Rethinking the role of National Development Banks

Third Regional Consultation on

"Rethinking the Role of National Development Banks in Africa"

Johannesburg, South Africa, 22-23 November 2006

Draft Report [1]

[1] This draft report was prepared by the staff of the Financing for Development Office for comments by participants and is not intended for quotation. Comments should be sent to Julien Serre at <serre@un.org>

Overview

1. The third Multi-stakeholder Consultation on “Rethinking the Role of National Development Banks in Africa” took place in the Industrial Development Corporation (IDC) premises and was organized by the Financing for Development Office of UN-DESA, in collaboration with the IDC, the Development Bank of South Africa (DBS

acknowledged the presence at this meeting, in addition to national DFIs, of International Financial Institutions (IFIs), Regional Development Banks (RDBs), the United Nations, academia, civil society and the private sector. She hoped this would contribute to moving forward on the theme addressed by these consultations, including with a view to contributing to the achievement of the Millennium Development Goals (MDGs). She mentioned a collective responsibility within developing countries to mobilize resources for development, before concluding on an optimistic note, citing a poem often attributed to President Mandela.

Session 1: The Evolving Role of NDBs

5. The session was chaired by Mr. Lumkile Mondi, Chief Economist at the IDC. He highlighted the relevance of the meeting and noted it comes in South Africa at a time of scrutiny regarding the role and activities of DFIs, their impact on competition and in particular their cost of lending. He then introduced the three panelists, Mr. Victor Nembelessini- Silue, Chairman of AADFI and CEO of Banque Nationale d'Investissement in Ivory Coast; Mr. Alex Trepelkov, Deputy Director of the Financing for Development Office at DESA; and Mr. Admassu Tadesse, Vice President of DBSA. The session provided an introduction to some key and cross-cutting issues, in particular regarding the notion and range of market failures, and the role played by NDBs/DFIs to be addressed.

Presentations

6. **The range of National Development Institutions** was the focus of a presentation by Mr. Victor Nembelessini-Silue. DFIs on the African continent, he indicated, achieved limited results and many institutions went bankrupt in the 1980s. Yet they can fill market failures, and restructured banks should be supported, he said. He presented the results of a new census of AADFI members, done with the support of FIRST Initiative and AfDB. Three types of DFIs were identified: (1) Standard DFIs often funded with the support of donors, (2) Government institutions, like the Japanese Bank for International Cooperation and (3) Commercial banks that often provide term finance with separate agencies providing advisory services. AADFI members are equally divided in these three groups. It appeared that (1) 85% of these institutions were government-owned and (2) many were not regulated by the Central Bank, or regulated as non-banks. It also appeared that privately-owned banks did significantly better than public entities. Private DFIs also focused on profitability objectives, rather than economic, social or political goals. In the long run, private banks produced clear benefits, as illustrated by the lower demand in official funding and bailout support, as compared to public entities. The study also shown that DFIs had various auditing practices, equally divided between government, international and local auditing. The study, analyzing AfDB's lines of credit, also found that 25 institutions in Africa benefited from these but only four of them were National DFIs: this meant that an additional effort was required to better tap on these resources, in particular by improving prudential regulation and building on best practices. Mr. Nembelessini-Silue then illustrated these points and cases of cooperation with a number of examples, including from Ivory Coast, Tunisia, Ghana and Nigeria.

7. Mr. Alex Trepelkov then described the **Multi-stakeholder consultations acvcing AT50TD0bed the**

Development Banks”. In follow-up, a series of “multi-stakeholder consultations” was launched

10. A representative from the National Treasury of South Africa raised a number of important questions to be addressed throughout the two-day meeting. First, how can one reconcile NDBs' focus on development with financial sustainability? The need for support by multilateral organizations and donors was highlighted by several panelists in that regard. Second, how can competing policy objectives be reconciled? Should the prioritization of policies be conducted by the government? Third, who should be part of the Boards in DFIs? Shouldn't there always be some government representatives to foster coherence at policy level with the government

that the bank aims to prioritize regional projects, in order to contribute to the economic and social development of its member countries.

15. Dr. Dan Ndlela from Zimconsult described

importance of DFIs, when working in cooperation with MDBs, in particular for projects in transports. Some noted that both national and regional DFIs such as ECOWAS Bank needed to engage more in PPPs. It was noted that specific problems remained in areas such as water, sanitation and energy concessions, where partnerships were harder to design, and political and social issues on tariff issues needed special attention. To some participants, those problems precisely justified PPPs, as the private sector was unwilling to go alone on initiatives it felt were unaffordable. They agreed that, at the end, the aim was probably to attract the private sector into development projects and on a sustainable basis.

18. Participants discussed the need for bigger involvement of NDBs in inter-regional trade and investment, in addition to infrastructure projects, and insisted on the priority of infrastructure financing. In this view, the Chair noted the worrying trend of declining resources to fund infrastructure and the need to reverse it to achieve more growth in Sub-Saharan Africa. The representative from Ecowas Bank noted that the focus on infrastructure was a response to the need to create the adequate conditions for development in Africa, as illustrated for instance by projects in transports between Toho and Ghana.

19. Coming back on regional trade, Mr. Viljoen noted that if African countries made most of their trade overseas, half of their imports for food also came from overseas. Such imbalances needed to be addressed and in this regard, NEPAD was to play in the coming years a crucial role. NEPAD was now working on a long term framework, which transcended regional barriers. NDBs can provide much needed support in this view – such as DBSA, which had created its own NEPAD unit, working on fostering inter-regional trade, with private sector led initiatives such as the Eastern African oil pipeline project. Some participants called for greater cooperation between NEPAD and DFIs to complement often scarce resources.

Session 3: Sustainable Development

20. The session was chaired by Dr. Owusu Tweneboah of the M.D. National Investment Bank of Ghana. He introduced Ms. Moufida Jaballah Srarfi, Director of International Cooperation in Tunisia, Vincent Mhlanga, CEO of Fincorp and Dr. Simon Roberts, Head Economist at the Competition Commission in South Africa.

Presentations

21. The **Tunisian Experience in financing agricultural development** was described by Ms. Moufida Jaballah Srarfi. She first summarized the financing of the Tunisian economy. She then presented the weigh of agriculture in the economy, and the government strategy for this sector, insisting on the multidimensional nature of interventions. Noting that private investment in agriculture was done mainly through equity and less so through bank credits and subventions, she insisted on the need to develop credit and presented Tunisian initiatives in that regard. She described the main bank in Tunisia focusing on this mission, the Banque Nationale Agricole (BNA). But adding that many farmers could not bring the necessary guaranties, she presented a recent creation, the Banque tunisienne de solidarité (BTS), which has been offerince since 1997 agriculture financing, without requiring guaranties. Another mechanism to bring credit to farmers without guaranty is microcredit, promoted by the government since 1999. Ms. Jaballah Srarfi finally described government-funded agricultural development funds, and various insurance mechanisms.

22. Dr. Vincent Mhlanga, reminded the participants of the **Role of NDBs**. NDBs are generally defined as financial institutions primarily concerned with provision of long-term capital finance to projects generating positive externalities,

whether this involvement was important enough in agriculture. It was answered that, at least in the Tunisian case, there was no dichotomy between public and private interests in agricultural development, as common constraints needed to be addressed. It was also said that the private sector was becoming a crucial partner of DFIs in a context where basic infrastructure was a priority, due to the major investments involved. The need to enhance NDBs' catalytic role in getting markets to work for development was highlighted in that regard.

26. The importance of Board independence was also frequently mentioned. It was described as a priority for DFI redesign and successful reforms in Africa. The cases of DBSA and IDC, where the overwhelming majority of Board members are independent from the government, were underlined. Some suggested that Boards of DFIs should be accountable to some extent of the impact of their institutions on job creation, a key element for development. Some participants also noted the link with the need for professional, qualified, staff that stays independently of government changes.

Session 4: Financing Sustainability

27. Session 4 was chaired by Mr. Antonio Carraro, Director of Associação de Bancos de Desenvolvimento (ABDE) in Brazil. He introduced Mr. Jose Garson, from BRED Bank; Mr. Lawal Kankia Ibrahim from FNIM, FIMC and Institute of Directors; Mr. Shehu Yahaya from the African Development Bank.

Presentations

28. Jose Garson presented a **Case Study on Guarantee Systems** in Africa. He focused on how to design efficient guarantee systems (GS), which he divided into two distinct objects: traditional guarantee funds, and Mutual Guarantee Associations (MGA). MGAs are a 'self-managed club' whose members pay a fee to participate and control decision-making processes: this translates in a self-blocking mechanism to avert risky and costly guarantee policies, while ensuring more transparency at the same time. He then listed some key parameters to set up a proper GS, and insisted on the need for GSs to build credibility. Mr. Garson also listed important elements of management for GSs, and finally looked at ways to set up or rehabilitate GSs. He listed in particular existing regional GSs such as the African Solidarity Fund (ASF), sub-regional GSs such as GARI and FAGACE, and successful national GSs like FODEX. Setting up new MGAs in Africa requires cooperation between various actors, as illustrated by current efforts from certain governments (Turkey, Spain), donors (like in the Philippines), members themselves (France, Germany) and banks (in West Africa and Cameroon for instance).

29. The **Nigerian Experience** was described by Mr. Lawal Kankia Ibrahim. He suggested ensuring collaboration with foreign technical partners to develop local technology, with regards to the fabrication of local plants and machinery, so that costs for establishing projects are substantially reduced. DFIs ought to be active players in capital markets and not just in buying and holding shares. Mr. Lawal Kankia Ibrahim concluded that, in the context of deregulation policies, many Nigerian DFIs need to undergo a far-reaching restructuring program. The elements of such a program should include transfer of responsibility for prudential rules and supervision to the Central Bank of Nigeria, the rationalization of the number of DFIs (already being done) to avoid duplication of functions, the liquidation of terminally distressed institutions and the recapitalization and restructuring to resolve the problem of bad loans. To ensure survival,

he said, management must reduce overhead costs, upgrade project appraisal and supervision skills and diversify funding sources to include deposit taking and capital market operations. He closed his presentation by saying that Nigeria, like any other developing country, needs vibrant and responsive DFIs for its economic growth and development and thus, development partners ought to support DFIs in performing their roles effectively.

30. Mr. Shehu Yahaya discussed the issue of **Balancing Service Delivery and Sustainability** for DFIs. First, he described the AfDB approach to national DFIs, both in terms of objectives and instruments. AfDB objectives for supporting DFIs includes: 1) increasing supply of medium and long term capital 2) facilitating financial intermediation 3) supporting SMEs 4) supporting small scale infrastructure 5) increasing supply of rural credit and 6) supporting low revenue housing. Instruments described include lines of credit, technical assistance, equity holdings and guarantees. Mr. Yahaya then focused on the effectiveness of NDBs/DFIs: an ongoing study in Africa by AfDB tends to conclude that 1) traditional DFIs are weak on financial sustainability and weak-medium on service delivery 2) public sector commercial banks are medium on financial sustainability and weak-medium on service delivery and 3) private sector banks are strong on financial sustainability and medium on service delivery. Finally, he described AfDB's strategic options for partnership with DFIs. They included a review of equity investment, increased use of guarantees, cofinancing of DFI-led operations, development of market risk management products and liquidity risk management products. He insisted DFIs needed to not only survive but also strengthen their capacity for both service delivery and financial viability. AfDB is strengthening its capacity to support them to achieve their transformations.

Discussion

31. Regarding the issue of guarantees, some participants asked for explanations on the importance of credibility for guarantee systems. It was answered that they need to be credible for banks to accept using them, which might require to separate them from ministries and to establish them as separate entities. Some participants noted that guarantees are a good illustration of the broad issues of financing for development that go beyond the notion of NDBs: it might be that the analysis would gain in focusing on development finance functions (which would include commercial bank activities) rather than development finance institutions. Others noted that guarantee funds can work for development without necessarily being profitable.

32. The role of certain MDBs such as AfDB was discussed, as they tend to use the hard window for loans to Sub-saharan DFIs for public-private partnerships, in particular for Spatial Development Initiatives. Despite efforts with guarantees, many projects similar to the Maputo Development Corridor can only benefit from a hard window. Nevertheless, it was reminded that AfDB's hard window accounts for only a quarter of its operations, and that most of its lending in Africa was going to recipients as grants.

33. Internationally agreed development objectives, such as the MDGs, were put forward as important elements in the decision-making process of DFIs. The role of MDBs was highlighted in this regard, as they can foster these objectives in their interaction with DFIs. According to some MDB participants, DFIs nevertheless remain essentially oriented toward a financial mission, so they can only tackle MDGs in specific, finance-related areas.

34. Privatization continued to generate discussion. It was repeated that NDBs/DFIs can be both financially sustainable and effective in promoting development. For some participants, between full privatization and public ownership, there was an opportunity today to foster private stakeholders in the capital of DFIs, which should be researched in future consultations. Some noted that full privatization was incompatible with development objectives of4749 DFIsltatia63ld

38. Mr. Paul Malherbe analyzed the issue of **Promoting and Supporting SME Development**, with the case of Kenya & Madagascar. He described BPI, then the case for SME promotion in South Africa. He described various factors that impede SME growth, before focusing on the Malagasy and Kenyan models, two joint initiatives with IFC. These projects focused on access to finance, access to information, access to skills and training (building human capacity) and building an environment conducive to business. He then insisted on the value of the lessons learnt by BPI, in particular in setting up structures and raising funds, understanding the environment (regulatory an investment requirements), and in fostering an entrepreneurial mindset regarding private equity.

Discussion

39. SMEs and the role of DFIs were discussed, focusing first on a recent study by FinMark Trust on small business in South Africa. It showed the complexity of SME segmentation. Multiple interventions are needed, and require segmenting the market in a new way to allow government and the financial sector to target their small business strategies more effectively. A large level of sophistication in the classification of SMEs is particularly important and was detailed in this new study. The importance of the business environment was again recalled, in particular the importance of doing business easily: ongoing projects in Madagascar and Kenya, involving governments and the IFC and the EIB, were cited.

40. The difficulties faced by the rural poor were highlighted again, in particular with the case of Tanzania where problems of rural development and associated difficulties in the respect of property rights was a significant challenge. It was said that microfinance institutions can target and support services to help small farmers and foster linkages with the markets.

41. The case of BPI was discussed as an example of successful initiatives involving international institutions like the IFC. In particular, some participants described the usefulness of equity participation to facilitate SME development in Sub-Saharan Africa. It was ansr

emerging global players (South-South approach); 3) help expand the sustainability agenda; 4) address constraints to private sector growth in infrastructure, health and education; and 5) continue to emphasize local financial market development. He then looked at IFC's role in resource mobilization and capital markets, with B loans, local currency loans, securitization and guarantees, which he described in detail. Mr. Ngassa-Batonga indicated that IFC's strategy for financial market development was to continue to develop existing products (B loans, local currency, structured finance), work on direct development of capital markets (for instance the Nigerian bond market), and maintain strong collaboration with other financial institutions, including DFIs.

44. Mr. Peter Mageza presented the **Role of NDBs to Crowd in the Private Sector**. He first described ABSA, one of South Africa's largest financial services groups. He then focused on the new partnership between ABSA and IDC. The objective of ABSA in that regard is to manage and share risks, through remarketing and buy-back agreements. ABSA and IDC established a Finance Scheme, targeted at the South African transport sector, to promote black economic empowerment (BEE), through the provision of asset finance and working capital. The Finance Scheme allows ABSA to provide funding to the target market with a Transport Contract, and IDC provides a 50% pari passu guarantee on losses incurred by ABSA.

45. **EIB's Support to Development Banks in Africa** was the focus of a presentation by Ms. Lena Eriksson-Ashuvud. EIB activities in Africa started in 1963 under the Yaoundé convention, in particular with operations focusing on funding SMEs through financial intermediaries, including NDBs and RDBs. In the 1970s, NDBs were seen as an effective response to financial market imperfections. EIB support aimed at two market imperfections: access to finance of SMEs and provision of long term financial instruments. However, weak performance in the 1980s entailed a retreat by EIB from lending to NDBs. NDBs accounted for less than €30M of EIB lending to financial institutions in Sub-Saharan Africa over 2000-2006, compared to more than €300M over 1976-1990 and €80M over 1991-1999. EIB's strategy now focuses on RDBs and commercial banks. Yet market imperfections are still present, which NDBs might help to overcome. Thus, EIB is still open to considering support to the establishment of NDBs in a number of African countries. This ought to be case specific interventions. Setting priorities and clear and realistic definition of tasks is also important. Technical assistance is useful but is no panacea. Also important are governance and an institutional framework – in particular a commitment to proper institutions and governance is essential. In conclusion, Ms. Eriksson-Ashuvud said that the European Investment Bank will continue to support partners in development that are best equipped to be effective in this work.

Discussion

46. The chair insisted that sound rules and good governance were essential for DFIs to succeed and receive funds from MDBs. The role of ODA, MDBs and capital markets were three issues also high on the agenda of DFI reforms and redesign.

47. The collaboration of MDBs and their role in resource mobilization was discussed. As noted by AfDB's representative, there are still many weaknesses in quite a few NDBs. However, he noted, some MDBs actually contributed to such flaws, for instance through inappropriate provision of lending in foreign currency. Today, the financial sector in Africa is changing and there is room for collaboration between institutions like the EIB and AfDB for this region. They

the private sector to dilute Government influence. Ms. Thomas then described the Development Finance Resource Center (DFRC) and its role to build capacity among DFIs, insisting on the role of networks in that regard. She highlighted the critical need to solve institutional weaknesses of DFIs and to enhance skills.

52. **A Case Study of the IDC** was presented by Mr. Geoffrey Qhena. He described the IDC strategy and how it successfully adapted to a changing environment since the 1990s. The role of DFIs in a market economy, he said, ought to be to address market failures, as well as to provide additionality and encourage investments. IDC’s raison d’être and success, in particular, depend on its ability to identify, and successfully address, new gaps in the market, before its current field of operations is ultimately taken over by private financial institutions. He explained how the IDC proceeded to assess new areas for development, according to guideline questions: is it within the Corporation’s mandate? Is there a market gap? Is there a viable market? Are IDC’s competitive advantages applicable? And, most important, is it aligned with IDC’s corporate objectives and strategy? In his concluding remarks, he highlighted that DFI roles are critical for supporting accelerated, balanced and sustainable economic development. Furthermore, he insisted on the fact that national priorities, the competitive environment and client needs change over time and DFIs thus need to continuously adapt. If DFIs want to avoid being “victims of their success”, Mr. Qhena added, they need to stay in the forefront and regularly review strategies and re-position themselves.

53. Mr. Clive Kellow focused his presentation on **Innovation and Financing for Entrepreneurship Development**, through the example of his bank’s investment in ProCredit Bank, seven Microfinance Banks in Albania, Bulgaria, Bosnia-Herzegovina, Romania, Serbia and Montenegro, Kosovo, and Georgia. They all have a similar shareholder structure, of public private partnership, aimed at the commercialization of development aid in the financial sector. They share the same basic business-policy orientation. They have all received start-up support in the form of international experts and training to promote institution-building, but no subsidies. They use the same credit approach. ProCredit Group views itself as a global leader in lending to households and enterprises that previously had very little chance to become clients of mainstream banks. The target group for the banks’ range of financial services consists of micro and small enterprises and private households. Shareholders measure the success and significance Thafor052 Tw

55. It was suggested repeatedly to foster linkages and collaboration. There was agreement on the need to enhance DFIs' capacity to deliver for development by making better use of their resource and of stakeholder networks, as described in one of the presentation. Some also called for the

fact that "finance flows where corporate governance grows", he provided a number of illustrations before analyzing the particular case of State-owned enterprises (SOEs). Heavy superintending structure, moral hazard, regulatory forbearance and free riding contributed to the dispersion of responsibilities in DFIs. In this regard, he insisted on the need for reform of the interfaces between ministries, of superintending and auditing structures, financing agencies, and the need to improve the appointment of directors, board structures, processes and practices, managerial tasks in control, risk and compliance. He called for building a roadmap on reform to implement corporate governance, both at the policy level and at the firm level.

Discussion

61. The issue of politization of DFIs was mentioned by several participants in this last session. African economies were described as driven by firms and the policy environment, but also often by vested interests, in particular in State-owned enterprises. That is why there was a need to reduce the 'governance premium' in Africa compared to Asia or Latin America.

62. Some participants noted that corporate governance was not a theory but dealt with clear elements such as Board independence, audit committees, etc., based on previously mentioned principles that include transparency and accountability. The win-win situation created by corporate governance was highlighted, because it allowed, once in place, to protect the main stakeholders, the Chairman of the Board himself and the CEO.

63. Questions were raised regarding the South African case and its approach to decision-making. It was answered that, although the prioritization of development projects was not always clear, there was a focus on macro-economic stability but less so on abiding by rules of the so-called Washington consensus. South Africa focused instead on binding constraints, with a result-oriented strategy. Overall, this allowed for a good balance between macroeconomic stability and development objectives

Wrap-up session