Session 7: Enhancing NDBs Delivery for Development

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

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*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?)

 ליצור 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)

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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…**

  - 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 ...

A. SMEs and Infrastructure

B. Enhance DFI delivery

C. Ensure conducive Policy environment and Govt. support

D. Efficient and Effective Network
Infrastructure Project Preparation Facilities ("Tunnel of Funds")

- **Private only**
  - Japan (EPSA)

- **PPP & Private**
  - INFRACO 20m USD

- **PPP only**
  - PPIAF 6m USD/year

- **Public & PPP**
  - DEVCO 25m USD

- **Public only**
  - IPPF

- **All**
  - ADB - NEPAD IPPF 7m USD
  - Japan (outside facilities)
  - ACGF WB 9m USD
  - Norway
  - Norway
  - EIB <60 m EUR/2 yrs
  - EIB
  - AFD DBSA - NEPAD PPFS 25m ZAR

Enabling Environment
- Project Scoping/ Finding “Owner”
- Pre-feasibility Studies
- Feasibility Studies
- Detailed design
- Project Packaging Advisory Services
- Assistance In Deal Making
- Project financing

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…Proposed SADC Project Preparation & Development Fund

Expected Core Activities

1. Scan the horizon (by narrowing down sector & country opportunities)
2. Screen specific opportunities
3. Pre-Pre feasibility study
4. Identify Public & Private Partners
5. Feasibility study
6. Project Evaluation against eligibility criteria
7. Finalise Agreements with Partners
8. Finalise financial packages/close Deal

Sold

Opportunity for early sale

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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...

....Board Chairpersons Seminar

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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/PPPs 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…
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

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