identifying NDs, Listed investee companies 2.2.2.3.

⁸⁵ See *Rules and Procedures* ND Reporting Obligations- additional restrictions concerning listed investee companies 4.3.2

⁸⁶ EvD interviews with OL, ND and board notes

- With an AIM listed client, the external EBRD ND was a technical expert, but unable to make progress and communicated some of the issues with the operations team. When one of the larger minority shareholders decided to sell to a group the EBRD did not want to be associated with, EBRD decided to exit at a loss.

4.3.3 *Privatisations and the role of PE Funds and entrepreneurs*

EvD looked at four projects with investee companies which underwent privatisation from state ownership.⁸⁷ In three cases (two banks which were re-privatisations post crisis) and one telco), the governments had already taken the decision to privatise at the time the EBRD signed the investment. Further, they all involved investing with a major PE fund or single entrepreneur (in the case of two banks, two PE firms and for the telco, a local entrepreneur). In the fourth project, the government maintained controlling ownership through sovereign funds, and EBRD unsuccessfully tried to promote reform using the EBRD board nominee position.⁸⁸ This highlights the significance of pre-investment preparation and commitment for successful privatisation.

4.3.4 *Closely held share ownership*

In many direct equity investments, particularly in FI, the Venture Capital Investment Programme, and founder/family owned companies, shareholders may be limited to two to five. In these cases, more direct EBRD representation is required, unlike in more fragmented ownership where the EBRD ND takes on a more general representation of minority shareholders. In closely held companies the EBRD ND voices EBRD's viewpoints and can have more direct influence over the majority shareholder if the relationship is strong.

Examples: Two cases of closely held companies with PE fund

In the case of two investments in local banks (one realised, one current), EBRD invested where a private equity fund held the majority and worked together with them to resolve legacy issues and increase value.⁸⁹ In these cases, the PE funds were driving the strategy and EBRD NDs were acting as a check, or providing advice on specific issues after the financial crisis. Some questions arose over whether the PE fund in an advisory function was sharing information with the other non-executive directors on the board, and the EBRD and EBRD ND worked on the relationship to improve matters.

4.3.5 *Locally owned companies*

Amongst the case studies were several equity investments with companies founded by or taken over by local entrepreneurs/families. EvD found EBRD NDs worked hard to maintain trust and high levels of communication with clients who were receptive to creating value and improving corporate governance.

⁸⁷ EvD interviews OL, ND and Projectlink files

⁸⁸ EvD interviews OL, ND and Projectlink files

⁸⁹ EvD interviews OLs, NDs and Projectlink files

Examples: Three case studies of NDs with locally owned companies

- In one equity investment with a Russian manufacturer, there was a divergence in views between the EBRD ND and the majority owner on strategy, despite the ND organising for international consultants to prepare suggestions and provide advice.⁹⁰
- In another highly successful EUR 50m equity investment with a regional agribusiness company, the EBRD ND built a very strong relationship of trust with the owner, enabling him to advise on implementation of the full CGAP. This was a process and took time and effort from both sides, it was the first time the owner had engaged with a co-investor.⁹¹
- In another equity investment in petrol stations in Eastern Europe, the EBRD ND claimed that the company had the best management team in the country. He found them to be “progressive, honest, creative and proactive”. They implemented a full programme of corporate governance improvements, and the EBRD ND was able to be frank, point out serious issues and influence board decision-making, by pressing for revised plans where necessary.⁹²

4.3.6 *Observer role*

In two of the case studies, EBRD had no ND but only an observer role on the supervisory board agreed with the shareholders. In one 15% equity investment with a Turkish manufacturer with the intention of an IPO this was seen as a risk to transition since the CGAP formed a pivotal element in the project. This proved correct, since many of the CGAP objectives did not materialise, and the IPO is no longer an option.⁹³

In the second example of an EBRD 16% equity investment with an eastern European telecom, the sponsor requested EBRD take an observer role post-privatisation. For the sponsor, having a trusted EBRD staff member with local knowledge was important.⁹⁴ It was useful to the EBRD at that time as it enabled the flow of information, and gave EBRD the opportunity to provide financial advice. Having a full ND role would not have been useful in this case, as there was only one other shareholder with full control. The observer role ended when the company merged with the sponsor’s listed company.

⁹⁰ EvD interviews OL, ND and Projectlink

⁹¹ EvD interviews OL ND and files

⁹² EvD interviews OL, ND and Projectlink

⁹³ TIMS review

⁹⁴ Interview with OL, Observer

4.3.7 *Expertise brought by external EBRD nominees*

Results in the 4 case study projects where the EBRD ND was external were mixed due to the different operating environments.

Example 1: Two exchange projects

In two exchange projects, EBRD chose external candidates as NDs, and both had extensive specific experience, but outcomes were different:

- In one project, due to the limitations on the equity agreement and political influence, it was impossible for the EBRD ND to effect change. When a new CEO was appointed by state owned shareholders EBRD was not consulted, and did not approve. The ND resigned and EBRD exited the investment.
- ✓ In the other project, the external EBRD ND worked primarily on strategy and business development and was able to build up a good rapport with the board and CEO, organised a twinning trip with an exchange in another country which was a highly valued learning experience, and introduced new investors and business. The board was dynamic and target driven and included asset managers and pension funds. Whilst a target in the board document was improvements to corporate governance, there was no CGAP on record, although the company eventually listed. The external EBRD ND had no involvement in improvements to corporate governance, that was clearly not his area of expertise.

Example 2: Two telco projects

In two of the telco equity investments EvD reviewed, the EBRD board nominees were external appointees brought in for their specialist industry expertise.

- ✓ In one equity investment with an internet service provided in eastern Europe, the EBRD exited with high returns when the investee company was sold to a highly successful international operator. There are no written records of the ND's actual contribution but the OL worked hard with the ND and the company to bring about the result. The ND was engaged in discussions on strategy and technical matters.
- Another Russian telecom equity investment has struggled and the ND has little influence due to a takeover and divergence of directions among key shareholders. Initially the OL shadowed the external EBRD ND as an observer.

4.3.8 Co-investments with DFIs

In two case study projects with co-investment, EvD found contributions from DFIs were complimentary with EBRD tending to take the lead on governance issues due to its recognised technical expertise in this area.

Example: Co-investments

- EvD looked at one exited FI project with a bank in the Caucasus where IFC and DEG were already shareholders prior to EBRD investing. The client had plans to IPO which didn't materialise due to market conditions. IFC had been a shareholder for nine years already, and DEG for seven years by the time EBRD subscribed. The EBRD ND described the working relationship on the board as amicable but fairly passive. The EBD ND took the lead on communicating with the Central Bank about a governance issue which was then resolved.⁹⁵
- In another project with a petrol station operator in Eastern Europe, IFC provided extensive debt financing and EBRD worked alongside them, investing in equity and supporting their corporate governance development programme. The work of the institutions has been complimentary, working towards mutually shared objectives.⁹⁶

4.4 Committee chairing and membership

Fifty percent of NDs surveyed had been a member of the audit, HR, remuneration, strategy or other committees, and 14 out of 55 were committee chairs, indicating many are taking a proactive role on investee boards.

Membership of board committees or chairing of such board committees is an indication that NDs are taking a proactive role on the board, and using their experience, skills and expertise to advise the investee company board on critical decisions, and to implement CGAPs. Half of all NDs who answered the EvD survey indicated that they had been a chair or a member of the audit, HR, remuneration or strategy committees. Others indicated they sat on risk, acquisition, corporate governance, health and safety, environment, social action and technical committees.

The majority of those who participated in the committees were members. A third of those involved in the audit committee (eight NDs) were the chairperson. Three chaired the remuneration committees, two chaired the strategy committees and one the HR committee of their respective investee companies.⁹⁷ Half of those surveyed however did not participate in committees. This may be because there were no committees, the board was very small, or it was not required.

There is scope for the Equity team to better track this data as part of the assessment of NDs, as it may only be recorded in the board notes, which EPMU does not have access to.

⁹⁵ EvD interview with ND, OL

⁹⁶ EvD interviews with ND, OL Projectlink files, EvD Operation Evaluation

⁹⁷ EvD survey of NDs November 2020

4.5 Compass report on board effectiveness

From 2017 to 2019, the Equity Group ran the **Board Effectiveness Initiative** and commissioned Compass, a consulting firm that specialises in board performance assessments, to establish a baseline of performance and overall governance practices for the boards of investee companies, nurture a culture of good governance and promote dialogue amongst colleagues about board effectiveness.

The Compass Governance Framework includes four pillars of **right people, right focus, right dynamics, right structure and processes** (see Compass Consulting Final report, provided by the Equity Group). It involved surveys of 117 NDs and 38 chairmen and resulted in a report at portfolio and company levels which highlights key strengths and weaknesses and provides three key recommendations to enhance investee company governance, including a review of the Nominee Directors' (training) Programme and continued evaluation of investee company boards. The Compass report reflects the strong value EBRD places on strengthening boards through the ND presence. A limitation of the study was that investee boards were not independently assessed. The findings only represent the views of existing investee board members.

- The results of the Compass report shows a correlation between effective board governance practices and investee company financial performance.⁹⁸ High performing investee companies also scored highly along the four pillars of the Compass Corporate Governance Framework. Those companies with weaker scores struggled particularly in the areas of talent management, performance review and directors' capabilities and selection.⁹⁹
- Compass recommended that the EBRD should make a Nomination or Governance Committee mandatory for equity investments; that the EBRD ND should be a member of such a committee, and that the EBRD should assist in developing a terms of reference or authority matrix for the investee boards to leverage the committee's support.

After consultation with experts, the Equity team decided this was impractical due to the small size of many EBRD investee companies.

- The Compass report also identified specific corporate governance gaps in individual investee companies reviewed, and recommended that EBRD conduct full board reviews discuss with the relevant NDs and agree on a way forward.

The Equity team decided there was little value in conducting repeat reviews of all investee companies straight after the Compass review, as board composition only rarely changes. They are planning to revisit this when the portfolio composition and investee boards change sufficiently, and are looking at other potential studies to provide further insights.

⁹⁸ Compass EBRD Board Effectiveness Study Final Report B page 5

⁹⁹ Ibid. p4

5. Recommendations

From the findings above, EvD makes the following recommendations. Implementing these recommendations are likely to require additional budget and resources, which would need to be defined more specifically by the Equity Group in developing its chosen courses of action.

1. Develop an Equity Policy, Strategy or Approach covering key priorities for use of EBRD NDs across the Bank' wide range of direct equity investments. Present a 3-5 year vision for the programme, making clear how NDs will be selected, used, and input tracked, reported on and assessed to ensure the programme has a basis on which to develop. Link the strategy/approach to updated operational guidance, duties, principles, rules and procedures. Provide details on how to ensure a diverse and high-capability pool of candidates, through use of board networks, and development of supporting knowledge management platforms and information systems.
2. Update and standardise objective setting, monitoring, reporting and assessing ND inputs and defining incentives. Provide and keep record of briefing packs for NDs upon appointment, and track ND contributions to EBRD objectives. Require OLs to regularly report on ND contributions to VCPs and CGAPs through strengthened annual ND assessments, final assessment and de-brief on conclusion of the assignments. Use this as input for the wider project self-assessment.
3. Mine the ND experience as a valuable and distinctive corporate asset for insights to inform new projects, and to expand on existing orientation material for new NDs. A new Strategy/Approach should pay particular attention to these issues. Develop specific training modules for OLs managing NDs based on experiences sourced through activities such as a formal "After Service" interview/de-brief/survey and shared through systematic use of case studies in equity workshops.
4. Recruitment/retention of NDs, particularly from outside the EBRD orbit, merits a more systematic and ambitious approach. This could tap into and establish board networks across the COOs, along the lines of IFC's approach. Consider a formal mentoring programme for suitable internal mid-level staff. Review current incentive levels for both internal and external NDs.

6. References

EBRD external website – ebrd.com

[Agreement establishing the EBRD 1991](#)

[Legal Reform: Corporate Governance](#)

[Transition Report 2019-20](#)

EBRD Internal Documents

Nominee directors Intranet page

Rules and Procedures relating to the selection and appointment of EBRD Nominee Directors and members of Equity Fund committees

EBRD Operations Manual, Chapter 17 Equity, Chapter 9 Appraisal

Policies and Operational Guidelines, Equity Notes

Client Services Group Banking Equity Post Investment Stage

Duties and Guiding Principles for Nominee Directors, Annex 1 to Schedule A in a standard Terms of Reference for externally hired EBRD nominee directors

OLs aide memoire relating to nominee directors, see Operations Manual 17.4.4 Investee Company Board Nomination and Representation – Further Information

Pre-assessment of Transition Qualities tool- Excel: Corporate Governance Questions and Objectives, EPG

Compass EBRD Board Effectiveness Study Final Report B 2018

New rules and procedures on Nominee Directors have come into force 18/4/17, Intranet Article

Guell, A., Value Creation Plans for Equity Investments Corporate Equity, Feb 2013

Project files

Board notes, Shareholder/Subscription Agreements, VCPs, Approval documents, Credit analysis reviews, equity exit notes

Board documents

BDS91-7 (Final) *Operational Policies*

CS/FO/94-9 FOPC *Guidelines for Board Representation in Companies with EBRD Equity Investment*

SGS96-174 *Legal Transition Programme*

CS/FO/97-3 FOPC *Transition Impact of Projects 'Qualitative Aspects of TI of Projects: A Checklist'*

CS/FO/99-2 FOPC *Board or Committee members nominated by the Bank for Banking Operations*

SGS10-180 *Review and update of EBRD Rules and Procedures relating to the appointment of EBRD Nominee Directors to the Boards of investee companies and to the Committees of equity funds*

WS15-04 Transition Concept see *Discussion Note for Board Workshop November 2015 from review panel members Tim Besley, Sergei Guriev and Beata Javorcik*

CS/FO/17-06 *Enhanced Equity Approach*, February 2017

SGS17-114 Add 2 Information Session *Transition Impact Methodology: Project Christopher – Guidance Paper on Operationalising the TI Qualities*

SGS18-329 *EBRD's Enhanced Approach to Additionality – A quick reference guide*

External documents

Larcker D. and Tayan B., *Board of Directors Duties and Liabilities* Corporate Governance Research Initiative, Stanford Graduate Business School.

OECD (2015), *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris, <https://doi.org/10.1787/9789264236882-en>

[2016 Guidebook for DFIs on nominating members to the boards of investee companies](#), Corporate Governance Development Framework

3i website [How we add value](#)

Appendix 1: People interviewed

EvD interviewed the following people involved in managing or acting as nominee directors:

- EBRD staff across multiple departments, including Private Equity, Equity Portfolio Management Unit, Banking sector groups, Office of the Chief Compliance Officer, Economics Policy & Governance (EPG) and the Office of the General Counsel. They include Directors, Associate Directors and Associate Bankers.
- Internal and external EBRD Nominee Directors (past and present), Operation Leaders and Equity Leads in relation to the 14 case studies.
- The EBRD Nominee Director Training Consultant, Partners at three private equity firms, and peers running nominee director programmes at IFC, FMO and PROPARCO.

EvD would like to thank interviewees for providing rich information and making the study possible.

Appendix 2: Summary table of case studies

All Company names have been redacted in line with the EBRD's confidentiality requirements.

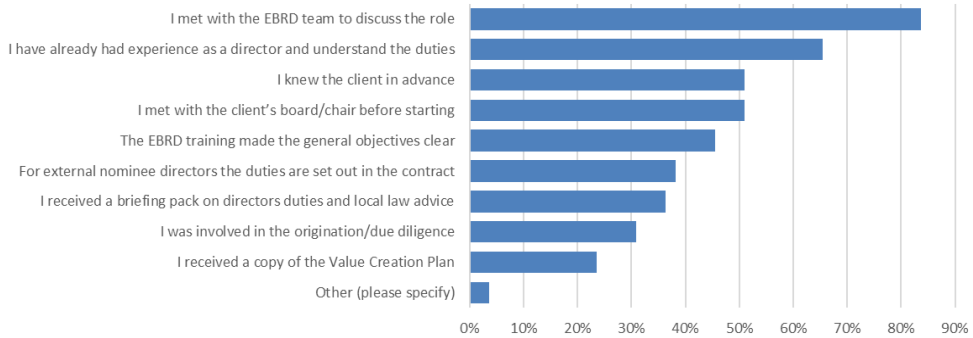
Case Study companies (anonymised)	Ownership type	IPO Achieved	No. of EBRD NDs in SA	Indep. NDs	Corporate Action Plan	VCP/ Business Plan	ND in TIMS	CG bmks in TIMS Achieved?	Gross IRR	Gender of NDs over duration of investment	ND Impact level (high, medium or low)
<i>Realised investments</i>											
A	Closely held Regional	N/A	1		Yes✓	Yes	FW	N/A	IRR 18.26%	2 Females 3 Males (external)	High
B	Closely held Local, IFC & DEG	No	1	2	Bank Regulated	Yes	Yes	3/3	IRR 16.67%	2 Males (internal)	High
C	Closely held Local	✓Yes	2	2	Yes ✓✓✓	Yes	Yes	4/7	IRR 4.69%	2 Males (ex EBRD)	High
D	Pre-IPO closed Local	✓Yes	1 ND 1 Ob		Yes✓✓✓	Yes	No	4/4	IRR 4.5%	1 Male (internal)	High
E	Fragmented International	N/A	1	No	No*	No doc	Yes	N/A	IRR -47%	1 Female (external)	Low
F	Sovereign majority	No	1	2	No *	No doc	Yes	1/4	IRR 2.4%	1 Female (external)	Low
G	Closely held Local	No	1 observer	1/3	Yes*	Yes	No	0/10	IRR 4.05%	1 Male (observer, internal)	None
<i>Current Investments</i>											
H	Pre-IPO closed w/PE Fund International	✓Yes	3 holdco, group & subsidiary	Yes	Yes✓ Bank Regulated	Yes	Yes	3/3	IRR 206%	2 Males 1 Female (internal)	Medium
I	Closely Held w/PE Fund International	No	1	1	Bank Regulated	Yes	Yes	1/1		2 Females (ex EBRD)	Medium
J	Fragmented Regional	✓Yes	1	2	Yes but not shared	Yes	No	No		1 Male (external)	High
K	Closely Held Local/IFC/EBRD	No	1	3	Yes-IFCs	No	No	11/12	Floor price IRR 5%	4 Males (3 ex EBRD, 1 externa)	Medium
L	Closely Held, Local	No	1	1	Yes	Yes	Yes	4/4	FV +2 % above cost	1 Male (ex EBRD)	Medium
M	Closely Held, Int	No	1		No	No	No	No		1 Male (external)	Low
N	Pol closely held, Local Now CP (Listed)	✓Yes	1 observer holdco	No	No*	No	Yes observer	2/2		1 Female (internal)	None

Appendix 3: Survey results

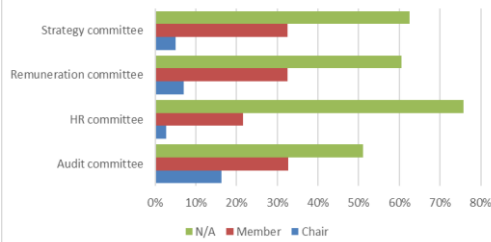
Responses to a selection of key questions from the survey are provided here. EvD sent the survey to all current and recent NDs, and staff managing them, with 95 responses (out of 186 recipients, or 51%). EvD thanks all those that took part, and made the findings possible.

Questions directed at nominee directors

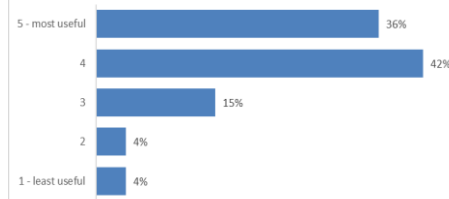
In your most recent EBRD ND role, how did you receive your objectives before you began? *Select all which apply.* (55 responses)



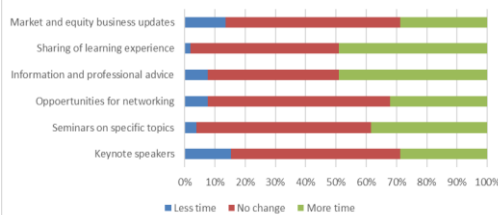
Did you chair or join any committees during your time as EBRD nominee director? (55 responses)



If you attended, how useful was the EBRD's nominee director training programme? *Rate on a scale of 1 (least useful) to 5 (most useful).* (53 responses)



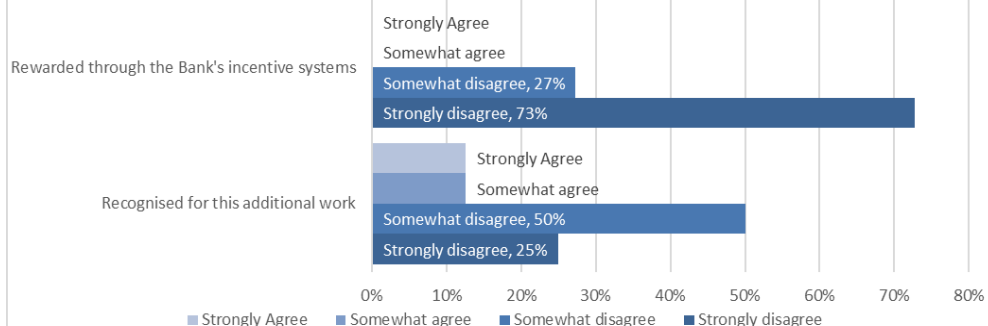
At the annual workshop, which elements would you like to see more or less of on the schedule? (53 responses)

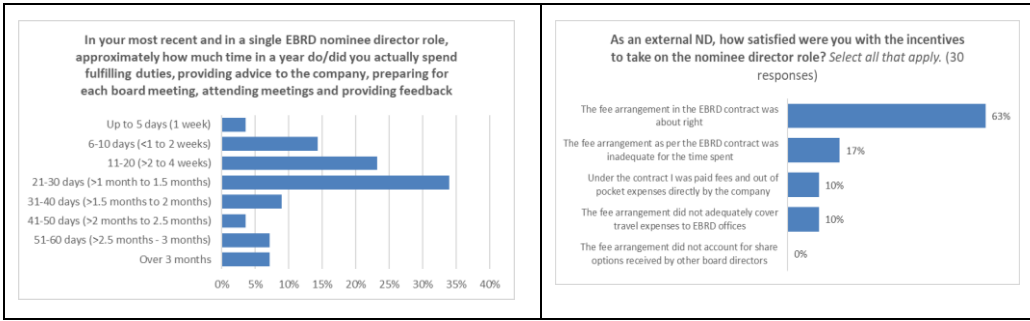


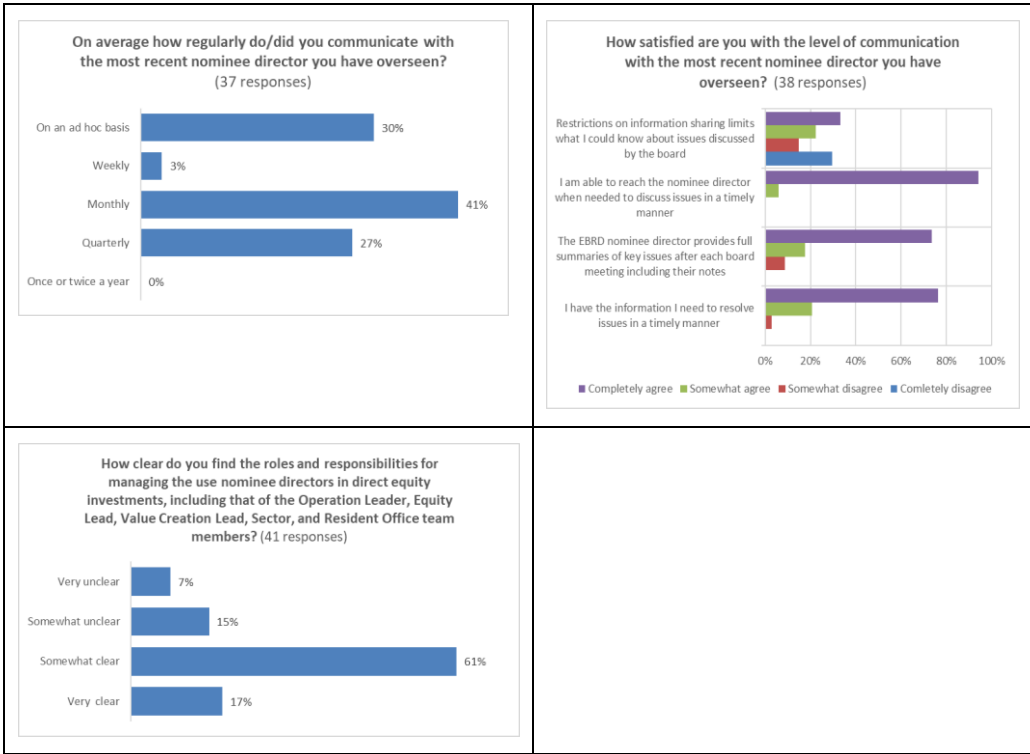
As an EBRD nominee director whilst being an internal member of staff at EBRD, what was your main motivation for taking on the nominee director role/s? *Select all that apply.* (26 responses)



As an internal ND do you feel rewarded for your efforts in performing the ND role? (26 responses)







Endnotes

ⁱ **General role and responsibility of board of directors:** Literature on corporate governance establishes that the board of directors of a company has a dual mandate of delivering *advisory and oversight* functions. They are a crucial part of risk management and checks and balances on the executive. The advisory side is to advise management on strategic and operational direction of the company, and the oversight to monitor company performance and ensure cost efficiency. Companies have either a single tier or two-tier board system, depending on the size of the company, the jurisdiction and the listing requirements. In the single tier system, the board includes both non-executive directors and executive directors. In the dual system, the management board includes executive directors responsible for day to day running of the business, and the supervisory board includes non-executives representing workers and shareholders (where EBRD NDs would sit), responsible for developing company policies and appointing key members of the executive such as the CEO.

According to the OECD Principles of Corporate Governance:

“The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board and the board’s accountability to the company and the shareholders.”

Board directors (executive and non-executive) should maintain independence by acting solely in the interest of the company, free from conflicts of interest and maintaining ability to challenge management. This independence is often set out in local regulations, and defined by board members individual profiles (such as their experience, relationship to management as so forth).

ⁱⁱ **Briefing and Objective Setting continued:** The survey reveals that the vast majority of NDs (83% of respondents) received their objectives when they met with the EBRD team prior to taking on the role.ⁱⁱ This suggests that they have had plenty of opportunities to ask questions and receive a verbal briefing. External NDs received specific ToR and a briefing pack. 50% knew the client prior to taking on the role, and had met with the client’s board before starting. A third (28%) were actually involved in the due diligence of the client company. This suggests that most NDs have multiple opportunities to become acquainted with the general expectations before they begin which is positive but should be seen as supplementary to the core briefing materials and specific objectives set out in VCPs and CGAPs.

Both from the survey results and EvD’s conversations with OLs it is clear that there is little formal adherence to the Rules and Procedures relating to Briefing and Objective Setting. To meeting these requirements in full, and to strengthen clarity, it might be useful to provide OLs with a checklist of items to put in the pack, covering each area, and particularly itemising the areas for ND engagement. The lack of formality leaves room for important information to fall through the cracks and a lack of ability to follow up. This should not include internal EBRD documents though. Some of the items to include are: CGAPs and VCPs (in full, although the Equity team suggested it only shares those items relevant to the ND); relevant sections of the SHA/SA or the whole document should be made available to the ND, previous board notes and transition objectives. Priority areas for ND contribution should be highlighted.

iii **The Duties and Guiding Principles** usually include: acting in the best interests of the company, maintaining familiarity with current industry developments, attending board meetings and provide notes, seeking legal advice for major decisions, monitoring, advising, proposing and encouraging action and sharing information as agreed and subject to local law. Since the introduction of the EBRD's 2016 Gender policy, raising gender awareness at investee companies has been a new addition to the duties and guiding principles.

In the general guidance note entitled Equity Specific Issues, goals include to:

- Foster good corporate governance;
- Enhance the protection of the Bank's investment;
- Be able to facilitate dialogue between various investors;
- Be able to influence the company's medium or long term strategy;
- Provide the company with useful technical guidance or fulfil a company deficiency.

Specific duties towards EBRD: The ToR for external nominee directors also contains a client specific section (Schedule A) which sets out background about the client and some additional duties towards the EBRD. These cover how the ND should liaise with the EBRD for example: reporting from board meetings with highlights of key issues; relevant information that may impact on the Bank's operations (where permitted); liaising with EBRD on issues requiring action to achieve targets and assisting the OL in developing strategic options and helping to obtain cooperation from company management.

iv **VCPs:** In looking at a sample of Value Creation Plans that were specifically set out and attached to the Shareholder or Subscription Agreement, EvD found that the person responsible for implementation was often the CEO or management/ member of the executive arm of the investee company. EvD did not see a case where the ND had any direct responsibility, in keeping with the ND's role as a non-executive. However, the ND will have an advisory/oversight role to play in strategy and policy development and approval, which is instrumental to the value creation plan. The ND, due to their specific knowledge, experience or skills may also play a role in business development.

v **CGAPs - Meeting investee needs:** CGAPs for investee companies are intended to address gaps and weaknesses discovered in the corporate governance review conducted by EBRD during due diligence and often include objectives to strengthen board composition, skill and process including ensuring independent membership, and providing voice for minority shareholders (including EBRD). They are the direct way in which projects are designed to meet investee needs. CGAPs for new projects are assembled after concept review by the Legal Transition Team. LTT conducts a Corporate Governance Review of the investee company via a screening tool, questionnaire, CG matrix and discussion of key issues at the project team's Legal Strategy Meeting. The Corporate Governance Review section 9.5 of the Operations Manual, Chapter 9 Appraisal does not specify how this takes place (the section is 'under discussion').

The Corporate Governance questionnaire is extensive and focuses on broad questions of governance including shareholder rights, the board of directors (or supervisory board, independent directors, corporate secretary for the board of directors, board committees (audit etc), executive committee, management, internal controls, internal audit, transparency and disclosure rules, strategy budget risk and KPIs, remuneration and group of companies. Separate questionnaires are tailored for companies with 1 tier, 2 tier and listed companies.

The resulting CGAP will often then be included in the subscription agreement/shareholders' agreement, with a pledge to conduct its business accordingly. The CGAP is included as a transition objective, which the operations team tracks in the annual transition impact monitoring reviews.

vi **CGAPs:** The implementation of the CGAPs may only involve the work of the client without EBRD assistance or it may involve extensive input from the EBRD nominee director. There is currently no indication of how much effort the EBRD has expended in implementing the CGAP, in some cases extensive. Improvements to the follow up and reporting on CGAP implementation could include a section on ND contribution, as reflected in ND written and verbal reporting to the OL.

vii **Board Notes continued:** The EBRD Board Nominee Report contains three sections: highlights of financial and business performance, key issues arising/key decisions taken, and Observations on Management and governance (if relevant). There is no requirement for NDs to repeat detailed information found in financial reporting sent by the company to the EBRD in the normal course of reporting, although this is not emphasised as there is no guidance in the template. The template was designed to highlight key recent developments and capture key pieces of information not found elsewhere. Guidance notes could be added to steer NDs so that reports remain focussed and brief. The template is currently silent on ND objectives and progress. It could ask NDs to highlight their own specific contributions where relevant. Some NDs already do this, but there is no consistency so it is impossible to draw full conclusions about ND performance with the current reports produced.

One ND commented that a lot of information discussed at investee board meetings was confidential and privileged regardless of whether it was public or private. This should be in the country legal briefing notes from OGC. The SHA or SA often has a provision for sharing of information discussed at board, and the ND needs to be aware of this. A typical SHA clause included under the section on 'Membership of the Board of Directors' is: "*Each of the Shareholders hereby acknowledges and agrees that members of the Board nominated by EBRD be free to share with EBRD all of the information received by such a member whilst in office*". It is important that the ND is crystal clear on information sharing rights and restrictions from the outset, and that this is kept under review where any changes take place during the investment period. This should prevent misunderstandings or confusion about what kind of information sharing can take place.

EvD noted cases of board reports sent by the ND via email, but which never made it to the file. Across the 14 case studies, EvD found some filed in the correct allocated Projectlink Folder for Nominee Documentation and some in the folder for Mandatory Client Reporting and Monitoring.

Some team members had difficulty in obtaining access to the Nominee Documentation folder to file them, which had prevented them saving things there. Filing procedures should be reviewed and access issues resolved.

The quality of ND board reports varies, as seen across the case studies. Some NDs took the time to write very detailed reports, in some cases too detailed, others concisely summarised key issues and their contributions, others were almost entirely silent. From conversations with NDs, it appears that some NDs rely on multiple forms of communication with OLs, from in person meetings, teleconferencing and emails. The survey of NDs showed that 50% of respondents considered board notes very important, and 30% somewhat useful.

viii **ND records and information systems**

ND database and candidate approvals workflow: EPMU currently coordinates the candidate approval process, which involves multiple sign offs and checks by OCCO. The candidate approval process is manual, and lacks an IT workflow platform to capture key data for reporting. EPMU manually enters candidate details into the ND database. In 2018 EPMU prepared a requirements document for development of an IT workflow system and enhanced ND database. This was set aside in the wake of Project Monarch.

Specific ND documentation related to appointment and resignation, including candidate approval forms (until COVID these were approved manually), annual declaration forms, resignation letters, and contracts are held by EPMU/OCCO.

ND objectives and reporting: Information on an ND's actual input to a project is in the domain of the OLs managing the projects.

- As discussed in 3.3 above (objective setting), EvD did not find any evidence of briefing packs other than the principles and guidance provided to external NDs as part of their contract. In 2019 EPMU issued guidance for OLs in an Aide Memoire for OLs Relating to NDs, containing specific information about the content of a briefing pack OLs should provide NDs with upon commencing their role. OLs EvD spoke to seemed generally unaware of this document. The survey revealed that ND initial briefings are often held orally in meetings (see Appendix 3).
- The OLs retain board notes submitted by the NDs, and these are generally filed in Plink, although EvD noted consistency in the filing location was mixed (the designated folder for ND documentation was often empty, and board notes saved elsewhere).
- There is no record of objectives, performance assessments or achievement of CGAPS and VCPs, making it difficult to review the individual ND's situation and contribution.

Candidate databases: The candidate databases are currently held by nominated individuals in Equity and FI and are not directly accessible to OLs undergoing searches for NDs. There is no direct link to the actual ND database held by EPMU, despite the data connections, resulting in opportunities lost for reporting and duplication of manually created database records.

^{ix} **Recruitment process:** OCCO recently handed over administration of the approvals process for new NDs to EPMU, to align better with OCCO's remit of compliance and conflicts of interest. OLs fill out a checklist which helps identify which projects require specific OCCO screening. EPMU runs the approvals and sign off process manually (External and Internal Candidate Approval Forms). There is no workflow data system, nor linkage to the candidate databases, suggesting inefficiencies and a lack of ability to slice data gathered for reporting or to connect with other data (such as project data or candidate CV repositories, ND assessments and annual declaration forms). These issues should be addressed by regular IT infrastructure development within the Bank.

^x Factors influencing the decision to select internal or external talent for EBRD ND roles

The type of investee company often determines whether an external or internal EBRD nominee would be more suitable for the board.

- If the company is closely held (early stage, with few shareholders, and a very specific purpose around acquisition, sale, venture capital) or the company explicitly requests an EBRD staff member with whom they already have a relationship of trust, and who was involved in the due diligence for the investment, a specific internal ND may be considered the best fit. Existing staff often tended to have a deep understanding of the background of the investment, and were in a strong position to see through implementation of objectives. The Rules and Procedures prevent Operation Team members from taking the ND position themselves, except if they are a closely held company with only a few shareholders holding the majority of shares. Many of the EBRD's equity investments share this feature, as they are often early stage companies or SMEs.
- If the company has a wide shareholder base with multiple minority shareholders, is listed, and specific sector experience or other niche skills are required, an externally recruited EBRD ND may be necessary. In some cases, whilst an EBRD staff member may be desirable as EBRD ND, no suitable candidates may be available at the time and an external person will have to be found.
- Former EBRD staff have the advantage of a deeper understanding of and experience the EBRD and its countries of operations. Many retirees have the time and flexibility to take on an EBRD ND role out of their own interest rather than just financial motivations, which works well since many of the roles in the COOs lack the level of compensation offered in more developed economies.
- Factors to consider when considering external talent have been as follows: i) many roles are not compensated on a par with roles in more developed countries; ii) in some cases external NDs can be at odds with the EBRD's agreed investment objectives, leading to little or no progress and the EBRD stepping them down.^x Some have argued that external hires can reduce potential conflicts of interest by being more independent. Flexibility in the approach has been important because each investee company has its own requirements and finding

the best fit is of greater importance than simply whether they are internal or external.

- *Changing ND appointments during the investment* - The case studies include many where multiple NDs with differing experience and skill sets were used over the life of the investment. OLs indicated that different types of NDs may be suitable at different stages. For early start up or family founder owned companies it may be important to have someone from the EBRD to build trust with the client, and work on corporate governance. At a later stage, once things are established, it might be more appropriate to have an individual with business development or specific industry experience. When the EBRD is looking to work with one or two other shareholders in a closely held company, or the project goes into special assets, an EBRD staff member may be required. After listing it is important to have an ND that is external. Changes to the ND are often a sign that the equity investment is being proactively managed by the EBRD to meet the needs of the investee company.

^{xi} **Candidate databases - suggestions for improvement**

Given that many candidates in the database are current or former EBRD NDs, data around their previous roles and performance could be linked for reference. This, like the administration and approvals process should be part of the regular IT infrastructure of the Bank, as part of regular bank business. Some suggestions for enhancing the processes around the databases include the following:

- The strategy or approach to finding candidates and requirements for establishing key ND objectives could be set out clearly in an equity operations manual (potential sources of candidates, establishment of shortlist etc)
- The responsibilities and process for sourcing and including new candidates in the database or removing them should be made transparent and be aligned with the EBRD's stated priorities with regard to the Bank's inclusion policy, sector and country strategies, 2016/17 Enhanced Equity Approach and the ND Rules and Procedures for hiring NDs.
- The equity group and FI could for example continue to nominate specific professionals to be responsible for the outreach, interviewing and approval of new candidates, but once approved, all data should be handed to EPMU for inclusion in the database.
- It would be better if candidate databases were centrally administered by EPMU to ensure that they are widely accessible, integrated as far as possible into the Bank's information systems, kept up to date and linked where possible to results from operations teams,. EPMU has recently taken over other administrative functions of the ND work from OCCO, this centralisation of administrative responsibility would ease migration to future new systems and enable better data management.
- EPMU should be equipped with adequate IT systems to house an accessible ND database.

^{xii} **Hiring experience of PE firms**

The experience of some private sector PE firms and venture capitalists in hiring nominee directors is of value when considering the best approach due to their niche expertise in handling direct equity investments and strong performance. Those that EBRD spoke with typically invested for a minority shareholding, similar to EBRD. They have a strong tendency to use internal staff, specifically the deal originator (or OL equivalent) as they consider the relationship with the client absolutely central to the equity investment. The deal leader generally already has a strong relationship with the client, went through the due diligence process with them, and best understands the needs. The deal leader was therefore in a unique position to drive the strategy and implementation, to advise the company on business development and corporate governance. At one highly successful PE firm which pursues minority shareholdings up to £40m, the deal originator sits on the board as the nominee director because they know the company well and understand the relationship best.

Another Private equity firm, which also takes minority shareholdings (up to £100m), much preferred to use people they have worked with in the past or knew, as this is most efficient and minimises risks associated with hiring individuals with whom they would need to go through a learning curve. However they did recognise that the person who does the due diligence might not be the best person to sit on the board. For this reason they have built up a network of candidates with successful track records that they work with, including CEOs or directors.^{xii}

Another former member of the Operating Committee and former Communications Director at a firm which invests in private equity and infrastructure assets for a majority (proprietary) shareholding, told EvD they tried various models, but mostly use staff, and have a preference for using people with a track record of success – they will reuse them if they do well. They discovered that the deal leader wasn't always the best board member, so would look to other staff with relevant skills, sectoral or geographic knowledge. The firm also manages relationships with global search firms which provide chairs for boards, CEOs, CFOs, and non-executive directors. By negotiating with a preferred supplier they ensured better rates. The firm has developed its own 'Business Leader Network' to draw on for board NED and chair positions and to add value to investee companies. These industry leaders work with 3i from origination, due diligence and value creation through to board seats.

From this it is clear that whilst internally selected nominee directors are heavily favoured by PE firms, they augment this by developing a network of potential board candidates or business leaders who can assist with value creation.

The most highly successful EBRD projects amongst the 14 case studies for this study had internal staff as EBRD NDs. This speaks to the importance of the close relationship, and aligned goals for success. The decision to have an internal or external ND was very much a product of the perceived needs of the investee company board as defined during due diligence, the relevant local experience and financial and sector know-how of EBRD banking staff, their relationship with the client, and their availability. Where staff were not available, or specific industry expertise was needed, an external candidate was often chosen.

^{xiii} **Incentives** - In comments, one external ND said the fee arrangement was unfair because other board directors were receiving share options. Another said the EBRD ND role did not pay the market rate they received on other non-EBRD roles. One indicated that working for a major investment bank as an ND they received a flat monthly fee payable quarterly and had travel arranged by the bank. At the EBRD consultants arrange their own travel and claim expenses by submitting invoices which some external NDs find extremely bureaucratic. One also said their fee had not changed in seven years of being an EBRD ND, which did not reflect their level of experience growing over time.

^{xiv} **Example 4 – ICT project**

In a highly successful ICT project, EBRD invested in an internet service provider in Eastern Europe, for expansion, acquisition and infrastructure. Much time was spent by the OL and externally chosen EBRD ND to help the company implement the terms of the Shareholders' Agreement on corporate governance issues and to provide strategic advice for value creation. Building a strong relationship with the client and trust, through site visits and active participation was a strong feature of the project.

Example 5 – M&S project

In one current project with a manufacturer in Russia, EBRD invested in equity for growth and competitiveness with both VCP and CGAP set out. The former EBRD ND, a former EBRD staff member, was a substantial influence on renewal of the company's strategy, and appointment of external advisors to develop it. The ND remarked on the challenges of being an ND for a family owned company, and the importance of having the support of the owner/founder for introducing changes. Sometimes views on the way forward would diverge for example on whether or how the company should expand internationally and at what rate.