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Session 7: Enhancing NDBs Delivery for Development

Topic: “Developing the DFIs’ capacity to deliver (with discussion on DFI Cooperation “

Dr. Ros Thomas – CEO: SADC-DFRC

*Rethinking the Role of National Development
Banks in Africa: IDC, Sandton
22-23 November 2006*

Topics to be covered:

- ⊕ The SADC Development Finance System
 - ⊞ DFS 1998
- ⊕ Failure of development finance to yield results
 - ⊞ Institutional & Capacity weaknesses in national DFIs
- ⊕ But DFIs continue to be critical actors in SADC
- ⊕ The DFRC's mandate
- ⊕ DFI Network & Cooperation
- ⊕ Developing the capacity to appraise & manage projects

The SADC Development Finance System?

- ✦ 1998 Development Finance Study (DFS 98)
 - ❑ DFI Network (May 2000)
 - ❑ SADC-DFRC (July 2003)
 - ❑ PPDF (still under construction)
- ✦ Study informed by history of past failures as detailed also in 1993 AfDB “SEISA”

Failure of development finance...

⊕ African DFIs in Distress?

- ❏ 1990s - development finance & role of DFIs underwent fundamental re-examination
- ❏ Governance issues prominent
 - General picture for African DFIs - reflected issues relating to governance
 - Political interference resulting in credit diversion
 - Resource allocation on basis of fiat rather than market signals
- ❏ Institutional & Capacity Weaknesses
 - Erosion of financial discipline
 - Poor selection of projects - appraisal skills wanting?
 - Inadequate risk management

Failure of development finance...

⊕ African DFIs in Distress...

❖ Financial & Lending Strategies?

- Subsidies on cost of funds on-lent & non-performing assets
- Resource misallocation through directed credit,
- NO sectoral diversification = Risk concentration
- Failed to allocate credit productively
- Scarce forex lent to SOEs with poor operational and financial performance
- Over-exposure to cyclical & default risk because of excessive exposure to large enterprises/ projects financed

⊕ Result?

- ❖ DFIs - aggravated weakness of local banking & financial systems
- ❖ DFI lending – viewed as leading to negative growth & income distribution in Africa
- ❖ Crowding out activities - lending to parastatals & TNC subsidiaries
- ❖ Contaminated portfolios
- ❖ Most DFIs became insolvent

But: DFIs still critical actors in SADC...

⊕ Despite problems (DFS '98 found): -

❖ DFIs & development finance will remain part of financial landscape in SADC because:

- Despite reforms, Financial Systems remain underdeveloped
- Private finance reluctant to bear risk of difficult country environments
- In absence of capital markets, liberalization programs failed to emphasize continued importance of DFIs
- DFIs especially important in sectors like agriculture; SMEs and housing
- They CAN be strengthened to meet challenges
- But this requires partnerships with stronger DFIs and MDBs/IFIs

❖ Network concept therefore adopted

❖ DFRC key to success of this strategy

⊕ H/ever prevailing view amongst IFIs - need for development finance sign of temporary imperfections in market – do not suggest need for DFI

❖ But they have no other credible solution as alternative ...

DFS'98 proposes a solution which is credible (...provided?)

⊕ **DFIs in SADC can close the gap in e.g. long-term lending...**

- ❖ Have skills base to appraise projects;
- ❖ Structure complex risk sharing contracts;
- ❖ Provide badly needed intermediation between investors/ promoters & banks, capital markets & institutional investors;
- ❖ In respect of infrastructure, are able to engage Govts on policy constraints & mediate between Public and Private partners on PPI
- ❖ Can handle/ mitigate risks associated with medium –to long-term finance
- ❖ Can close the gap for SMEs and small infrastructure financing that large DFIs and Private banks won't touch
- ❖ Can play a role in developing deal pipeline
- ❖ BUT: Require access to long-term finance (in local currencies)

DFIs in SADC...

✚ However -

- ❏ Some DFIs still dealing with adverse macroeconomic conditions:
- ❏ Have not as yet corrected inadequate structures
- ❏ Remain too dependent on financing from MDBs/RDBs and/or National Governments
- ❏ Lack insufficient institutional capacity & shortage of appropriate Human Resources
- ❏ Still struggling to achieve commercial and financial viability
- ❏ Operating at very low (unsustainable) levels

✚ Either wholly/ majority state owned

- ❏ In Countries with low credit rating & severe fiscal constraints, public ownership hampers financing of institutions
- ❏ Access to lines of credit restricted
- ❏ Cannot rely on fiscal transfers for re-capitalization or loan funding
- ❏ Notably, ownership in some being broadened through privatization

Action to Improve performance of DFIs?

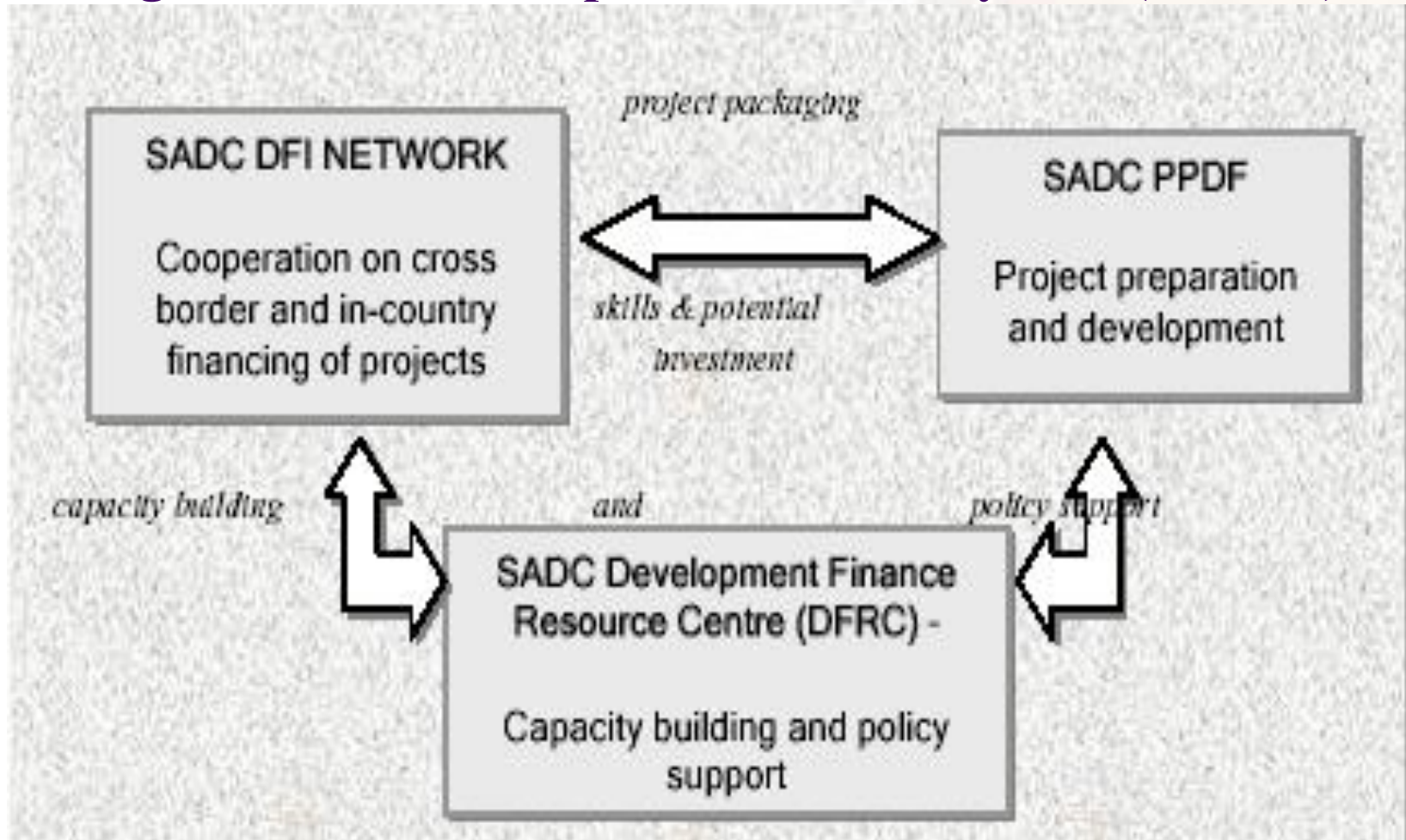
✦ At policy level...

- ❑ SADC Governments changing ownership structures & strengthening laws & regulations
- ❑ Changing Board representation to capture variety of skills & experiences
- ❑ Inviting equity participation from private sector to dilute Government influence
- ❑ DFRC mandated to support this process

DFRC's Mandate in respect of DFIs

- ⊕ DFS '98 – Member States agreed on need for DFRC – established to serve all DFIs capacity building needs
- ⊕ Tasked to facilitate the following:
 - ❑ Assist DFIs to deal with non-performing assets;
 - ❑ Support DFIs efforts to increase financial autonomy & independence;
 - ❑ Encourage cross-border strategic alliances & operational partnerships for the efficient & optimal use of development finance;
 - ❑ Help corporatize and privatize financially sound DFIs; &
 - ❑ Encourage cross-shareholdings in each other
 - ❑ Capacity Development
 - ❑ Catalyse DFIs activities to facilitate greater cross-border collaboration
- ⊕ Responsibilities captured in SADC-FIP (Annex 9)

Workings of SADC Development Finance System (DFS'98)



The DFS of SADC – Network's Role?

❁ DFI Network a virtual reality

- ❁ Secretariat - DFRC

❁ Aim of Network?

- ❁ Collaborate on cross-border & in-country financing of projects in SADC
- ❁ Pool resources to mobilize intra- & extra-regional funds for development projects
- ❁ Share experiences
- ❁ Where viable take equity in each other's institutions
- ❁ Invest jointly in new structures where necessary
- ❁ Collaborate on appropriate institutional mechanisms to facilitate cooperation and development finance in SADC

❁ Relationship captured in SADC-FIP (Annex 9)

DFI Network's Role in SADC...

⊕ Other areas of DFI cooperation?

- ❑ Capacity building including TA and exchange of personnel
- ❑ Information technology, Policy research & analysis & technical cooperation
- ❑ To strengthen & build creditworthiness of Members
- ❑ Develop common best practice approaches to risk management
- ❑ Obtain credit ratings

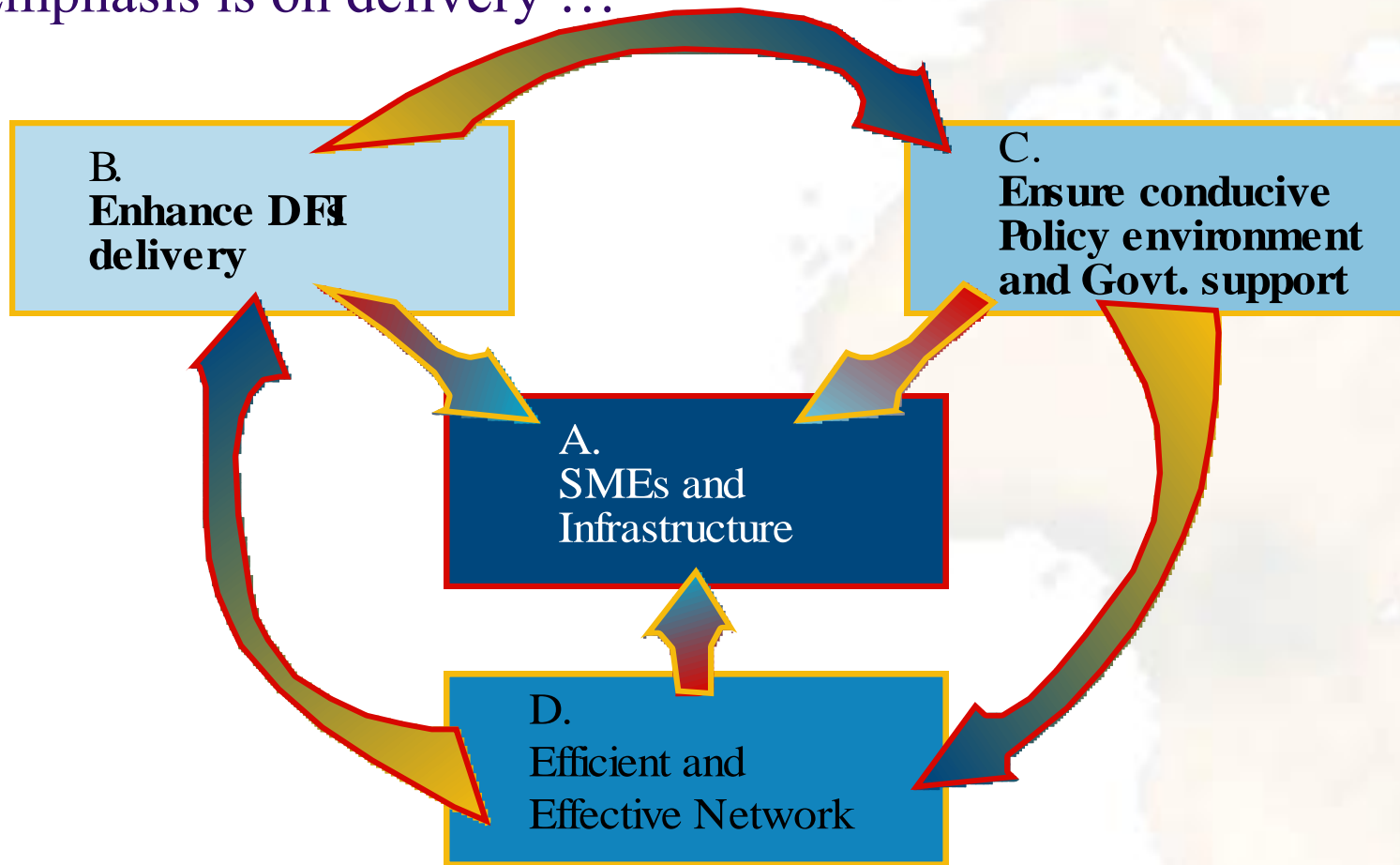
⊕ Through DFRC, support to SADC Governments on policy advise & financial sector strengthening and reform & support for capital markets development & deepening

Action taken to Improve Performance of DFIs?

🌟 Critical institutional weaknesses highlighted...

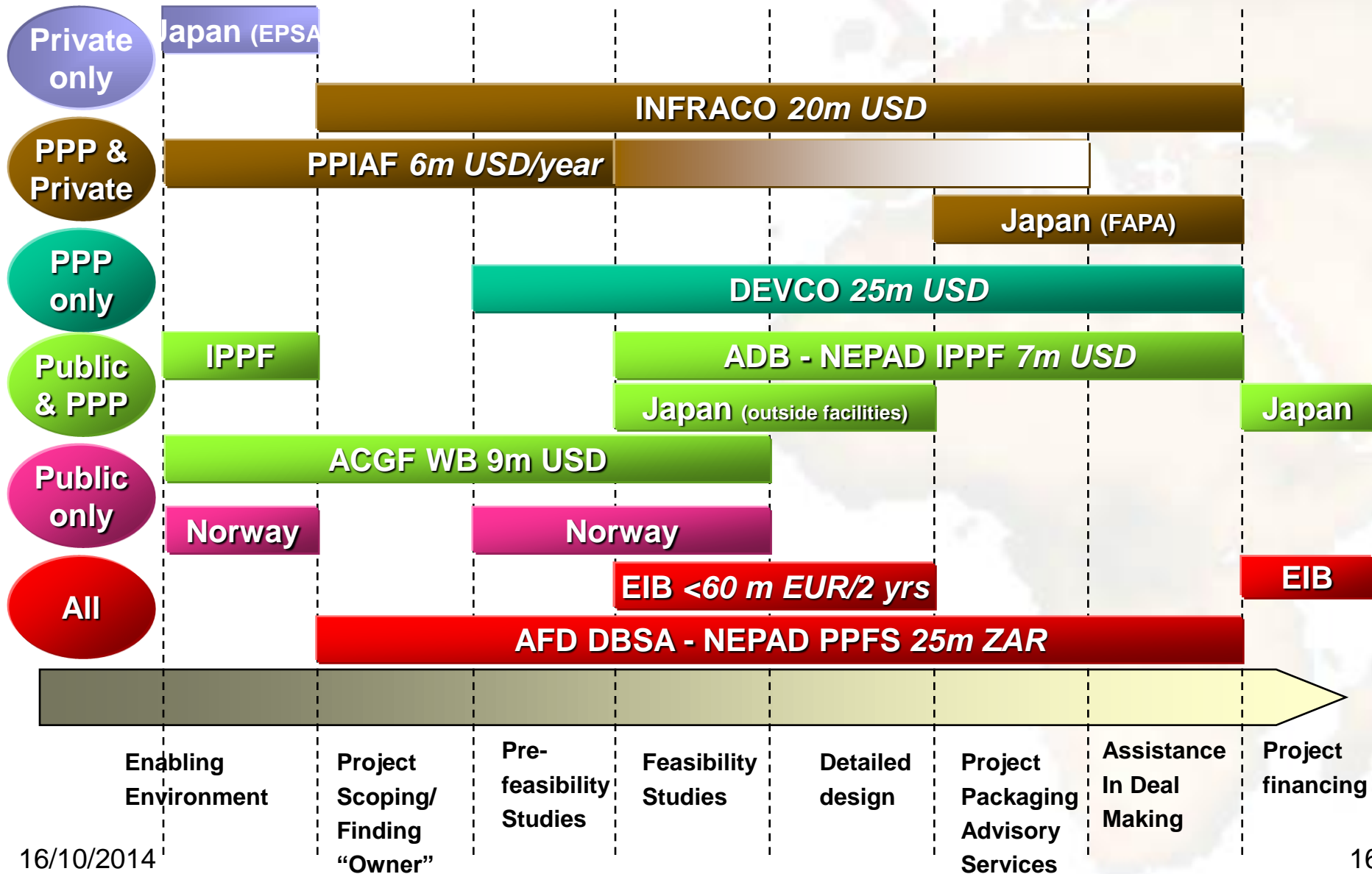
- ❑ FIRST (2003) – Needs Analysis and Skills Audit
 - 10 out of 18 DFIs audited
 - Decision to raise performance to best practice levels
 - Risk Management identified as an essential concern
 - Corporate Governance Strengthening required
 - Across the board strengthening of staff skills – but immediate focus on project finance; appraisal skills; project management
- ❑ Capacity Building Workshops/ Seminars -
 - Chairpersons – May 2005
 - Other Directors (Audit/ Asset-Liability/ Credit) at country level
 - Training of Trainers – DFIs Corporate Secretariats (IFC/GFCG)
- ❑ Specialized Training
 - Investment Appraisal & Risk Analysis (Infrastructure & SMEs)
 - Training of Trainers
 - Risk Management training
- ❑ Secondments

Emphasis is on delivery ...



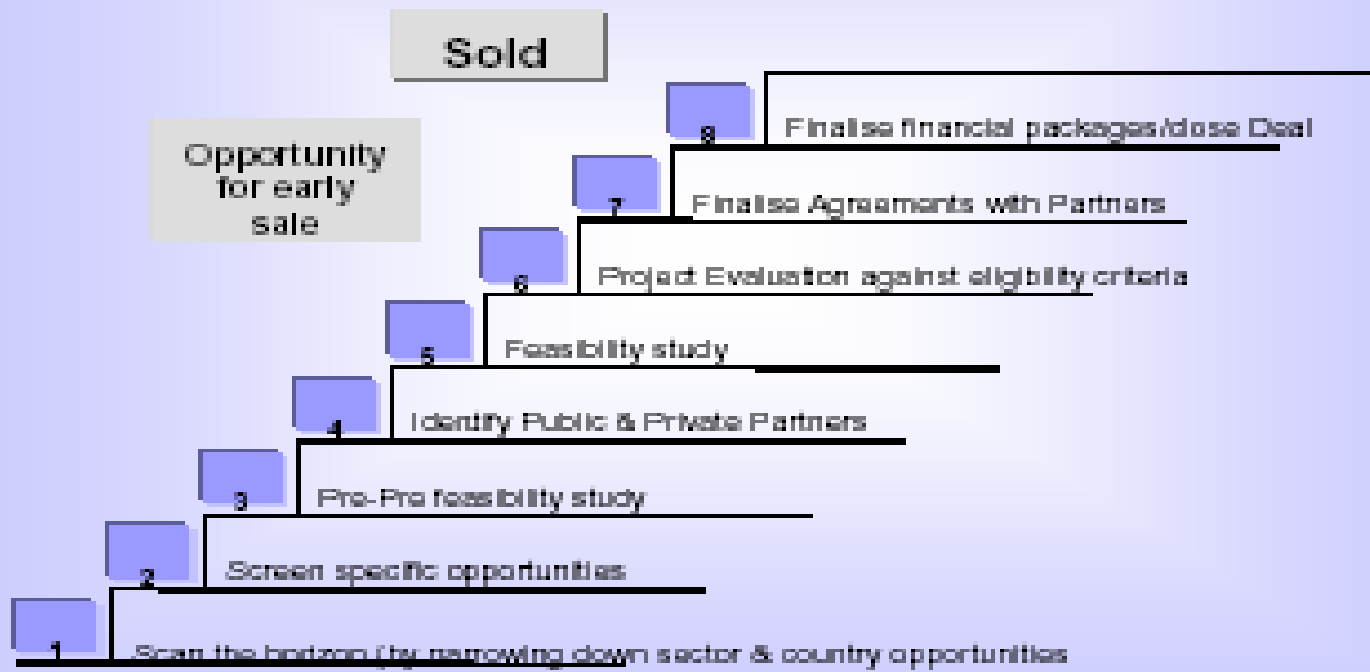
Infrastructure Project Preparation Facilities (“Tunnel of Funds”)

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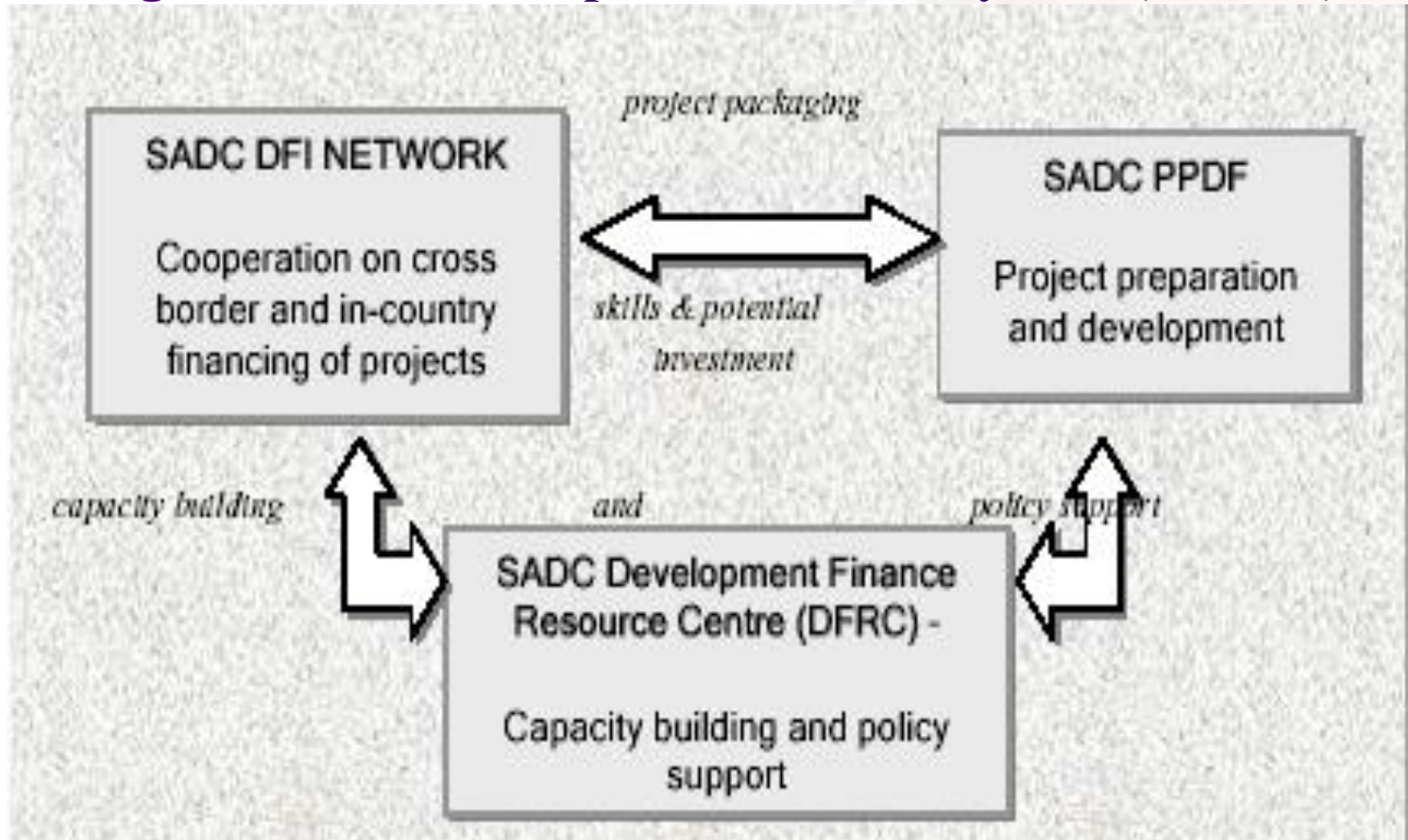


...Proposed SADC Project Preparation & Development Fund

Expected Core Activities



Workings of SADC Development Finance System (DFS'98)



Institutional / Skills development...

✿ DFRC's Approach -

- ❏ Institutional Strengthening (corporate governance/ Credit ratings/ funds mobilization amongst others)...
- ❏ PPP Appraisal Methodology (NEPAD Project) & Training
 - Guidance Material – to develop quantitative & analytic techniques & methods for preparing, managing & monitoring PFI, PPP & similar types of PPI (analysis of PSC, VfM and Discount Rate)
 - Case-based Appraisal Methodology – training soon to be developed incorporating above & most recent experiences with PPI – ready by **June 2007** (PPIAF funding being sought)

Corporate Governance...

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....Board Chairpersons Seminar



Institutional / Skills development...

DFRC's Approach -

- ❑ Establish PPP Facilitation Units (Pilot: NDC –Mtwara Corridor) & develop skills for:
 - Deal conceptualization
 - Consultant procurement
 - Project packaging
 - Proposal Evaluation and contract negotiation
 - Ensuring appropriate Govt. engagement in the project
 - Ensure Government attention to post-closure compliance monitoring of PPP deals
- ❑ Malawi, Mozambique & Zambia following
- ❑ Training on PPI Appraisal methodology to be rolled out first to PPP Units & operational staff of DFIs engaged in infrastructure/PPP activities



....Institutional Development

Mtwara DC/PPP Unit ...



Addressing capacity constraints in DFIs...

⊕ DFRC's Approach (cont'd) ...

- ⊞ Training on Investment Appraisal and risk analysis covering Financial & Economic Analysis of projects and Risk Analysis & modeling.

Participants -

- Plan and assess all aspects of investment projects
- Add value through the redesign of projects
- Prepare project financing agreements
- Design strategies to address stakeholder concerns

- ⊞ Training of Trainers course to deepen local knowledge

- ⊞ Project Management skills using *MS Project*

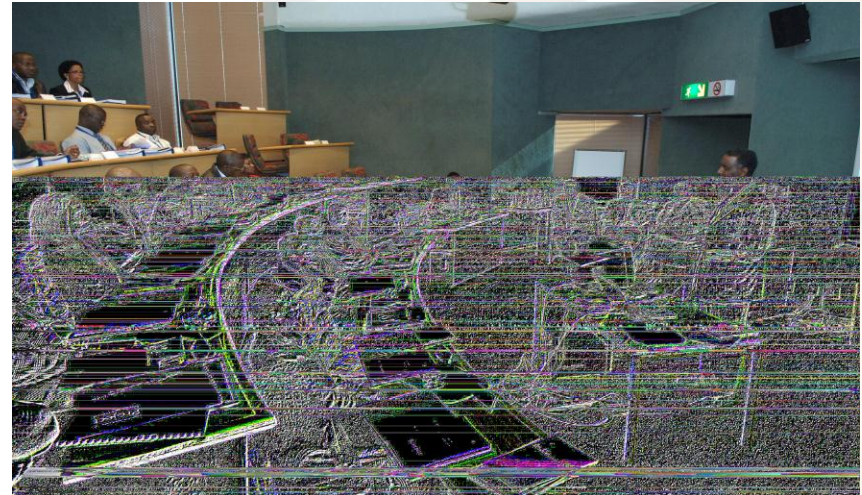
⊕ Supportive of generating deal flow but requires resources including grant funding ...

Investment Appraisal & Risk Analysis...



Capacity development in SADC DFIs...

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Once DFIs strengthened... what then?

✿ Support needed from stronger DFIs/ RDBs and IFIs

- ❑ Assist in development of new –innovative financial instruments (incl. risk mitigation)
- ❑ Access to financing
 - Information needed on what is available -(loans/equity/ guarantees/ partial risk guarantees, etc.)
- ❑ Use as intermediaries ► funding facilities ► especially for SMEs

✿ Result?

- ❑ Increased deal pipeline
- ❑ Joint financing of projects
- ❑ DFIs crowding in Private Sector
- ❑ Deepening of capital markets
- ❑ Growth & Development
- ❑ DFIs evolving over time into universal or investment banks

THANK YOU

Dr. Ros Thomas (CEO)

SADC-DFRC

P. Bag 0034

Gaborone, Botswana

Rthomas@sadc-dfrc.org

www.sadc-dfrc.org