Perspectives on Development Banks in Africa

Case Studies and Emerging Practices at the National and Regional Level

Edited by
Joshua Yindenaba Abor · Daniel Ofori-Sasu

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General
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Contents

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List of Figures

List of Tables

PART I

Overview of Development Banking in Africa

CHAPTER 1

Introduction to Development Banking in Africa

Joshua Yindenaba Abor and Daniel Ofori-Sasu

1.1 Introduction

Development banks are financial institutions that focus mainly on providing long-term capital to industry (de Aghion, 1999). They mostly have the support of the state, which enables them to plan in the long term and generally provide long-term financing for productive investments in capital-intensive industries, often through technical assistance. Development banks intervene in addressing market imperfections by supporting projects that hitherto have difficulty in accessing capital from the financial market. They are also noted to perform important counter-cyclical role, which helps in maintaining a country's overall investment levels and protect its productive structure in times of economic downturn (Abor, 2023; Abor et al., 2020; Attridge et al., 2021; Griffith-Jones et al., 2018).

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Their counter-cyclical role was evidenced in their response to the global financial crisis and the COVID-19 pandemic as they provided major support to the global economy during these periods.

Development banks are critical to the development of both developed and developing countries. They include multilateral development banks, regional development banks, and national development banks, and these various types of development banks play important roles in providing development finance to various economies. Multilateral development banks (MDBs) are established by various countries with the objective of supporting development activities through long-term loans and grants. They provide mostly lending at low or no interest and sometimes grants to finance projects in areas that promote development. Development banks include the Word Bank, regional development banks, and sub-regional development banks. Regional development banks and sub-regional development banks concentrate on financing development projects in specific geographical areas, and they tend to have regional countries and other large donor countries as majority shareholders (Abor, 2023). National development banks (NDBs) are also financial institutions that are wholly or partially owned or controlled by a national government with the mandate of achieving socio-economic goals in the respective country (Ocampo & Ortega, 2022).

The number of development banks increased rapidly since their emergence in 1950s through the 1960s to support social and economic development. However, they started experiencing a decline occasioned by the economic liberalization and reforms that occurred in the 1980s and 1990s. A good number of them were privatized during the period (1987–2003), and a large number of them were also either restructured or liquidated. The privatization drive at the time changed their mandate more towards profit orientation. Subsequently, the global economy has seen many more development banks being established in spite of the privatization (Abor, 2023). They have sought to focus on providing financing for specific national or regional projects and to private or public institutions; they may operate in conjunction with other financial institutions. They have been instrumental over the years in promoting private investment opportunities and directed their efforts towards industrial, agricultural, and infrastructural development. They have also in recent times focused more on issues regarding climate finance and sustainability.

Development banks have been instrumental in financing the development process in the past, and their importance is even more recognized now considering their countercyclical role in response to major crises. These banks are considered an important component of the financial system made up of banks, other financial intermediaries, financial markets, as well as public and private institutions. Such a diversified financial system encourages intense competition and lowers system risk. Recent trends in terms of the re-emergence of many NDBs in many countries and the establishment of larger MDBs across the globe such as the Asian Infrastructure Investment Bank and the BRICS's New Development Bank reflect a paradigm shift in development banking space towards a more balanced public–private mix in the provision of development financing (Griffith-Jones et al., 2018). There has really been a dramatic shift in the last decade, with many new NDBs established after 2010, and many others emerging from mergers and restructuring of previous institutions. In 2019 alone, 4 NDBs were created in West Africa, specifically in Benin, Burkina Faso, Côte d'Ivoire, and Guinea (Attridge et al., 2021). A large number of NDBs were also established in the period, 2020–2022, mainly in response to the COVID-19 crisis (Abor, 2023).

Developments in research and the policy space present an interesting opportunity to contribute to the evolving literature on development banking. We look at the subject matter, focusing on development banks in Africa, which have been under-researched. We examine various cases of development banks by looking at their evolution, ownership, policy mandate, corporate governance, risk management, regulation and supervision, monitoring and impact evaluation, business models, major achievements, and challenges. Luna-Martinez and Vicente (2012) suggest that development banks with well-defined mandates, better corporate governance structures, effective risk management, proper regulation and supervision, and a strong management team tend to be successful. We examine both MDBs and NDBs providing in-depth case studies on emerging development banking practices in Africa.

The remainder of the chapter is structured as follows. Section 1.2 provides the theoretical perspectives on developing banking. Section 1.3 discusses the key roles of development banks. Section 1.4 explains the purpose of this edited book, while Sect. 1.5 provides a review of the various chapters. Section 1.6 concludes the chapter.

1.2 Theoretical Perspectives on Development Banking

The extant literature provides different perspectives on development banking. In the first instance, development banking and broadly speaking development finance reflects the need to address the financing gap between capital required and capital available, which is explained by the theory of market failure or financial market imperfection (Stiglitz, 1989; Stiglitz & Weiss, 1981). Credit rationing tends to occur because of improper functioning of the financial markets, which is caused by asymmetric information or imperfect information. Asymmetric information arises when borrowers and finance providers have unequal access to information regarding the creditworthiness of the potential borrower. The problem of asymmetric information also leads to adverse selection and moral hazard, and this is likely to be endemic since these markets are mainly information-intensive. So information imperfections and asymmetries as well as incomplete contracts are more important and disruptive than other sectors of the economy. In the financial markets, therefore, market failures tend to outweigh government failures, necessitating the need for government's intervention, which may be through effective public development banks and strong regulation of the private financial markets (see Abor, 2023; Abor et al., 2020; Griffith-Jones et al., 2018; Stiglitz, 1989, 1994; Stiglitz & Weiss, 1981).

It is also argued from a complementary theoretical perspective that investors and banks prefer liquidity, which may account for the limited supply of credit to the economy, even in developed financial systems. Thus, the relevance of development banks goes beyond the issue of 'market failure', though it may be part of the consideration (Atkinson & Stiglitz, 1980; Ndikumana et al., 2021). Banks generally tend to shy away from providing long-term finance because of future uncertainties. Therefore, the presence of development banks is important for financing long-term projects that are associated with higher risk. Private financial systems do not favour such long-term projects but rather projects or sectors with expected returns that are relatively certain. These projects are generally more complicated and expensive and, thus, require special expertise in ascertaining the positive effects on the economy (positive externalities) and/or those in which social returns surpass private returns (Atkinson & Stiglitz, 1980; Ndikumana et al., 2021). Public banks and, for that matter, development banks are said to have traditionally been the ones that have been instrumental in financing long-term investment projects to support industrialization and transformation. However, the recent dominance of private financial institutions has tended to limit the supply of long-term finance for development (Griffith-Jones et al., 2018; Kregel, 2015).

The likelihood of a financial crisis occurring brings to the fore the need for development banks. The functioning of financial markets is generally associated with the 'boom and bust' cycle. The theoretical foundations of Keynes and Kindleberger are based on an analysis that considers financial crisis as a reaction to excesses in prior years, and these excesses tend to be much larger in more liberal and poorly regulated financial systems (Keynes, 1936; Kindleberger, 1978). The pro-cyclical nature of private finance implies that development banks are necessary to be able to provide counter-cyclical financing in the short to long term (Griffith-Jones & Ocampo, 2014). The 2007/9 global financial crisis has revealed that even developed financial markets do not guarantee the supply of capital for financial economic development periods of crisis and non-crisis (Griffith-Jones et al., 2018; Luna-Martinez & Vicente, 2012).

Financing the current sustainable development goals (SDG) also provides justification for encouraging development banks. The SDGs, which were set by the United Nations (UN) with a 2030 timeline, include seventeen (17) specific goals built on the progress made with respect to the Millennium Development Goals (MDGs) and incorporate additional goals. Some of these new goals include reducing inequity, ensuring sustainable consumption and production patterns, combatting climate change and its impact, promoting peaceful and inclusive societies, and providing justice, among others (Abor et al., 2020; Biekpe et al., 2017). The achievements of these goals are dependent on the availability of long-term financing and development banks have been recognised to play a crucial role in this respect. For instance, since the establishment of the World Bank and regional banks after World War II, they have played significant roles in providing long-term financing to support regional and global public goods, as well as promoting long-term financing in developing countries. Since global and regional development banks may not be able to provide the required funding, NDBs also play a critical role in supporting the growth of respective countries (Abor, 2023).

1.3 Key Roles of Development Banks

Development banks play crucial roles at the multilateral, regional, and national levels. The extant literature recognizes the important roles of development banks to include: (i) providing counter-cyclical financing or counteracting the pro-cyclical nature of private financing; (ii) promoting innovation and structural transformation, which are inherent to dynamic economic growth; (iii) enhancing inclusive finance; (iv) supporting the financing of infrastructure investment, which is also crucial for economic growth; (v) supporting the provision of public goods, particularly combatting climate change and, more broadly, promoting environmental sustainability and 'green growth'; and (vi) deepening financial markets and intermediation (see Abor, 2023; Griffith-Jones et al., 2018). These are discussed briefly in turn.

Development banks provide counter-cyclical financing. In other words, they counteract the pro-cyclical nature of private financing during and after periods of crises, which is important in preserving long-term investment, ensuring the continuation of existing projects, and assisting the introduction of new initiatives that are beneficial for both short-term and long-term development (Griffith-Jones & Ocampo, 2014; Rezende, 2015). Multilateral development banks across the globe increased their grant and lending support to emerging and developing economies by over 72% during the 2007/9 global financial crisis, which impeded the flow of private capital into these economies as it had in the past (Griffith-Jones et al., 2018). In developed and emerging countries, counter-cyclical financing provided by multilateral and regional development banks was supplemented by NDB lending. The financing provided by worldwide NDBs during the global financial crisis increased by 36% between 2007 and 2009 according to a World Bank survey. Development banks' lending also expanded during the COVID-19 pandemic, as many provided special funding arrangements to help during the pandemic. Counter-cyclical lending is crucial during and after crisis periods to have long-term investment as a way to mitigate the effects of the crisis. It is also to support firms and prevent them from becoming insolvent and bankrupt, in order to avoid unemployment escalating. Development banks certainly require a strong capital base to enable them to provide such assistance, which will capacitate them to respond swiftly during and after crises.

One of the key roles of development banks is promoting innovation and structural transformation. The lending provided by development banks helps in promoting innovation and structural transformation, which is critical to having a more inclusive and sustainable economy. Development banks are also critical in providing support for innovation and entrepreneurship in many economies. They contribute significantly to financing new sectors and cross-sector projects, which helps countries to become more dynamic in their respective economies (Griffith-Jones et al., 2018). This role of development banks is in recognition of the value of a modern 'industrial policy' (Rodrik, 2004) and the importance of an 'entrepreneurial and development state' (Mazzucato, 2023), which, in collaboration with the private sector, helps to provide an evolving boost for private sector research and development, innovation and structural change. Development banks' role in terms of innovation is important for two reasons. In the first place, the technology requires significant funding for research and development (R&D) which requires long-term investment and is mainly associated with a high risk of failure. Also, as technological advances become more functional and their deployment gains traction, financing is required for large-scale and long-term investment (Griffith-Jones & Cozzi, 2016).

Another important role of development banks is enhancing inclusive finance. These banks, especially NDBs, are instrumental in providing finance for small and medium enterprises (SMEs) as well as microenterprises, including household agricultural activities on a long-term credit basis (World Bank, 2013). SMEs mostly face difficulty in accessing the needed finance for their operations and activities. The lack of adequate finance SMEs in Africa and other developing countries experience has been attributed to the fact that the provision of finance for Africa is generally rated as riskier than for other regions of the world. Also, finance provided to SMEs is globally considered riskier than to large corporates (Abor & Biekpe, 2007; Abor et al., 2014; Collier, 2009; Quartey et al., 2017).

Thus, such finance is associated with high costs and short-term maturities, which tends to be unsustainable in enhancing inclusive finance. NDBs support in the implementation of national development strategies with the aim of driving inclusive finance in these sectors of the economy that are traditionally excluded from the formal financial sector, especially those in the rural communities (Griffith-Jones et al., 2018). Improving inclusive finance among SMEs is a precondition for improved productivity and innovation. Financing SMEs is still an important policy issue in emerging and developing economies. In spite of the significance of SMEs in terms of their contributions to employment generation and GDP, they seem excluded from the formal financial system in developing economies. This is often attributed to the fragmented nature of financial systems in developing countries which tends to exclude a significant portion of the real economy. Whereas commercial banks may avoid providing long-term financing to SMEs, development banks are ready to provide long-term patient capital to finance their activity, which helps in spurring growth. NDBs tend to focus on financing SMEs as a way of addressing the market failure by tailoring their lending products to suit the specific needs of these enterprises.

Development banks also support the financing of infrastructure investment, which is crucial for driving economic growth. Infrastructure development is critical for enterprise growth and for African countries to migrate from being consumer-based economies to investment-driven economies, infrastructure will be key. The private sector can thrive in an environment of solid infrastructure in the areas of transportation, water, ICT, energy, and power (Abor, 2023). The African continent is, however, plagued by the challenge of limited access to sustainable infrastructure. Traditionally, infrastructure development has been financed through public funds. However, given the dwindling nature of public finance, governments' budgets are not able to support such large-scale public infrastructure projects. Development banks have been instrumental in providing infrastructure financing. They have high credit ratings, which enables them to raise long-term finance from the capital markets at a lower cost, which can be passed on to their borrowers. Given the high level of investment required, development banks are capable of providing such long-term financing to support infrastructure development. NDBs, especially, have been recognised to play a critical role in financing infrastructure in general, thus complementing public and private efforts in infrastructure investment, especially in times of fiscal challenges. They also facilitate public and private partnership (PPP) deals between government and private sector players. They leverage the financing provided to crowd in private investment into the project in the form of a PPP arrangement (Abor, 2023).

An important role of development banks is financing the provision of global public goods and this involves promoting environmental sustainability by combatting climate change. A major threat to the efforts of achieving global sustainable development is the challenge of climate change. The importance of ensuring sustainable finance for climate action has become very topical in the policy space and countries across the globe are realizing the need for urgent action to combat climate change and to adapt to its consequences. Many countries have so far ratified the Paris Agreement. Nevertheless, efforts to achieve the goals of global climate remain inadequate. Greenhouse gas emissions continue to increase and some governments are very much concerned that climate policies could reduce economic growth, which will not augur well for the already struggling global economy. Taking timely climate action offers several opportunities for growth and modernization in a number of areas such as promoting low-emission and resilient infrastructure, drawing on untapped economic potential, driving exciting new technological developments, and building more inclusive societies. Focusing attention on smart, green agriculture, clean energy, and green infrastructure comes with unique benefits that can spur growth (World Bank, 2022). Though different players have a role in mobilizing support in addressing climate change and sustainable development, development banks have been defined as critical actors in this regard. Development banks are able to support the scaling up of climate finance by interacting with government agencies, manage resources, and influence policy. They also scale up climate finance to limit the level of risk by combining small projects through a portfolio approach and streamlining the application cycle to limit credit evaluation and transaction costs, thereby ensuring the participation of local private financial institutions in climate finance. Apart from addressing market failures, development banks help in making and moulding the market, which is vital for development. This improves investor confidence to engage in climate finance, thereby helping to scale up climate finance. Development banks can leverage private finance to attract the private sector to finance climate change since they have a very knowledgeable- and long-term relationship with the private sector (Abor, 2023).

In the financial market, development banks also play an important role in financial intermediation and economic growth. This has the potential to spur private sector growth, which is essential for job creation and economic development. NDBs, especially, are critical in moderating the functions of financial markets in both developed and emerging economies. They focus on the maximization of the social wellbeing and benefit of the public, by offering long-term credits to their customers. Their participation in the financial market promotes competition, enhances borrowers' access to credits, lowers costs, and improves the level of efficiency among players in the financial market. The intermediary role of

NDBs as well as their role in facilitating collaboration between governments and the private sector help in deepening the financial markets. They collaborate with other private financial intermediaries in mobilizing the needed financing in delivering on their mandate of financing development projects, which is necessary to drive economic. Their collaborative efforts in supporting infrastructure projects help to deepen the financial markets. NDBs are used by various governments to mobilize funds from the private sector to undertake investment projects for the public good. They act as transaction and investment advisors to both governments and investors. They also provide the necessary expert advice to the government on policy and project implementations. In essence, they help in raising finance in the financial market on behalf of governments and other investors who wish to undertake infrastructure projects (Abor, 2023).

1.4 Purpose of This Book

Development banks are designed to provide medium- and long-term capital for productive investment, often accompanied by technical assistance, in poor countries. There are books focusing on regional development banks in developed economies. However, there is scanty literature on the subject focusing on Africa. This edited book contributes to the limited texts in the area by providing a comprehensive resource focusing on both national and regional development banks in Africa. It provides useful cases on development banks in various African countries, showcasing the nature of development banking across the continent. Similarly, this book examines practical cases of national and regional development banks by illustrating emerging development banking practices in Africa. It contributes to improving our understanding of development banks in Africa and serves as a useful guide for researchers interested in understanding development banking from the African perspective.

This book on *Perspectives on Development Banks in Africa*, is made up of contributions from scholars in finance and economics as well as practitioners from development finance. The book provides very relevant resources and guides to development banking in Africa. The book is made up of four parts with nineteen chapters.

1.5 An Overview of the Chapters

The book is divided into four parts. Part I provides an Overview of Development Banking in Africa. Part II focuses on the Political Economy and Economics of National Development Banks in Africa. Part III examines Multilateral, Regional, and Sub-Regional Development Banks, while Part IV looks at the Future of Development Banks.

Part I: Overview of Development Banking in Africa

This section of the book covers the introductory chapter which provides an overview of development banking in Africa. It also discusses the purpose of the book and gives an outline of the rest of the chapters in the book.

Part II: The Political Economy and Economics of National Development Banks in Africa

In Chapter 2, Joshua Yindenaba Abor, Daniel Ofori-Sasu, and Bumi Camara examine the political economy of Development Bank Ghana (DBG) by providing an insight into the emergence and early years of the bank. The study highlights that DBG, through legislative instruments, operates within a specific governance structure, supervision, and regulatory framework designed by the government of Ghana and the central bank (Bank of Ghana). The operational activities of the bank include lines of credit to eligible participating financial institutions for on-lending to viable micro, small, and medium enterprises (MSMEs) and offering credit guarantees through a credit guarantee facility of participating financial institutions (PFIs). Although the bank is established in a fragmented political system with frequent political interventions, it is committed to working with development partners and stakeholders to design programmes directed at revamping priority sectors of the economy. Despite its initial interventions, the bank is faced with operational challenges, especially in line with inadequate information provided by borrowers, climate financing gaps, as well as uncertainties in the credit market.

Chapter 3, by Paul Terna Gbahabo, Benjamin Agyeman, and Sylvanus Ikhide, examines the system of NDBs in Nigeria focusing on the case of Development Bank of Nigeria (DBN). The chapter reveals that DBN has a complex network of development financing activities, ranging from financing, leasing, risk-sharing, credit guaranteeing, insurance coverage, refinancing, debt factoring, and technical assistance provision to enterprises across all sectors of the economy under the regulation and supervision of the central bank. Unlike the prevalent wholly-owned ownership structure amongst DFIs in Nigeria, the DBN is a public limited company with joint ownership and control between the government and other international development partners. The Bank operates a wholesale lending business model under strict corporate governance and risk management regime.

In Chapter 4, Christian A. Aboua, Charles Odoom, and Jules F. Konan, present a case study of a national development bank in Côte d'Ivoire, namely the Banque Nationale d'Investissement (BNI). The study examines the activities of BNI in terms of corporate governance, regulation and supervision, monitoring and evaluation, impact evaluation practices, business models, achievements and challenges, and financial performance. The BNI operates in a more favourable political, institutional, and regulatory context for carrying out its mandate. At the regulatory level, the authors highlight the application of Basel 2 and 3 standards, which might offer the board of directors and bank management significant autonomy and competence, as well as sound risk management. However, BNI has had major shortcomings which can be attributed to issues with governance and political influence, as well as SMEs financing, agriculture finance, and new financial products.

Chapter 5 explores how the Development Bank of Ethiopia (DBE) has been established as a catalyst for economic growth and development. In this chapter, Asenafi Fanta and Habtamu Berhanu show that although DBE has contributed to Ethiopia's growth and development by promoting agriculture, industrial and SMEs' development, it is confronted with some obstacles, including borrowers with limited skills in project design and implementation, political interference in its governance and operations, and a high proportion of non-performing loans due to defaults engendered by political instability. This calls for development policies that strengthen DBE's capital base.

Chapter 6 provides an overview of the activities, contributions, and challenges of Development Bank of Rwanda (BRD). In this chapter, Daniel Ofori-Sasu, Joshua Yindenaba Abor, and Frank Abaho Gakwaya examine the political economy and institutional context, corporate governance arrangement, regulation and supervision, monitoring and evaluation, and impact evaluation practices, BRD's business models, contributions and challenges, and financial performance of BRD. It shows that BRD operates within a strong governance structure and regulatory framework designed by the government of Rwanda and the central bank of Rwanda. Although the bank is established in a fragmented political system with frequent political interventions, it is praised for its professional independence. BRD commits to working with development partners and stakeholders to design programmes in priority sectors in order to attract blended finance to support agriculture, energy, housing, and SME development. Despite the significant benefits reaped by the government, and the many contributions to the social and economic development of Rwanda, the bank is faced with resource constraints and many project implementation challenges. BRD's performance has increased due to its ability to effectively manage capital adequacy, management efficiency, and internal liquidity coverage while the non-performing loan ratio of the bank has reduced its profitability.

Chapter 7, by Peter W. Muriu and Victor Murinde, uncovers the evolution and role of DFIs in the development discourse paying special attention to Kenya Development Corporation (KDC). The authors establish that although KDC's activities are growing, it nevertheless lacks proper regulation and supervision. There are legal barriers arising from the laws around which KDC was established that hinder its core mandate. Furthermore, the political class/actors influence the activities of the corporation through the appointment of the board of directors and the CEO which affects independence in decision-making process. The global political economy and development agenda which most often are characterized by value chain disruptions have also affected the corporation. KDC adheres to high standards of corporate governance. However, there is no framework for measuring development impact. The main challenge facing KDC is the lack of sufficient and affordable funding.

Chapter 8 by Sunil Kumar Bundoo, Baah Aye Kusi, and Isaac Kofi Bekoe presents a comprehensive overview of the Development Bank of Mauritius (DBM). From the review, the authors highlight that DBM plays a key role in the growth and development of Mauritius through the stimulation of micro, small, and medium enterprises (MSMEs) activities. DBM has implemented generally accepted board-level governance, institutional, and supervision mechanisms, and it has ensured appropriate risk management practices. However, the bank lacks a systematic monitoring and evaluation framework within the bank for purposes of ensuring that its impact on the economy is well measured and to ensure informed and quality decision-making.

In Chapter 9, Mondher Khanfir and Charles Odoom explore the system of national development banks and the financing of small and medium enterprises (SMEs) in Tunisia, with a specific focus on the Banque de Financement des Petites et Moyennes Entreprises (BFPME). The bank was established with the explicit mandate to provide financing to micro-enterprises and industrial SMEs, as well as achieving sustainable economic development in Tunisia. In general, the chapter confirms that SMEs play a crucial role in boosting economic growth in the country. The chapter highlights that BFPME is an important asset in the development finance landscape in Tunisia, despite the many challenges the bank has faced over the past decade.

Chapter 10 focuses on Botswana Development Corporation (BDC). In this chapter, Mbako Mbo reveals that the corporation evolved through distinct but interrelated phases of organizational growth, veering into a series of missteps along its investment and risk management journey and quickly finding its feet back through a decisive transformational action plan. The chapter illuminates the need to align a change in strategy with core capabilities and operational policies in a coordinated fashion, with the positive outcomes of a non-interference stance by government and with the fundamental importance of good governance in the performance of DFIs.

Chapter 11, by James Atambilla Abugre, Joshua Yindenaba Abor, and Mercy Marimo, examines the role of the Infrastructure Development Bank of Zimbabwe (IDBZ) in infrastructure financing in the country. The authors provide an overview of development finance institutions (DFIs) in Zimbabwe, discussing the profile and history of IDBZ, its policy mandate, political economy and institutional context, corporate governance arrangements, among others. Risk management mechanisms, monitoring and evaluation structures, lending model of the bank, products, and services of the bank, main achievements, as well as the challenges the bank faces are explored.

Part III: Multilateral, Regional, and Sub-Regional Development Banks

Chapter 12 examines the contributions of Multilateral Development Banks (MDBs) and discusses the challenges confronting them. In this chapter, Joshua Yindenaba Abor, Lakshmy Subramanian, Khadijah Iddrisu, and Randolph Nsor-Ambala show that MDB has made significant contributions to member states. However, in order to align national and global requirements, it is crucial to revamp the financing patterns of multilateral activities. This can be achieved through the implementation of innovative financial and policy incentives, meticulous evaluation of multilateral funding decisions, enhanced data collection mechanisms, and more effective prioritization of multilateral activities.

Chapter 13 discusses the role of regional development banks (RDBs) in the economic development process and agenda of the regions they serve. In this chapter, Lordina Amoah, Ebenezer Bugri Anarfo, Janet Talata Abor, and Joseph G. Nellis put the spotlight on two regional banks, the African Development Bank (AfDB) and the Asian Development Bank (ADB), given the unique and intriguing similarities in the history and growth trajectory of the two regions they each operate in.

In Chapter 14, Anthony Coleman, Kanayo Awani, and Joshua Yindenaba Abor explore the role of the African Export–Import Bank (Afreximbank) in trade financing. The authors highlight the challenges African countries face in accessing trade finance and present an overview of the origin and mandate of Afreximbank. The bank's ownership and membership structure, its funding and operations, as well as its contributions to trade finance in Africa are discussed in this chapter.

In Chapter 15, George N. A. Donkor, Olagunju M. O. Ashimolowo, Sydney O. Vanderpuye, and Daniel Ofori-Sasu present an overview of the ECOWAS Bank for Investment and Development (EBID). The authors provide a comprehensive review of the major achievements and challenges of the bank. They discuss the evolution and mandate, ownership and membership, funding, and operations, as well as the significant contributions and challenges the bank is confronted with.

Chapter 16, by Jared Osoro, Roseline N. Misati, and Samuel Tiriongo, shows the system of development finance by the East Africa Development Bank (EADB). Although EADB is constrained with scale, the authors highlight that the bank's common development aspirations, motivation, and continuous efforts are hinged on the need to bridge the long-term financing shortfall among member states.

Chapter 17, by Matthew Kofi Ocran, presents an examination of the structure, funding, and contributions of the New Development Bank

(NDB) established by the BRICS countries (Brazil, China, India, and South Africa) to sustainable development in the Global South. The author looks at the evolution of NDB, analyses the alignment of the bank's portfolio to the United Nations, and discusses the bank's financial risk safety net and the Contingent Reserve Arrangement. The author identifies a few challenges facing the bank and makes some recommendations for policy consideration.

In Chapter 18, Abdul Nashiru Issahaku, Jabir Ibrahim Mohammed, and Sherif Sulemana present an overview of Islamic Development Bank (IsDB) by exploring the various Islamic financial products and services, the risk-mitigating mechanisms, the financing models, monitoring, evaluation, and impact assessment of projects financed by IsDB in Africa. The authors highlight that Islamic finance is increasingly gaining prominence in the global financial architecture and IsDB provides a good opportunity for high debt-ridden African countries to adopt, especially through the issuance of sukuk, to help finance infrastructure in Africa.

Part IV: The Future of Development Banks

In Chapter 19, Joshua Yindenaba Abor and Daniel Ofori-Sasu present a framework for the future of development banks in Africa. The authors provide a comprehensive and systematic review of the contemporary issues in development banking in Africa, key features of development banks in Africa, as well as their contributions and major challenges. They highlight some lessons from development banks' experiences in Africa and conclude that development banks in Africa cannot be seen in isolation; instead, policy coordination that supports development initiatives is urgently required.

1.6 Concluding Remarks

Development banks are very important in providing development finance to various sectors of the economy among member states and regions. These banks include multilateral development banks, regional development banks, and national development banks. They play key roles, including providing counter-cyclical financing, promoting innovation and structural transformation, enhancing inclusive finance, supporting the provision of public goods, and deepening financial markets and intermediation. For development banks to be effective in performing their roles and delivering their mandate, it is important to improve their corporate governance system, monitoring and evaluation, risk management practices, and on their business models. There is also the need for sound regulation and supervision of their operations. These are essential in enhancing their performance and maximizing their development impact.

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PART II

The Political Economy and Economics of National Development Banks in Africa

CHAPTER 2

The Political Economy of Development Bank Ghana: Emergence and Early Years

Joshua Yindenaba Abor, Daniel Ofori-Sasu, and Bumi Camara

2.1 Introduction

The failure of development financial institutions (DFIs) in the past decades, predominantly in the 1980s and 1990s, has stirred up the interest of many governments to re-establish development banks aimed at addressing the shortage of finance and overcome various challenges that led to their failure. It is well documented that most national development banks (NDBs) established in developing countries and emerging economies have not been able to achieve the purpose for which they were

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set up due to the funding challenges they face across the region. Ghana has been no exception to the failure of DFIs, and this has rekindled the interest of the government of Ghana to establish the new Development Bank Ghana (DBG). The bank has learned from the past mistakes of DFIs and other NDBs in Africa and beyond—by designing regulatory mechanisms and measures that can deal with similar challenges and curb possible failures in the future.

The DBG was established to complement Ghanaian banks in providing financial support to the various sectors of the economy, including agribusiness, manufacturing, information communication technology (ICT), and mortgage finance—hence, to spur growth and transformation of the Ghanaian economy. It is a development finance institution that acts as an important financing institution for businesses in Ghana, which is meant to sustain the market by providing long-term capital to Ghanaian businesses. The bank has a core mandate of alleviating the financing constraints faced by micro, small, and medium enterprises (MSMEs). The bank provides wholesale financing and credit guarantees to financial intermediaries that are eligible for on-lending to an underserved MSME sector, and small corporates in business, manufacturing, and high-value services.

The rational for establishing the DBG by the Ghanaian government was to accelerate inclusive and sustainable economic transformation by fostering the growth of a competitive private sector. In achieving these goals, the bank is expected to act as a catalyst for fostering strong partnerships to finance economic growth, create jobs, and build capacity for SMEs; providing long-term financing and de-risking services underpinned by technology and evidence-based research; attracting, developing, and retaining exceptional people; operating as an independent, financially sustainable class institution; and promoting environment, social and governance (ESG) excellence within the businesses it supports.

As part of the broader mandate of global sustainable development goals within the context of Africa's Agenda 2063 and "Ghana Beyond Aid" agenda, it will be important to understand the contributions of DBG since its establishment as well as its development mandate and business models, and the challenges faced by the bank. This chapter provides a case of the DBG. The chapter provides an overview of DFIs in Ghana, the profile and evolution of DBG, the political economy of DBG, corporate governance arrangements, risk management practices, regulation and supervision, monitoring and evaluation, impact evaluation structures, business model, initial interventions and challenges, conclusions, and the way forward.

2.2 Overview of Development Finance Institutions and Programmes in Ghana

From the time of independence in 1957 until the mid-1960s, Ghana's approach to development finance was initially state-led. Public firms predominated during this period in all sectors of the economy. In order to serve Ghanaian traders, farmers, and enterprises that could not access the foreign banks that dominated the market (including banks like Standard Chartered Bank and Barclays Bank), the Ghana Commercial Bank was established in 1957 (from the former Gold Coast Bank). Three significant development banks were established in Ghana as a result of the realization of the need for long-term financing: the National Investment Bank (NIB) in 1963, the Agricultural Credit and Cooperative Bank in 1965, and the Housing and Construction Bank (BHC) in 1965. The Agricultural Credit and Cooperative Bank became known as the Agricultural Development Bank (ADB) and BHC went through some reforms but it eventually ceased operation in 2000. When the BoG abolished the distinction between commercial and development banks in 2004, both the NIB and the ADB underwent significant restructuring and became universal banks. The state-owned Merchant Bank was established in 1972 as well, and in 1976, the Bank of Ghana passed legislation allowing the establishment of rural and community banks (RCBs) as local unitary banks with only a modest minimum capital requirement (Abor, 2023; Nissanke & Aryeetey, 1998; World Bank, 2016).

The implementation of economic reforms in the middle of the 1980s resulted in a greater liberalization of the financial sector in the 1990s, with a focus on demand-side strategies and DFIs with lines of credit targeted at particular economic sectors. The formation of new DFIs and programmes resulted from the government's efforts during the liberalization era to direct more funding towards priority sectors, particularly exports and MSMEs. In order to support and advance SMEs across the nation, the National Council for Small-Scale Industries (NBSSI) was founded in 1985. It offers services for business development, lending, and the promotion of SME associations. The Export Finance Company (EFC) was established in 1989 to provide short-term money market instruments and company financing, as well as to guarantee export financing. In order to assist banks and non-bank financial institutions in lending to debtors without sufficient collateral, Eximguaranty Company Limited (ECL) was also established in 1994. Additionally, it aimed to help public financial institutions refinance their debt, make it easier to finance and market agricultural products, manage trust funds, and give local exporters working capital and insurance. MSMEs and agricultural value chains are supported by the Export Development and Investment Fund (EDIF), which was formed in 2000 (Abor, 2023; ACET, 2022; World Bank, 2016).

In 2003 and 2008, the Social Investment Fund (SIF), established in 1998 (as a private limited company) to oversee community development initiatives, increased funding for microfinance. As a "mini central bank" for the Rural and Community Banks (RCBs), ARB Apex Bank was established in 2002 under the Rural Financial Services Project (RFSP) that acted as an administrative tool for managing a number of credit lines for the World Bank, IFAD, and other on-lending initiatives through the RCBs (World Bank, 2016). Additionally, in 2004, the Venture Capital Trust Fund (VCTF) was created to provide funding for the growth and promotion of venture capital firms that finance small and medium-sized businesses in priority industries. The government has created new local DFIs, such as the Export Development and Agricultural Investment Fund (EDAIF) and the Microfinance and Small Loans Centre (MASLOC), to provide credit at interest rates that are lower than those of the current market. To address EFC financing deficiencies, EDAIF was first formed in 2000 as the Export Development and Investment Fund (EDIF). It was renamed Export Trade, Agricultural and Industrial Development Fund (EDAIF) after its scope was enlarged in 2011 to include the promotion of agricultural processing and export development, as well as in 2013 to include industrial development and equity financing. In addition, the establishment of MASLOC in 2006 sought to coordinate and promote a decentralized microfinance system, hold and manage donor money for micro and small loans in trust, and work with non-bank financial institutions (ACET, 2022; World Bank, 2016). In 2016, EDAIF, EFC, and ECL merged to form the Export–Import Bank of Ghana (EXIM). The Savannah Accelerated Development Authority (SADA) was created in 2010 and the Ghana Infrastructure Investment Fund (GIIF) was established in 2014 as additional government development funding projects. The goal of the GIIF, which was founded as a development finance agency, is to mobilize resources to manage, coordinate, and finance investments in a diverse portfolio of assets and infrastructure projects. The

Northern Savannah Ecological Zone was the focus of the Savannah Accelerated Development Authority's (SADA) efforts to promote economic growth. SADA advocated the establishment of a wholesale development bank to enable long-term financing for regional development in light of the limited availability of government funds (Abor, 2023; World Bank, 2016).

2.3 Profile and Emergence of Development Bank Ghana

The new national development bank, known as Development Bank Ghana (DBG), was established in 2020 and licensed in November 2021 with GHS1.6 billion (US$141.68 million) share capital. DBG is owned by the Government of Ghana and was created to provide long-term financing to the productive sectors of the economy. These include agribusiness with a focus on activities in the non-agricultural value chain, as well as manufacturing, ICT, software and related services, business process outsourcing, and tourism. Another goal is to increase homeownership through affordable, longer-term mortgage financing. Its business model involves the provision of finance through private-sector financial institutions to drive economic growth and shared prosperity. Ghana has decided to set up a new national development bank as a key vehicle in pursuing economic transformation and job creation as part of the national overall strategy. In addition, the bank has the mandate to (1) empower commercial banks and entrepreneurs through innovation to strengthen the business environment; (2) facilitate and strengthen long-term capital flow to businesses in the country; and (3) promote efficient markets that support the best practices of the environment, social and governance (ESG) principles.

The Environmental, Social, and Governance (ESG) strategy is being implemented by DBG with the intention of generating shared value and impact with a purpose. DBG is committed, aligned, and strengthened to achieving UN Sustainable Development Goals (SDGs) objectives and targets. As a development bank, it is capable of accelerating the adoption of sustainable and ethical banking practices by its participating financial institutions.

It has been argued that this new initiative will reflect new ways of thinking about development finance, as well as lessons learned from experience and current international best practices in development banking, backed by good corporate governance and sound operations. The government is expected not to repeat the same mistakes made with previous NDBs such as NIB, ADB, and BHC. DBG raises long-term funds both on the national and international capital markets and from international financial institutions on the basis of its own balance sheet. The government has also indicated that the establishment of the new national development bank will be important to recover from the impact of the COVID-19 crisis. The new development bank is to become a model institution to support the creation and expansion of jobs in the private sector (Abor, 2023; ACET, 2022).

The DBG was established under the Development Finance Institutions Act 2020 (Act 1032) to provide innovative and long-term financing instruments to specific economic sectors, particularly agriculture and industry. The Development Finance Institutions Act 2020 (Act 1032) provides four license classes: (Class 1 license)—DFIs which provide for wholesale development finance; (Class 2 license)—DFIs which provide retail development finance; (Class 3 license)—FIs which provide guarantee development finance; and (Class 4 license)—DFIs which provide a combination of any of the three. DBG provides wholesale financing and partial credit guarantees, thus, operates under a Class 4 license.

To ensure that DBG is successful, it has designed a framework that carefully replicates the successes or achievements of some development banks in Asia, including the development bank of Singapore (DBS), Japan Development Bank, Korean Development Bank, and KfW (Germany). For instance, DBS was established 3 years after the independence of Ghana, and its main function was to finance Singapore's industralization and urban development projects set up by the government. It is the first bank in the region to launch comprehensive internet banking and has established about 28,000 enterprises through various programmes and nurtured close to 300 social enterprises across Asia—creating more jobs and catalyzing Singapore's industrial development as well as constructing a 50-storey DBS building to pave the way for higher buildings. KfW is also one of the biggest, most successful, and respected NDBs in Germany, having been awarded the *World's Safest Bank 2020*. DBG is learning from KfW, currently modelling and replicating its business operations.

As of December 31, 2022, DBG's total assets were valued at almost US$200 million with shareholders' equity, which stood at US$138 million. As of March 2023, six universal banks in Ghana had signed on to participate by accessing funds from DBG, for on-lending to eligible businesses and they include Absa Bank, Cal bank, Consolidated Bank Ghana (CBG), Ghana Commercial Bank, Access Bank, and Fidelity Bank Ghana (DBG Business and Financial Times, 2023[1]; DBG Financial Report, 2023[2]).

2.4 Political Economy of Development Bank Ghana

Issues of political interference have been a recurring phenomenon in most African countries in the pre- and post-independence period. These have had far-reaching negative effects on the financial economy. Ghana stands out as an encouraging success story. For instance, in comparing Ghana to the rest of Africa on the rule of law, Ghana, per the world justice project (WJP, 2021), ranks 7 out of 33 countries—the second best performer (after South Africa) in sub-Saharan Africa and 51 out of 128 countries in the world. Although Ghana has demonstrated an effective and solid political and governance system and sound rule of law in the past two decades, its development and DFIs are prone to political interference. The political view of development banks largely acts as an instrument that serves politicians' personal objectives and as a channel for rewarding businesses that are politically connected. The political view can contribute to either the successes or failures of development banks. Political connection facilitates development banks' access to more resources and also serves as an important channel for financing various sectors of the economy. NDBs tend to have close ties and relationships with politicians, as most board members are government-appointed and may be supported by an individual politician or political party with campaign funding. They have a higher degree of negotiation with governments in regional blocs. Political connections are strongly linked to the development mission of the NDBs and, therefore, directors with political experience and connections are often represented on their boards. In addition, the government's position as the authority, regulator, and potential lenders and borrowers of development banks leads to political interference and weak independence

[1] https://www.dbg.com.gh/1903-2/.

[2] https://www.dbg.com.gh/wp-content/uploads/filr/2965/FY%202022%20Summary%20Audited%20Financial%20Statement.pdf.

of the development banking system. The government may neither provide funds to meet the development banks' development goals nor support the execution of bank contracts in favour of related interests.

In most African countries, government agencies, including the Treasury (a department responsible for technical oversight) and other government institutions, are involved at the highest level in NDB governance. They act in the capacity of shareholders to intervene directly in the day-to-day operational decisions. Further, they have a responsibility to ensure that state-controlled banks, including DFIs, are supervised and controlled. At DBG, the system of governance and appointments go through an independent process. At the political level, the government of Ghana is supporting the development of the economy through the DBG. The Ghanaian government has the goal of expanding DBG in the region in the future, though this is not in sight for the coming years. Political motivation and the availability of funds are key elements for achieving the DBG goals and building momentum for the achievement of the SDGs and "Ghana Beyond Aid". While the DBG plays an important role as a facilitator that can translate the national agenda into economic action, the bank will likely face political interference as the government and regulator define strategic growth sectors. For example, DBG's success depends on building a strong and solid corporate governance culture, which requires support at all levels. While DBG's mandate is to reduce perceptions of political risk, insufficient integration or cohesion between government agencies can undermine the bank's effectiveness within national development frameworks. The political environment of development banks in Ghana may present a more negative perspective on development policy as a whole. For instance, the development financing mandate may shift from directing financing towards social aims to funding the preferred projects of politicians, leading to the distortion of the financial and labour markets. The government may use subsidies as guarantees for lending funds to inefficient market players or bailing out failing firms rather than efficient ones. Thus, while DBG can reduce market failure, it may adhere to government policies that end up reducing economic welfare.

2.5 DBG's Corporate Governance Arrangements

As defined by the World Bank, NDBs are any type of financial institution seen to be supported by a national government and owned partially (usually at least 30% government-owned) or fully by the government.

The government of Ghana is the shareholder of the DBG and the bank's role in supporting national developments, particularly in integrating governance decisions to provide funding to complement these efforts, remains critical. Good corporate governance, transparency, and procedures are crucial to DBG's success. This describes the process and structure for overseeing the management and control of the bank so that it can effectively fulfil its mandate. The failures of DFIs in the past have been attributed to executives: acting almost autonomously (without clear hierarchical lines) and pursuing unintended goals; making decisions that are contrary to the principles of business and/or financial management and undermining the "self-sustainability" of the institution. There is also the potential for a lack of accurate and complete financial reporting, leading those who rely on reporting to make uninformed decisions, thereby misleading shareholders, investors, legislators, and society at large. Another criticism of development banks is that they were poorly managed, and their lending was politically motivated. Bad governance practices within development banks went unchecked and became a way of life across much of the sector. Corporate governance in development banks failed because boards ignored these practices leading to management misdirection, complicity in raising unsecured loans at taxpayer expense, and a lack of skills to apply good corporate governance in bank management. Lessons from the past have stirred up the interest of the regulator (i.e., BoG) to provide DBG with the best corporate governance mechanisms that are in line with those of international DFIs.

The ownership, governance, and operational structures of DBG have been designed to ensure that the bank is able to be managed professionally in order to successfully carry out its economic mandate while remaining financially sustainable. The bank has a board that ensures that the "bank adheres to the principles of good corporate governance and high ethical standards enshrined in applicable laws and regulations". The Board is responsible for the overall direction and policy of DBG and the Board members are selected through an open and competitive process by an independent body. The selection is based on expertise, diversity of experience, and commitment to the integrity of DBG.

The governance structure of the DBG emphasizes and prioritizes development impacts on the key sectors that it funds and invests in. At the same time, the integrity of the long-term return profile of DBG's investments is maintained. The board and senior management also ensure that the corporate governance guidelines and regulations of the bank are followed. Under the guidance of the Board of Directors, DBG's goal is to manage its portfolio as an active investor and asset owner with full commercial responsibility.

In order to gradually lessen its reliance on public funds and raise its share of the loan market at competitive interest rates, DBG's long-term goal is to strengthen access to national and international capital markets. To increase access to finance, the Board intends to concentrate on creating a network of local and international partnerships.

With regard to the internal regulations, the Board of Directors follows the requirements of corporate governance, the responsibilities of the Board of Directors, and the operational structure of the bank. These regulations aim to strengthen the essential components of enterprise risk governance. In addition, it defines and describes the powers, duties, and prohibitions of shareholders. The bank follows corporate governance guidelines from the central bank (BoG) and international standards for code of ethics and anti-corruption policies. The Board's codes of ethics are regularly reviewed to ensure compliance with new corporate governance standards, the bank's strategic direction, shareholder interests, and corporate governance best practices. Although the ownership and control structure of DBG can be complex, with many government representatives on the Board, the bank insists that Board members are appointed by an independent private organization. The bank may become vulnerable to political interference if its institutional structure is not strong enough and the independent board appointment process is not sustained to withstand such political pressure.

Box 2.1 provides details of the bank's corporate governance framework.

Box 2.1: DBG's Corporate Governance Framework

Board composition: The majority of directors will be non-executive and an independent Chairman of the board will also be an independent director. Directors will be competitively recruited with the assistance of a credible international search firm.

Board responsibilities: The Board will have clear authority to appoint and hold accountable the CEO and other key management personnel who will be competitively recruited with the assistance of a credible search firm. The Board will be composed of a fully independent Audit Committee and a Risk Committee.

The management team receives general direction and policy directives from the Board. With the additional statutory obligation in collaboration with the CEO, it acts independently. The Board's primary concern will always be safeguarding the safety of the bank's reserves. The Board is planned to meet once a year, with periodic updates throughout the year. Additional meetings will be scheduled as required to conduct the institution's business. The formation of the Board is followed based on the Directives issued in the Development Finance Institutions Act, 2020 (Act 1032), Section 41(2). In most situations, at least 60% of Board members will be independent directors, and the following decisions will be reserved:

- Setting the overall long-term strategic objectives of the bank,
- Setting the annual budget as well as the review and approval of the annual audited statutory accounts,
- Reviewing and approving all investments and exit offers,
- Engaging the banks as well as all funding proposals,
- Approving the appointment of senior management and putting in place the right structures for succession planning related to the institution.

Required Board Committees

The following Board committees will be established with specifically delegated authorities in accordance with the Bank of Ghana corporate governance regulation, each chaired by a non-executive Director who is independent of management. The subcommittees' roles will be set up such that the Board can delegate authority only to the specific committees. The Board committees consist of: (1) Board Finance and Audit; (2) Board Credit and Risk; (3) Board Governance, Nominations, and Remunerations; (4) Board Technology; and (5) Board Cyber and Information Security.

Other committees will be carved out in due course to ensure the smooth running of the organization. The management of DBG aims to collaborate with the Board in an honest and open way. The Board will be able to successfully carry out its duties and make decisions on behalf of its stakeholders if the information is provided to it on an ongoing basis. The selection of the management will go through a transparent and competitive process by PwC, an independent body. This independent body insists that there is uncompromising commitment to global best practices. They have a proven track record of adding value to investments and delivering strong returns. The management has high ethical standards to achieve the development goals of the bank. Operation and value creation teams are made up of senior executives with local and international experience who drive the investment-making process.

Source Development Bank Ghana; https://www.dbg.com.gh/corporate-governance/.

2.6 Risk Management Practices

Risk management is extremely critical, and NDBs could benefit from implementing an efficient risk management system. The overall objective of the risk management process involves evaluating the potential losses that may arise in future and then taking the necessary precautions to deal with them when they occur (Abor, 2023). Risk management practices are an essential issue as they have a significant impact not only on bank behaviour but also on the economy. Like other development banks, DBG has established and enforced a number of policies and procedures to reduce or limit risks in the provision of development banking services. Against this background, it is of crucial importance for the bank to quantify the risk and to find the optimal mix of risk that can help achieve sustainable development. The framework of DBG's corporate governance practices is based on the principles of risk management, internal control, and internal audit. The primary functions of the DBG Risk Committee are to oversee senior management's implementation of the risk strategy and to advise the Board on the overall current and future risks of the bank. During this process, the Risk Committee also defines the institution's tolerance, appetite, and strategy for various risks, including Anti-money Laundering and Counter-terrorism Financing (AML/CFT) risks. A seasoned independent director with expertise in risk management, finance, accounting, economics, and other business disciplines serves as the committee's chair.

DBG is exposed to various risks in the exercise of its activity; namely, credit risk, liquidity risk, operational risk, strategic risk, political, social and environmental risks, as well as market risk (interest rate risk and currency risk). Among these risks, credit risk and market risk are the main risks faced by the bank, and these risks are regularly monitored. In order to reduce impairments and non-performing loans (NPLs) to a minimum, the bank has implemented a risk management system and monitoring strategies. Often, corrective actions are designed so that their impact on banking operations is minimal, if they do occur.

2.7 Regulation and Supervision

The regulatory and supervisory framework in place in the past was governed by the Banking Act 1970. However, that Act did not provide clear guidelines on minimum capital requirements, risk limits, prudential limits, and loan loss provisions for DFIs. There were specific Acts governing NIB (Act 163) and ADB (Act 286) prior to them becoming universal banks. The Ghana EXIM Bank is also governed by a different Act, the Ghana Export–Import Bank Act 2016 (Act 911). Uneven oversight and weak enforcement played a role in compounding the problems associated with the failure of these institutions. Regulators were unable to anticipate and monitor the major changes taking place in the industry or to remedy widespread corporate governance failures. The success of a development bank requires a well-functioning regulatory arrangement. The principle of independent and effective regulation and supervision of DFIs is a prerequisite for good governance and for ensuring good financial performance and sustainability. It is vital that DFIs are well-regulated and supervised, and this role is best fulfilled by the BoG. Regulatory and supervisory regimes for development banks should be very similar to the standards applicable to commercial banks but modified to reflect development banks' business models.

The BoG, which oversees DBG, frequently adjusts its laws, rules, policies, and guidelines to foster a climate that supports the bank's operations. The design features of DBG are reinforced by the new Development Finance Institutions Act 2020 (1032), which provides clear guidance on how DBG should operate and be regulated. The Act empowers BoG to exercise strong regulatory and supervisory oversight. DBG is registered as a limited liability company under the Companies Act (2019).

By implementing the international rules and principles governing the financial sector, the central bank strengthens the country's financial system. In order to ensure that financial institutions are adhering to regulatory norms and to safeguard clients and the financial system as a whole, BoG has created its legal and regulatory framework. In order to achieve financial stability in Ghana, DBG is supposed to comply with the Basel II and III sets of regulations. However, it is important to reflect the development and sustainability mandate of NDBs in their regulatory framework instead of wholesale adoption of the Basel requirements.

2.8 Monitoring and Evaluation, and Impact Evaluation Structures

The importance of the monitoring and evaluation (M&E) role within DFIs has been reinforced by the growing interest of M&E practitioners and emerging development partners who have brought to the fore the issue of effective development impact. This has become increasingly important for DBG to network among M&E practitioners and share knowledge on M&E and impact evaluation related to the delivery and effective development outcomes. Therefore, the role of DBG in supporting national developments, particularly in the quest to mainstream impact evaluation in their development areas and governance decision to deploy funds to complement these efforts, remains crucial. To ensure that the bank's mandate is consistent with DFIs' guidelines, efforts at maintaining good M&E and impact evaluation practices need to be strengthened.

DBG as a new entity has paid little attention so far to M&E and impact evaluation. Therefore, we will focus on discussing the structures that have been instituted to ensure effective M&E and impact evaluation. The bank has an economic and research department that is supposed to deal with issues concerning the value chain; policy advocacy based on the recommendations emanating from the research team; and the framework on how the bank will monitor and measure the impact of development projects. The bank will monitor and evaluate projects or businesses that have received funds from DBG through the participating financial institutions in order to measure development impact. Generally, the bank has an M&E framework that provides the relevant feedback for measuring the outcome of the project. The M&E unit is supposed to report to the economic and research department.

The evaluation of a project comes out of a monitoring procedure and normally it is done by an independent body, which may take about 5–6 years to complete a full M&E plan for a particular development project along the value chain area. For instance, before the bank will offer any credit, it has to conduct an evaluation of the development outcomes through the M&E work plan. For this reason, the business development unit is responsible for the M&E of the financing provided to end-borrowers. Although the bank has provided over GHS300 million (US$26,570,412) in loans since its establishment, it is still putting its M&E and impact evaluation structures in place. DBG believes in the quality and efficiency of the staff employed to work in the M&E unit. This is dependent on the recommendations for the system to be put in place and the projects to be supervised and monitored. In view of that, the bank is finding ways to recruit the best and qualified personnel to handle the various M&E and impact evaluation functions.

M&E may concentrate on the clients of the participating financial institutions with a substantial environmental and social risk category as well as clients with medium risk. In the monitoring of environmental and social management systems, issues of E&S, their transaction type, and various sectors of the economy are strengthened based on environmental rules and social standards applied by the participating financial institutions. In order to avoid and minimize any reputational risk, legal risk, or loan default risk, the bank is to be guided by its monitoring approach when examining the E&S compliance and performance of the participating financial institutions (including their end-borrowers), as expressly stated in the Master Financing Agreements signed with them. Participating financial institutions that lend to end-borrowers in industries with "substantial E&S risk" or "moderate E&S risk" are monitored strategically. The E&S Team is expected to evaluate and keep track of participating financial institutions' overall performance of E&S.

2.9 Business Models of DBG

The DBG is a non-deposit-taking development finance institution, which raises its finance from a number of sources, including shareholders' equity, issuance of bonds, acquisition of long-term loans (possibly with government guarantee), and reinvestment profits. DBG also receives grants from government and other sources to perform specified services consistent with its mandate. It focuses on financing projects in priority sectors of the economy. In executing operations, the bank offers competitive pricing and lending models and has developed a business model that covers the targeted sectors of the economy. The operational activities of the bank include lines of credit to eligible participating financial institutions for on-lending to viable MSMEs as well as offering credit guarantees, through a credit guarantee facility on participating financial institutions' loans made to those MSMEs.

Policy Mandate

DBG was established with the mandate to assist SMEs and indigenous businesses engaged in manufacturing, agriculture, and ICT in Ghana. For the purpose of transforming Ghana's economy and generating jobs, DBG offers long-term funding to important industries. It complements Ghanaian banks in providing financial support to SMEs and local corporates in agribusiness, manufacturing, ICT, and high-value services of the Ghanaian economy. DBG lends to participating financial institutions, including providing medium- to long-term loans that can be transferred to specified Ghanaian companies. DBG also provides participating financial institutions with loan guarantees, lines of credit, and other financial and non-financial services.

Funding Sources

DBG relies on various sources of funding including borrowing from the international capital markets and other financial institutions, receiving official development assistance from international financial institutions (such as the World Bank (WB), KfW, African Development Bank (AfDB), European Investment Bank (EIB), funds from the domestic market, and other regional development banks. The bank is expected to diversify its funding sources to lower high funding costs. The funding sources of DBG include equity and grants, as well as debts. DBG has received initial funding comprising of a total equity and grant of about US$338.3 million corresponding to 44.3% and a total debt of about US$425.3 million corresponding to 55.7%. For instance, the government of Ghana has supported the bank with US$250 million. Out of this amount, a total of US$200 million in initial equity was received and the remaining US$50 million was received in the fourth quarter of 2022. The AfDB provided an additional equity of about US$38.8 million passed on through the government in the 4th quarter of 2022. DBG also received a total grant of about US$50 million from the World Bank through the government of Ghana. In terms of initial debt funding, the bank received US$196.55 million from EIB in 2022, US$175 million from the World Bank in tranches of credit line (in 2022), and US$53.7 million from KfW in 2021.

Lending Model and Pricing of Loans

The DBG has been established as a wholesale development bank that lends to commercial banks and other financial institutions for on-lending to Ghanaian firms. With the wholesale lending model, the bank channels its funding through commercial banks and financial institutions to the targeted sectors of the economy. The bank provides funding to local businesses at competitive rates. The pricing of loans provided by DBG reflects the short-term interest rates of the central bank. The pricing and subsidy policies of the bank's loan products will be in line with the objectives of the government. Generally, the bank's lending is based on moderate interest rates. The BoG's monetary policy rate plays a role in determining DBG's pricing of loans.

Product and Services

DBG offers a wide range of financial products and services including long-term loans, equity, guarantees, advice, technical support, matching grants, investment accelerators, and guarantee facilities. It provides eligible participating financial institutions with tailored financing products and services to enable them to expand financing to enterprises in the target sectors and market segments. It is expected to develop a package of complementary products and services to address existing market failures. This includes medium-to-long-term lines of credit, partial credit guarantee facilities, and a digital platform to facilitate supply chain financing, among others. An important facility of the bank is to guarantee products that will allow the commercial banks to lend their own funds to SMEs. The bank is supposed to provide loan guarantees for its lines of business, which include providing SMEs with access to financing.

2.10 Initial Interventions and Challenges

The DBG has a specific mandate to provide financial support to the priority sectors of the economy in order to achieve the National Development Agenda. The mandate of the bank is to support the transformation of the economy through the private sector and to provide long-term financing. DBG, since its establishment, has been able to disburse over GHS200 million (US$177,778.69) to MSMEs. The bank has an equity investment fund dedicated to supporting viable economically transformative companies. The equity investment fund started operations in 2022. A partial credit guarantee fund has been set up in conjunction with credit risk mitigation guarantee on a participatory basis by DBG to ease MSME access to finance. There are some areas that the participating financial institutions are not able to cover and, for that matter, DBG will be able to cover those areas by helping to reduce the market failures that the participating financial institutions are unable to address. The bank has been able to implement programmes that help to de-risk through guarantees to support the private sector. The key areas of contributions by the bank are: (1) providing business development services to revamp capacity building in the economy; (2) providing partial credit guarantee to de-risk and support the banking sector in providing the needed support and much needed financing to the private sector; (3) providing climate support financing; and (4) providing equity financing.

DBG has established the environmental social management system that comprises a policy, procedure, and guidelines developed for the participating financial institutions. The bank has empowered and strengthened the participating financial institutions to enhance their capacity to meet the requirements of the environmental and social management systems. The bank continues to provide capacity to the participating financial institutions so that they will be able to manage the environmental and social performance of their clients and themselves. This has become an avenue for the bank to leverage opportunities. Partial Credit Guarantee (PCG) has been established by the bank to handle issues with regard to the quality of access to credit by SMEs. The PCG covers women-led businesses and green businesses. Further, the bank is able to provide guarantee cover up to 80% and, thus, lends to sectors that are highly risky. The bank looks forward to launching the whole structure of PCG by September 2023 in order to provide the needed capacity for SMEs to scale up their businesses and enhance productivity. The bank has built the capacity of the participating financial institutions and trained over two thousand women in the SME sector. It has also built on four value chains in the area of Maize, Soya, Poultry, and Rice around Kumasi, Sunyani, and Sogakope, thus contributing to job creation.

In spite of the bank's initial interventions, it is confronted with some challenges. The DBG faces some challenges in its operations, especially in terms of inadequate information provided by borrowers. Some borrowers are unable to provide sufficient information about their businesses, collateral, and others—making the assessment and evaluation of such customers' creditworthiness very difficult. Although the bank continues to leverage environmental and social sustainability (ESS) measures, it is confronted with climate financing gaps, impacts of climate change, as well as the challenge of supporting bankable green projects. The bank is also confronted with the challenge of mobilizing climate finance from a wide variety of sources, instruments, and channels, which turn to affect the consistent flow of funds towards greenhouse emissions and climate change-prone areas. In addition, major macro fundamental indicators such as exchange rates, inflation, effects of the COVID-19 pandemic, and external shocks from the global market have also had adverse impacts on the operations of the bank.

2.11 Conclusions and Way Forward

This chapter examined the political economy of DBG. In this chapter, we provided an insight into the emergence and early years of the bank. We discussed the political economy of DBG, its development mandate, corporate governance arrangements, risk management, regulation and supervision, monitoring and evaluation, impact evaluation structures, the business models, as well as the bank's initial interventions and challenges. DBG is seen as a key vehicle for pursuing economic transformation and job creation to achieve the overall national strategy. The chapter indicates that DBG operates under the legislative instruments, with corporate governance structures, and supervision and regulatory framework designed by the government of Ghana and the central bank. The operational activities of the bank include lines of credit to eligible participating financial institutions for on-lending to viable MSMEs and offering credit guarantees through a credit guarantee facility of participating financial institutions. Although the bank has been established in a fragmented political system with frequent political interventions, it is committed to working with development partners and stakeholders to design programmes directed at revamping priority sectors of the economy. Despite the significant benefits reaped by the government and the contributions to the environmental and social management system, the bank is faced with operational challenges, which include inadequate information provided by borrowers, climate financing gaps, as well as uncertainties in the credit market. Instituting strong monitoring and evaluation as well as impact evaluation systems is an important step in ensuring the bank fulfils its mandate and is consistent with the legislative instrument and international guidelines.

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CHAPTER 3

The System of National Development Banks in Nigeria: The Case of the Development Bank of Nigeria

Paul Terna Gbahabo, Benjamin Agyeman, and Sylvanus Ikhide

3.1 Introduction and Historical Background

The global economic landscape has witnessed policymakers harnessing the potential of development financing models to promote sustainable development at various levels of governance, including multilateral, regional, national, and subnational governance (Schclarek et al., 2023; Gong et al., 2023). Development finance refers to policy mandates designed to overcome market failures in strategic sectors of the economy, segments of

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society, and during cyclical episodes underserved by private financial intermediation mechanisms (Abor, 2023; Rudolph, 2009). Market failure is one of the major theoretical justifications for development financing models (Gutierrez & Kliatskova, 2021). Market failure refers to the limits of market mechanisms to achieve economically efficient or socially desirable outcomes (Rao, 2003).

Market failure in credit intermediation is ubiquitous and manifests in several ways. First, while information asymmetry induces a limited supply of capital to micro-, small-, and medium-sized enterprises, large corporations exhibit insatiable capital demand due to their economies of scale and external market access. Second, risk aversion often leads to an insufficient supply of long-term capital, and procyclical lending often limits private-sector financing during a financial crisis. Third, corporate greed and the quest for super-normal profit frequently price many businesses and viable projects out of the market (Gutierrez & Kliatskova, 2021; Gong et al., 2023; Jiang et al., 2023). Against this backdrop, policymakers often directly intervene to complement the financing responsibilities of the financial sector, especially in strategic sectors.

This complex interplay between policy financing and economic development deserves greater academic focus than it currently receives (Gong et al., 2023; Gutierrez & Kliatskova, 2021; Hu et al., 2022; Rao, 2003). Until recently, the economic literature paid little attention to the critical role of policy finance in economic development (Gutierrez & Kliatskova, 2021; Hu et al., 2022). Therefore, policymakers in Nigeria have, over the years, established several development finance institutions (DFIs) with policy mandates spanning financing, leasing, guaranteeing, risk-sharing and insurance, refinancing, debt factoring, and provision of technical assistance to different strategic sectors of the economy.

This chapter examines the system of national development banks in Nigeria, with a specific focus on the Development Bank of Nigeria (hereafter, the Bank or DBN) as a case study. The promoters of DBN are the Nigerian government, the African Development Bank, and the European Investment Bank, with support from the World Bank, the KfW (the German Development Bank), and the Agence Francaise De Development (the French Development Bank), with an explicit legal mandate to provide policy finance and technical assistance to micro, small, and medium enterprises (MSMEs). By addressing MSMEs' financing constraints, the Bank aims to facilitate their access to longer-term and concessionary loans, partial credit guarantees, and technical assistance through eligible financial intermediaries (DBN, 2021).

The remaining sections of the chapter comprise the institutional context, the corporate governance structure, a risk management profile, regulation and supervisory framework, the business model, major achievements and challenges, asset quality and operational performance, and conclusion.

3.2 Overview of Development Finance Institutions in Nigeria

Following political independence in 1960, the Nigerian government sought to intervene directly in the credit market to plug the existing financing gap stemming from the weak financial system inherited from the colonial authorities. In the subsequent years, many DFIs were established with a wide range of policy mandates comprising financing, leasing, credit risk-sharing, credit guaranteeing, debt factoring, refinancing, and technical assistance provision to business enterprises across several sectors of the economy.

However, a review of the history of DFIs indicates that despite the imperative to address the financing gaps and correct market failures, many experience difficulties fulfilling their mandates. The broad scope of their mandate to engage in investment financing and risk-taking activities has resulted in direct competition with the commercial banking sector. Therefore, DFIs became substitutes rather than complements to private-sector lending and credit risk evaluation capacity (World Bank, 2016). Further, many DFIs lacked the expertise to assess credit risk and were frequently obliged to undertake lending activities based on political exigencies rather than commercial terms. Thus, several DFIs in Nigeria experienced high levels of non-performing loans, compounded by the lack of effective independent oversight functions in many of these DFIs. These poor corporate governance arrangements and other risk management issues have made utilising DFIs as a tool for structural transformation in Nigeria challenging, as they could not effectively facilitate significant increases in financial intermediation in their respective sectors (World Bank, 2016).

Appendix presents an overview of some major DFIs and complementary development finance schemes in Nigeria, with date of establishment, asset size, and their respective mandates.

These DFIs were designated to cater to various sectors of the Nigerian economy. For instance, the Bank of Industry and its subsidiaries (comprising BOI Investment Company Ltd, LECON Financial Services Ltd, BOI Insurance Company Ltd, and BOI Microfinance Ltd) provide a wide range of financial services (including financing, investment, leasing, insurance, and microfinance services) to the manufacturing sector and the economy at large. The Bank of Agriculture, the Nigeria Incentive-Based Risk Sharing System for Agricultural Lending Plc and its microfinance subsidiary provide financing, credit risk-sharing, and microfinance services to the agriculture, Agro-allied sector, and the economy. The Federal Mortgage Bank, Federal Housing Authority Mortgage Bank, and the Nigerian Mortgage Refinance Company provide long-term wholesale financing, retail financing, and liquidity refinancing to the housing and real estate sector. The Nigerian Export–Import Bank caters to international trade financing, while the Asset Management Company of Nigeria provides debt factoring services to the lending sector. The Development Bank of Nigeria and its subsidiary Impact Credit Guarantee Ltd provide financing and credit guarantee services to the MSME sector.

Further, several other public ministries, departments, agencies, and educational institutions have established subsidiary microfinance banks to complement financing MSMEs and low-income households in their respective communities. Given that Nigeria is a federation of states, it is common to observe several sub-nationals (states and local authorities) possessing microfinance banks or public corporations operating the DFI model, specialising in infrastructure, MSMEs, or smallholder agriculture financing. The Nigerian DFIs Association (ANDFI) has over 40 members.

Besides these DFIs, the CBN often gets directly involved in providing development financing by establishing and managing several CBN intervention fund schemes targeted at various sectors of the economy to complement the activities of DFIs. These include the Agricultural Credit Guarantee Scheme Fund, the Agricultural Credit Support Scheme, Commercial Agricultural Credit Scheme, SME Credit Guarantee Scheme, the Small and Medium Enterprise Equity Investment Scheme, and the Youth Entrepreneurship Development Programme. Although the World Bank (2016) contends that there is no evidence that these CBN schemes are any more effective than existing DFIs, the government continues to use them to complement the mandates of DFIs. However, the provision of funding through such schemes, usually at highly subsidised terms, may create the unintended consequence of crowding out the development finance market and further exposing the existing DFIs to strategic market demand risks as some of its creditworthy borrowers and lenders may defer to CBN subsidies to shield themselves from DFI credit terms (World Bank, 2020).

Historically, public DFIs in Nigeria are typically wholly-owned public financial institutions or wholly-owned subsidiaries of the former. However, due to the governance issues that bedevilled the earlier DFIs, the government has recently adopted alternative ownership structures, divesting some of its stakes in wholly-owned public DFIs to become private-sector-led partially-owned. The Infrastructure Bank Plc (formerly Urban Development Bank of Nigeria Plc) benefits from this divestment strategy, giving 69% shareholding to the private sector. Another innovation regarding the ownership structure of DFIs is introducing other partially-owned entities with the government as the majority shareholder (75%) and the international development partners as the minority (15%). DBN is a classic example of this model.

The predominant business model adopted by some of Nigeria's earliest DFIs between 1960 and 2000 is the retail financing model. However, to overcome the challenges of the previous generation of DFIs, the government in the post-2010 era adopted wholesale lending as the alternative business model for the subsequent DFIs, as is the case with the Development Bank of Nigeria and its subsidiary.

3.3 Political Economy and Institutional Context

The Bank commenced operations in 2017, coming on the back of the 2016 economic recession. Three years into its existence, the economy underwent another economic recession in 2020, besides the prevailing low economic growth rate averaging 1.8 per annum (see Fig. 3.1). Similarly, an operating context of a rising double-digit inflation rate and a deteriorating exchange rate only led to macroeconomic instability. Although the oil sector contributes less than 10 per cent of GDP, it remains a critical source of government revenue and export earnings (World Bank, 2020). Therefore, the economy remains susceptible to fluctuations in global oil commodity prices. Indeed, the recent episodes of commodity price slump preceded the 2016 and 2020 economic recessions (see Fig. 3.1).

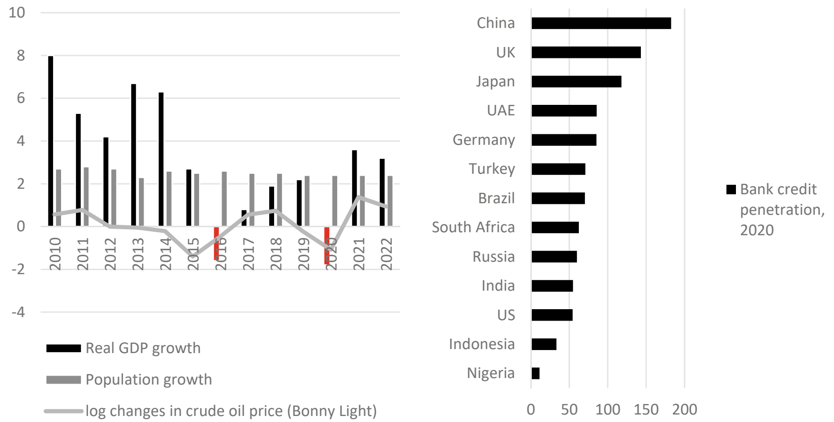

Fig. 3.1 **a** Trends in Real GDP growth, Population growth, and Log changes in crude oil prices (%) in Nigeria. **b** Comparative bank credit penetration (% of GDP) in 2020 for selected economies worldwide (*Sources* World Bank, 2023; Central Bank of Nigeria, 2023)

The global political economy of rising global inflation exacerbated by the 2020 COVID-19 pandemic and the onset of the Russia–Ukraine war set the tone for an unstable global economy. Therefore, it is safe to say the political economy and the institutional environment under which the Bank has operated since its inception has been one of economic turbulence. The implication is declining disposable income amid a low bank credit penetration, thus creating the conditions for the high demand for financing, especially amongst MSMEs frequently exposed to credit rationing (World Bank, 2016 and Fig. 3.1).

Against this backdrop, the Bank responded to the demands of the operating environment by implementing innovative measures to enable it to fulfil its mandate of plugging the MSME financing gap. Specifically, the Bank introduced new products and funding initiatives to ensure increased financial support to the MSME sector while maintaining its financial sustainability. Similarly, in recognition of the vulnerability of MSMEs during crises, the Bank also provided loan moratoriums to assist businesses in maintaining sufficient cash flow to sustain their financial viability during the recent economic recession (DBN, 2020).

The Bank also engages with a comprehensive stakeholder impact matrix that deals with stakeholder expectations. The key institutions whose activities and decisions directly or indirectly impact the operation and governance of the Bank include the shareholders, the development partners, the board of the bank, the regulator, the participating financial institutions, MSMEs, civil society organisations, academia and resource organisations and the media (Fig. 3.2). The Federal Government, as the largest shareholder, influences the Bank's operations through the appointments of the board and CEO of the Bank. However, this relationship can benefit the Bank by leveraging its political connections to attract external donor funding from multilateral development partners.

3.4 Corporate Governance Arrangements

An effective corporate governance arrangement is a critical factor to the management and operations of both public and private companies. The use of this power helps in achieving the goals and objectives of an organisation. Besides helping to achieve the goals and objectives of the organisation, corporate governance serves as the structures and processes of managing the economic and social resources of companies (International Finance Corporation-IFC). Having a competent board to oversee the activities of management of every company is paramount. The "primary role of the board is to protect shareholder value over the long term" as stated in the board mandate below:

> The board is committed to the adoption and observance of best-in-class corporate governance practices at DBN. The board acknowledges that corporate governance is an intrinsic element of business success, and as such, continually evaluates and upscales its governance practices to ensure that these are capable of enshrining in the bank, procedures, protocols and structures that are required to build a virile governance architecture and culture which serves to ensure that the bank's business not only remains profitable but is also sustainable and is positioned to deliver value to all stakeholders and is responsible to the economic and developmental interest of the shareholders. (DBN, 2021)

Corporate governance is a key focal point for the bank in its aspiration of being the reference point for international best practices in the financial service industry in Nigeria. Thus, the mechanism of corporate governance structure ensures that the issues of accountability, transparency, and other

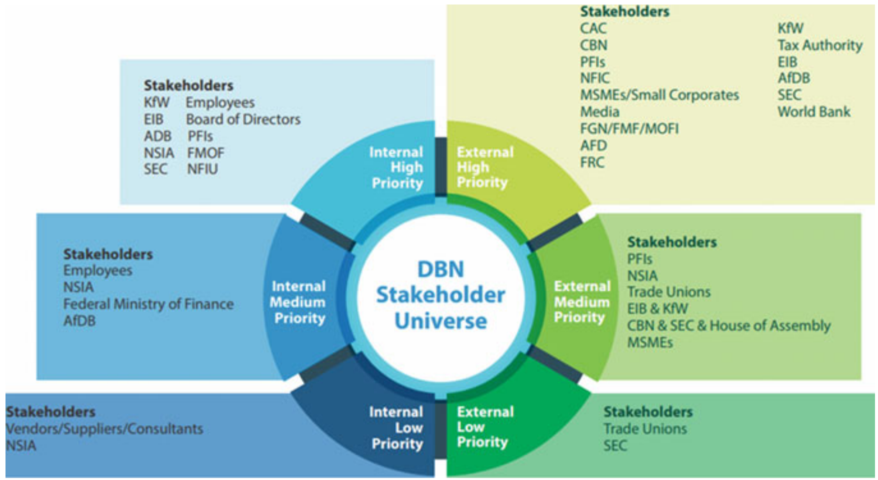

Fig. 3.2 Development Bank of Nigeria stakeholder identification priority (*Source* Extracted from DBN Annual Integrated and Statutory Report 2018)

good corporate practices are successfully achieved. DBN subscribes to the Code of CG for Public Companies by the Financial Reporting Council of Nigeria (the National Code). DBN's CG practices continue to be informed by the practices enshrined in the CBN code of CG for DFIs and the Securities and Exchange Commission's Code of CG for Public Companies (ibid.).

The governance structure of DBN is clearly indicated in its enabling Acts. Under the corporate governance systems, the boards are supposed to provide the policy directions while management sees to its implementation. The BoD is the highest governing body within the bank and is accountable to the shareholders. The board is headed by the chairman who is *primus inter pares* in relation to other members of the board. The roles of the chairman and the managing director/chief executive officer are separate, which is a core governance imperative of the bank. In order to maintain this duality position, the ascension of the CEO to the office of the chairman is strongly discouraged (DBN, 2019). The management team, under the leadership of the managing director, is being given a delegated authority by the board to handle the day-to-day operations of the bank. In that regard, the managing director remains directly accountable to the board for the effective management of the business for all activities and actions delegated. These activities are not limited to "the development of strategic and business plans, preparation of annual budgets and policy recommendations, supervising the execution of strategy and implementation of all policy decisions made by the board, managing the Bank's risk profile in line with the extent and categories of risk identified as acceptable as well as ensuring appropriate internal controls and safeguarding the Bank's assets and resources".

The board is mandated with the provision of the bank's strategic objectives to ensure necessary resources are in place for the implementation of the strategies and to ensure effective supervision and oversight of management. It also undertakes an ongoing assessment and review of the performance of the board, its committees, and individual directors annually. Moreover, the board approves the bank's annual targets and financial performance against forecast, budget, and prior periods. The board as well monitors the effectiveness of the bank's risk management and corporate governance framework (DBN, 2021).

The Article 9.5 of the bank's Article of Association was applied in appointing the first directors of the bank by the shareholders based on agreed minimum criteria. The procedure for appointing the first independent directors involved the establishment of an initial Nomination Committee comprising five (5) experts and professionals by the shareholders. The committee's work was supported by an independent executive search firm which screened potential directorship nominees against criteria that were agreed upon by shareholders before the commencement of the executive search. The recommended shortlist of candidates was presented to the shareholders from where the final decision was taken. The selected candidates were then presented to CBN for approval and, thereafter, the initial nomination committee was dissolved. After the inauguration of the board, the appointments to the board are undertaken by recourse to the bank's articles of association and it has an adequate board-level oversight. The law permits the shareholders to nominate their representatives to the board but such appointments must be approved by the board and the CBN before assumption of duty.

Section 259 of the Companies and Allied Matters Act (CAMA) and Article 10.3.3 of the bank's Article of Association require that the directors of the bank retire by rotation so as to keep institutional memory. Key partners of the bank are granted observer status and are entitled to attend all meetings of the board and to receive information provided to the board for meetings. However, the observers are not entitled to vote nor contribute to the board's deliberations. The board is only obliged to solicit information from the observers on technical issues but is not bound to act on such information. Principally, the observers assure their institutions that the board and the bank are operating optimally in accordance with agreed objectives. All shareholders of the bank have board representatives on the DBN board as of December 2021.

The board's approved Charter sets out its operations and activities. The board is of sufficient size relative to the operations, risk management, and mandate of the bank. The size of the board which currently permits 11 members, 6 being independent non-executive directors, 3 being non-executive directors and 2 being executive directors (DBN, 2021). It comprises an appropriate mix of knowledge, skills, and experience, including business, commercial, and industry experience. The majority of the non-executive directors are independent and each director exercises independent judgement when deciding on matters before the board. The decisions of the board are reached through a consensus. However, the board charter and the bank's article of association give the reserve to the chairman of the board to cast vote for the resolution of any

Table 3.1 The board composition as of 2021

Board composition	*2021*
Board size	11
Independent non-executive directors	6
Non-independent directors	5
Executive directors	2
Non-executive directors	3
Female board members	2

Source DBN (2021)

equality of votes on issues that would be put to vote. Table 3.1 shows DBN board characteristics.

The efficiency of the board is enhanced by the board committees as well as the facilitation of detailed discussions of technical issues and the application of relevant director expertise to specific areas. The board is made up of five (5) committees through which its oversight and affairs of the bank are exercised. These are the credit and risk committee (five members), the board audit and compliance committee (four members), the finance committee (six members), nomination and governance committee (four members), and the ethics committee (five members). All the committees have charters approved by the board of directors. The committees' charters detail the terms of reference, membership, quorum, and authorisation of each committee. Moreover, all board committees are chaired by independent non-executive directors. The chairman of the board is not a member of any of the committees.

It is mandatory for all the board committees to meet quarterly or as required ahead of board meetings to ensure that all directors can contribute effectively to discussions at board meetings. The board also meets quarterly with additional meetings being scheduled and held as required for the effective steering of the bank's business. The schedule of meetings for the board committees, the board, the annual general meeting, and the board/management retreat is agreed upon before the start of every financial year. The CEO also provides quarterly reports to the board on the activities of the management. The functional heads such as the Chief Operating Officer, the Chief Financial Officer, and the head of Internal Audit also make presentations to the board through the relevant board committees.

In addition, the board enriches the bank's governance practices by adhering to the principles and recommendation practices of the Nigerian Code of Corporate Governance 2018. The bank also complies with the code of corporate governance for DFIs issued by the CBN and the CG guidance for Public Companies issued by the Securities and Exchange Commission. Again, the board seeks guidance from its development partners to strive for excellence in governance; to deliberately seek and adopt tested practices that guarantee the sanctity of the bank's business; and to continuously differentiate DBN as a reference point for corporate governance in the development finance space in Nigeria. Moreover, the bank has met the requirements of Sections 3.1 and 5.3.1 of the CBN on whistleblowing and has instituted an efficient whistleblowing policy in its operations which is yielding good results.

3.5 Risk Management Practices

Risks are associated with banking operations, and the Bank is no exception. Some of the risks associated with the banking sector include, but are not limited to, operational, credit, market, liquidity, strategic, reputational, and compliance risks. The Bank must anticipate and respond to the risks and opportunities of sustainably executing its mandate. Due to the importance of risk management, the Bank has implemented a robust risk management system. It has created a credit and risk committee which effectively manages risk exposures by adopting an enterprise-wide risk management (ERM) framework and approach. The ERM has enormous benefits, including minimising operational surprises and related costs or losses and enabling management to identify and manage significant risks on an aggregate basis. The Bank has standard risk management policies structured as information security risk management, business continuity management policy, stress testing framework, operational risk management framework, reputational risk management framework, etc. The Bank avoids or mitigates any adverse impacts and risks to the community and environment from implementing its financing activities and operations. Table 3.2 presents the key risks faced by wholesale DFIs, focusing on the Bank while highlighting the drivers behind these risks and potential mitigating factors.

The potential dangers posed by cyberattacks and data breaches due to the increasing reliance on information technology in the banking sector have increasingly become the focus of the board risk management

Table 3.2 The bank risk profile, risk drivers, and mitigating factors

Risks	*Drivers*	*Mitigating factors*
Credit risk	a) Economic conditions b) Poor loan underwriting	a) Robust due diligence b) Risk-based pricing c) Strict enforcement of credit policy
Market risk	a) Volatility in financial markets b) Macroeconomic factors	a) Hedging strategies b) Stress testing c) Robust risk monitoring
Interest rate risk	a) Monetary policy actions b) Maturity mismatch	a) Asset-liability b) Interest rate derivatives c) Scenario analysis
Liquidity risk	a) Withdrawal of funding sources b) Deterioration in asset quality	a) Liquidity management framework b) Diversified funding sources c) Collateral management
Currency risk	a) Cross-border operations b) Foreign currency borrowings	a) Currency hedging b) Natural hedging c) Robust risk monitoring
Investment risk	a) Market volatility b) Poor investment selection	a) Robust investment due diligence b) Diversification c) Regular performance monitoring
Operational risk	a) Inadequate internal controls b) Technological disruptions	a) Robust internal controls b) Technology risk management c) Employee training and AWARENESS
Strategic risk	a) Limited market demand b) Inadequate diversification	a) Comprehensive market research b) Robust product development c) Diversification strategy

(continued)

Table 3.2 (continued)

Risks	*Drivers*	*Mitigating factors*
Compliance risk	a) Evolving regulatory landscape b) Inadequate internal controls	a) Robust compliance framework b) Regular training and awareness programmes c) Ongoing monitoring
Reputational risk	a) Misuse of funds b) Poor governance	a) Robust due diligence b) Strong monitoring and evaluation c) Transparent reporting
Environmental and social risks	a) Climate change b) Social norms violations	a) Environmental and social due diligence b) Compliance with ESG standards c) Capacity building of counterparties on ESG issues
Technology risks	a) Rapid technological advancements b) Dependency on digital systems	a) Robust and secure IT infrastructure b) Cybersecurity measures c) Business Continuity Planning
Cyber/IT risks	a) Sophistication of cyber threats b) Interconnectedness financial systems and reliance on digital infrastructure	a) Robust cybersecurity frameworks b) Employee awareness c) Collaborative approach

committee. Therefore, to ensure that the information technology and the assets of the Bank are managed against threats, the Bank has subscribed and implemented three major ISO standards and certifications: ISO27001 Certification (the standard for information security), ISO22301 Certification (the standard for business continuity management), and ISO20000 Certification (information technology service standard).

The Bank implemented the COSO 2013-Internal Control-Integrated Framework which enabled the board to establish the tone regarding the importance of internal control and the expected standards of conduct. The framework addresses control challenges by identifying critical activities, assessing the risk exposures, determining appropriate preventive and detective control measures, and monitoring such measures to ensure compliance. The overall objective of the internal control framework is to ensure that adequate and effective internal controls are in place and that these controls are applied consistently throughout the organisation to protect the Bank and its stakeholders from potential losses. This framework is managed within the five key principles of COSO, control environment, risk assessment, control activities, information and communication, and monitoring under the supervisory oversight of the board audit and compliance committee. The Bank has a dynamic process for identifying, analysing, and managing risk exposure to achieve the Bank's strategic and business objectives concerning the internal and external environments.

3.6 Regulation and Supervision

The Bank operates as a public limited liability company registered under the Companies and Allied Matters Act (CAMA) and as a financial institution under the regulatory framework of the development finance institution's mandate of the CBN. The regulatory guidelines for developing financial institutions in Nigeria, under the supervision of the Central Bank of Nigeria, provide the framework for licensing, regulating, and supervising DFIs.

Therefore, the Bank is subject to various regulatory and supervisory frameworks by the CBN, including the Bank and Other Financial Institutions Act, the Central Bank of Nigeria Code of Corporate Governance for Development Financial Institutions, the Bank's Code of Business Ethics, and Directors Code of Conduct. These regulations establish the foundation for the Bank's operations, governance, and ethical standards.

In addition to local regulations, the Bank has adopted a wide range of international regulatory standards to align its practices with global best practices. These standards include the Basel III framework, International Financial Reporting Standards (IFRS), Financial Reporting Council (FRC) guidelines, Global Reporting Initiative (GRI) guidelines, United Nations Environment Programme Finance Initiative (UNEPFI) principles, United Nations Sustainable Development Goals (UN SDGs), and the Securities and Exchange Commission (SEC) Code of Corporate Governance.

The regulations and supervision imposed on the Bank aim to ensure compliance with prudential guidelines, risk management practices, and ethical standards.

3.7 Business Model

The Bank's business model can be characterised as a wholesale, second-tier lending model, differentiating it from retail first-tier lending that engages directly with end customers. The Bank provides wholesale financial products, accounting for at least 80% of its lending activities. It also facilitates technical assistance to eligible participating financial institutions (PFIs) across Nigeria. This strategic approach ensures that the Bank complements rather than competes with the retail lending sector. The Bank's primary objective is to address the financing constraints faced by MSMEs. By leveraging the networks, financial expertise, and local knowledge of PFIs, it extends its reach and impact in providing financial support to MSMEs. The Bank adopts a market-conforming and financially sustainable approach to providing financing, partial credit guarantees, and technical assistance to eligible financial intermediaries. Through this mechanism, it disburses funds to PFIs to on-lend to local enterprises and projects operating in various sectors of the Nigerian economy.

This business model offers several advantages. Firstly, it enables the Bank to leverage the resources of PFIs, thereby increasing the overall volume of funds available for development. Secondly, it facilitates the transfer of financial expertise and risk management practices from PFIs to local enterprises, thereby enhancing their capacity for sustainable growth. Finally, on-lending through PFIs promotes financial inclusion and strengthens the local financial sector by fostering relationships and improving access to finance for local businesses (Luna-Martinez & Vincente, 2012).

However, it is crucial to acknowledge that the on-lending model also presents challenges and necessitates robust governance and transparency in the lending process. The Bank has implemented stringent conditionalities and eligibility criteria for PFIs to address these challenges. The Bank periodically conducts due diligence to ensure PFIs comply with the minimum eligibility requirements and appropriate action is taken if any breaches occur (see Box 3.1 for eligibility criteria).

Box 3.1: Eligibility Criteria for Participating Financial Institutions (PFI) for On-lending

To be eligible for financing from the Bank, the PFI must meet the following criteria:

(1) Possess a valid CBN licence for operating in the financial sector. (2) Demonstrate profitability in lending operations for two of the three most recent financial years while implementing effective risk management procedures and maintaining acceptable loan portfolio quality. (3) Ensure that shareholders and the Board of Directors meet regulatory guidelines regarding integrity and business/financial knowledge. (4) Provide evidence of compliance with all applicable CBN laws and regulations. (5) Have qualified and experienced management personnel, organisational and institutional capacity tailored to their risk profile. (6) Develop well-defined policies and procedures to manage financial risks (liquidity, credit, currency, interest rate, and market risk). (7) Maintain adequate capital and liquidity levels per CBN's prudential regulations. (8) Establish procedures for Anti-Money Laundering and counter-financing terrorism, aligning with the Bank's requirements. (9) Comply with Know Your Customer circulars issued by the CBN and the Bank. (10) Implement Environmental and Social practices meeting the Bank's requirements. (11) Adhere to existing and future consumer protection laws and regulations, including assessing each customer's repayment capacity before lending. (12) Establish arrangements with at least two credit bureaus. (13) Maintain an acceptable risk profile and loan portfolio quality. (14) Possess adequate management information systems. (15) Demonstrate a commitment to serving the MSME sector by establishing satisfactory MSME corporate loan approval processes and risk management procedures

PFIs will not be considered in good standing and will be ineligible for financing from the Bank under the following circumstances:

(1) If the PFI is subject to holding action by the CBN; (2) If the PFI receives a qualified audit opinion on its most recent audited financial statements; (3) If the PFI remains unprofitable for four consecutive quarters after the start-up period, defined as three years from the commencement of its business activities; (4) If the PFI fails to meet its capital adequacy requirements during the most recent examination and cannot inject additional capital to reach the regulatory threshold; and (5) If the PFI becomes a borrower for which the Bank has received a written notice from the CBN expressing significant concerns about the PFI's financial condition or business operations based on the most recent supervisory inspection

Source The Bank's website.

In addition to its lending activities, the Bank offers risk-sharing facilities and technical assistance to PFIs, enhancing their ability to serve the targeted beneficiary enterprises. While capacity-building services and technical assistance mitigate project risks, they do not deviate from the Bank's primary mandate of providing long-term finance at reasonable interest rates to credit-rationed MSMEs. These services are administered separately under designated departments or units, ensuring a focused approach to its core offerings.

The Bank's capitalisation involves various entities, with the Federal government holding a majority stake of 75% through two subsidiary entities, namely the Ministry of Finance Incorporated (60%), and the Nigeria Sovereign Investment Authority (15%), followed by the African Development Bank (18%), and the European Investment Bank (7%). Although the national government is the sole beneficial owner of the shares held by MOFI and NSIA, the Bank operates independently. The Bank does not receive budgetary allocations or capital releases from the government. The Bank's funding structure combines sovereign loans, retained earnings, and equity, including a substantial investment of up to USD 500 million from the African Development Bank Group (AfDB) and other international development partners. Additionally, 20% of AfDB Group funding is a donation for on-lending to MSMEs.

3.8 Major Achievements and Challenges

The Bank has achieved significant milestones since its establishment, demonstrating its role as a countercyclical institution during financial constraints. The Bank has disbursed over N495 billion since its inception in Nigeria's MSME sector (DBN, 2021). Notably, during the COVID-19 pandemic, the Bank disbursed N190 billion to 30,000 MSMEs, effectively alleviating the credit and cash crunch experienced by these businesses. This highlights the Bank's commitment to scaling up development financing operations during financial instability when private financial institutions tend to reduce lending operations to the private sector.

The Bank's policies and programmes align with the government's agenda by supporting a vibrant MSME sector towards sustainable structural transformation. It reinforces its commitment to supporting government policies during times of economic crisis by participating in government initiatives such as donating to the Central Bank of Nigeria's

COVID-19 relief fund and reinforcing its commitment to supporting government policies during times of economic crisis (DBN, 2021). As of December 2021, the Bank had extended the sum of N482 billion to 208,000 MSMEs through 51 PFIs (DBN, 2021).

Furthermore, the Bank established a wholly-owned subsidiary, Impact Credit Guarantee Limited (Impact). Impact collaborates with licensed financial institutions to disburse development financing credit to MSMEs in Nigeria. This subsidiary was formed through a partnership project with the World Bank, with the primary objective of guaranteeing loans to eligible MSMEs via PFIs in Nigeria. Impact currently offers three types of guarantee products to PFIs: Individual Guarantee, Blanket Guarantee, and Portfolio Guarantee. The guarantee products provided by Impact come with distinct characteristics. First, the maximum guarantee cover offered is 60% of the loan amount disbursed. Second, the maximum loan size is defined periodically. Third, the maximum tenor for these loans is five years, although it can be extended to eight years for special projects. Lastly, the guarantee covers all sectors within the MSME business segment. Additionally, Impact provides Technical Assistance to PFIs on a need basis to enhance their capabilities in financing MSMEs (DBN, 2018).

Moreover, the Bank has obtained three ISO certifications: ISO 27001, ISO 22301, and ISO 20000. These certifications highlight the Bank's commitment to information security, business continuity, and service management excellence (DBN, 2021). Regarding certifications, the Bank stands out as one of the first DFIs in Africa to obtain the highest level of certification under the SSCI programme. The Bank aligns its investment decisions with climate change considerations to support carbon–neutral projects, aiming to achieve the National Climate Change Policy Goals 2015 and the Green Growth Development Strategy 2031. Additionally, the Bank holds three ISO certifications: ISO 27001, ISO 22301, and ISO 20000, reflecting its commitment to robust information security, business continuity, and service management standards.

The Bank is committed to achieving sustainable development goals (SDGs) through implementing programmes consistent with the UN SDGs. The Bank has implemented programmes and policies to achieve the SDGs, demonstrated its commitment to sustainability, and addressed climate change by incorporating climate considerations into its investment decisions. For instance, it has implemented specialised products, including Green Product offerings. Therefore, the Bank has obtained the highest level of certification under the Sustainable Standards Certification Initiative (SSCI) programme, making it one of the first DFIs in Africa to achieve this feat (DBN, 2021).

In its pursuit of inclusive development, the Bank has prioritised gender equality and women's empowerment. It has implemented specialised product propositions, including women's and youth's product offerings, to increase the participation of women and youth in the country's development agenda. The Bank has achieved significant milestones in promoting gender opportunity and equity. For instance, it has increased women's labour participation, diversified their available options, and facilitated greater access to productive assets for women. Women constitute 41% of the Bank's workforce. These efforts enhance gender inclusivity and socioeconomic empowerment (DBN, 2020).

Despite the achievements, the Bank continues to face some challenges that hinder its ability to fulfil its mandate. These challenges include price distortions in the market space, creating an uneven playing field and impacting the Bank's lending operations. The proliferation of intervention funds introduces complexities in the financial system and may crowd out private-sector credit. The Banks' inadequate knowledge of wholesale lending to the MSME segment restricts the flow of credit to this vital sector of the economy. The attractive returns on government securities tend to incentivise banks to invest in these low-risk instruments rather than lending to MSMEs. Additionally, the Bank faces other obstacles, such as an unstable macroeconomic and policy environment, including high inflation and a volatile exchange rate. Political influence concerning the board and management succession and achieving financial self-sufficiency are other sources of challenges.

The unstable macroeconomic and policy environment adds further difficulties. High inflation erodes the currency's purchasing power and reduces lending's profitability. The volatile exchange rate introduces business uncertainties and affects loan repayments and asset quality. Achieving financial self-sufficiency is crucial for the Bank's sustainability and long-term operations. However, it requires careful management of resources and cost-efficiency measures.

Political influence, especially regarding the board and management succession, challenges the Bank's governance and operational effectiveness. Ensuring a smooth transition of leadership and minimising external interference is essential for maintaining the Bank's focus on its mandate and long-term strategy.

3.9 Financial Performance

The period 2017–2022 saw DBN exhibiting sustained balanced financial and non-financial performances. Table 3.3 depicts the key performance metrics of the bank indicating positive changing and steady trends over the period.

Capital Adequacy

The bank's capital adequacy ratio (CAR) over the period 2017–2022 is far above the regulatory 10% required of DFIs by the Central Bank of Nigeria (CBN). The bank witnessed higher CAR in its early years of operations, especially in 2017 and 2018 but the figure reduced drastically and hovered between 75 and 65% from 2020 to 2022 (see Fig. 3.3). There is, therefore, an indication that the bank is in a comfortable position to handle situations of financial distress or financial losses.

Management Efficiency

The bank operated in an efficient manner over the period, 2017–2022, as all three indicators of management efficiency fell below 21%. The three ratios, cost-to-income, personnel expenses, and non-interest expenses ratios have been declining from 2017 to 2019 but increased marginally from 2020 to 2022. This marginal increase in the ratios can partly be blamed on the COVID-19 pandemic where banks resorted to putting certain measures in place which came with some costs. Notwithstanding, the ratios are quite good and healthy (see Fig. 3.4).

Asset Quality

The behaviour of the Bank's credit risk is a declining one from 2017 to 2021 but rose marginally in 2022. As depicted in Fig. 3.5, the loan impairment ratio declined steadily from approximately 2% in 2017 to 0.11% in 2021 and rose to 0.33% in 2022. The level of Bank's credit risk is encouraging, indicating that the policies towards risk management are indeed working over the years.

Operational Performance

Table 3.3 Financial indicators

		2017	*2018*	*2019*	*2020*	*2021*	*2022*	*Average*
Capital adequacy	Regulatory CAR (%)	319.98	324.11	140.52	75.24	64.21	63.67	164.62
Asset quality								
	Loan impairment ratio (%)	1.99	1.22	1.05	0.39	0.11	0.33	0.85
Operational performance	Portfolio yield (%)	5.56	16.46	20.10	13.1	14.34	41.80	18.56
	Operating profit (%)	67.14	74.02	73.04	51.48	41.17	41.08	57.98
Earnings	Return on assets (%)	2.7	8.1	7.1	3.6	3.3	3.9	4.78
	Return on equity (%)	9.3	18.0	21.2	10.1	8.5	9.4	12.75
	Net Interest Income Margin	3.38	9.39	7.92	2.29	2.34	7.11	5.41
	Net Interest Margin	283.1	92.50	36.86	10.35	8.09	9.96	73.47
	Interest margin to gross income (%)	85.30	85.40	82.09	66.00	68.20	77.35	77.39
Liquidity assets	Broad liquidity assets to total assets (%)	71.71	76.90	69.87	46.63	70.13	71.95	67.87
	Core liquidity asset to total assets (%)	28.46	32.86	49.39	94.34	91.90	97.29	65.71
Management efficiency	Noninterest expenses to gross income (%)	17.48	10.72	8.11	9.23	10.64	11.75	11.32
	Personnel expenses to gross income (%)	10.32	4.10	3.47	3.69	4.99	4.99	5.26
	Cost-to-income ratio	20.50	12.5	10.6	15.3	15.6	16.8	15.22

Sources Authors' computations based on DBN Annual Integrated & Statutory Report (2017–2022)

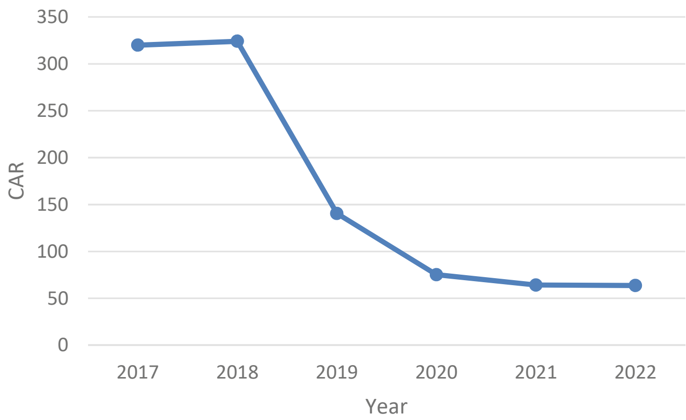

Fig. 3.3 Regulatory capital (*Sources* Authors' computations based on DBN Annual Integrated and Statutory Report [2017–2022])

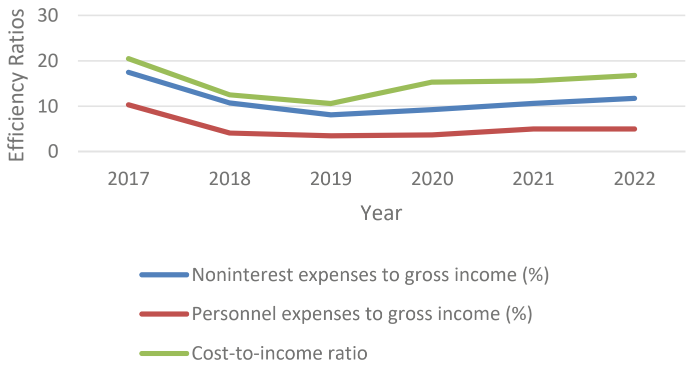

Fig. 3.4 Management efficiency ratios (*Sources* Authors' computations based on DBN Annual Integrated and Statutory Report [2017–2022])

The Bank's records suggest a robust tool that controls operational risks and the Bank's risk culture in general over the years. The portfolio yield, which shows the Bank's ability to generate cash on the gross portfolio, has shown a positive trend from 2017 to 2019 but declined in 2020. It then rose in 2021 and skyrocketed in 2022. The decline in 2020 is attributed

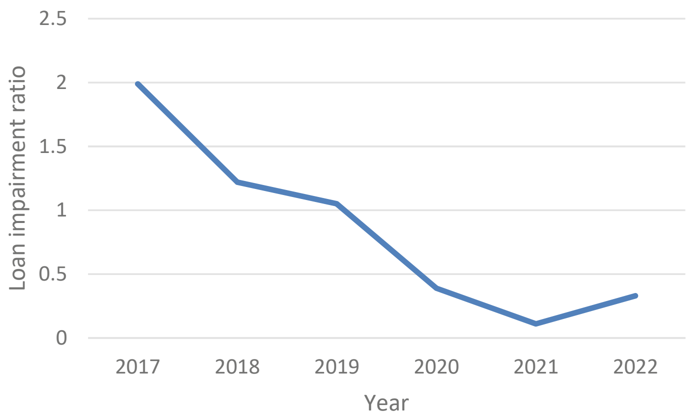

Fig. 3.5 Assets quality (*Sources* Authors' computations based on DBN Annual Integrated and Statutory Report [2017–2022])

to the negative impact of the COVID-19 pandemic. The average yield for the past six years is 18.56 (Fig. 3.6).

Earnings/Profitability

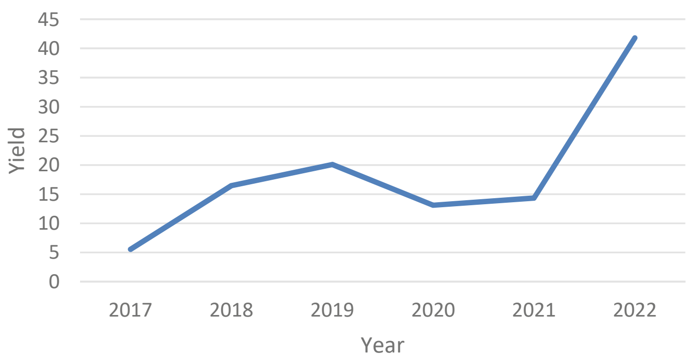

Fig. 3.6 Portfolio yield (*Sources* Authors' computations based on DBN Annual Integrated and Statutory Report [2017–2022])

The return on equity (ROE) values have been higher than those of the return on assets (ROA) over the six-year-period with average values of 12.75% and 4.78% respectively (see Fig. 3.7 and Table 3.3). The ROA saw an increase in 2018 but declined between 2018 and 2021 and rose marginally in 2022. ROE also increased between 2018 and 2019, declined between 2020 and 2021, and rose in 2022. On the other hand, the interest margin to gross income ratio averaged 77.39% during the six-year-period, experienced a marginal increase in 2018 but declined afterwards until 2022 when it rose again.

Liquidity

The indicators for the Bank's liquidity measures (Broad and Core Liquidity Assets) depicted positive trends over the six-year-period with averages 67.87% and 65.71% respectively. The broad liquidity assets ratio declined in 2019 and 2020 but rose in 2021 and 2022. The core liquidity assets ratio increased sharply in 2020 declined marginally in 2021 and rose in 2022. This paints a good picture of liquidity and solvency of the Bank (see Fig. 3.8).

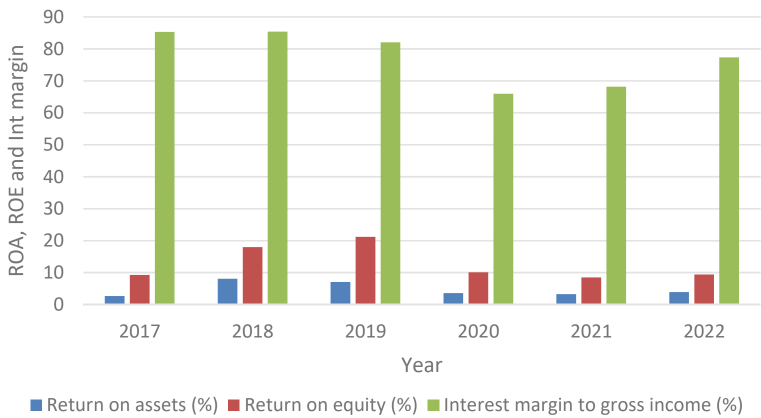

Fig. 3.7 Earnings/probability ratios (*Sources* Authors' computations based on DBN Annual Integrated & Statutory Report [2017–2022])

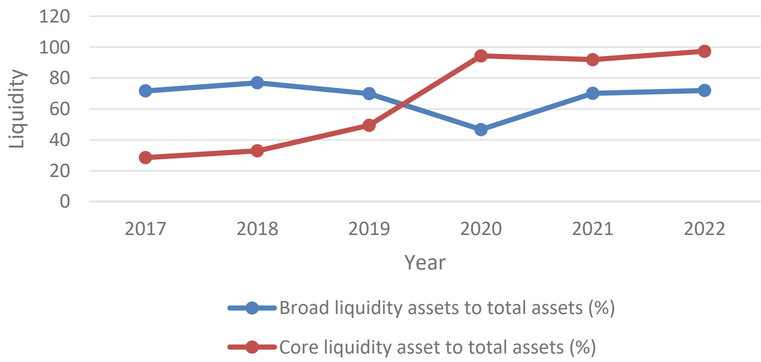

Fig. 3.8 Liquidity ratios (*Sources* Authors' computations based on DBN Annual Integrated and Statutory Report [2017–2022])

DBN's Performance in the Pre-COVID, COVID, and Post-COVID Lockdown Period

The comparative analysis of the Bank's performance Pre-COVID, COVID, and Post-COVID lockdown periods depicted not much difference in terms of the trends in the indicators over the period. This suggests that the Bank's policies are very solid and resources are judiciously handled. Most of the changes witnessed across the periods were marginal and followed a particular trend for all indicators except ROE and the liquidity ratios in the crises period that were at variant with the other periods (see Fig. 3.9 and Table 3.3).

The profitability ratios rather showed the same trend over the different periods where ROE is higher than ROA as shown in Fig. 3.10.

3.10 Conclusion and Recommendations

This chapter has examined the system of national development banks in Nigeria, with a specific focus on DBN. DBN is a public DFI with the explicit mandate of providing wholesale concessionary loans, partial credit guarantees, and technical assistance to MSMEs on a market-conforming and financially sustainable basis. Although the Bank operates in an unstable political and economic environment which underwent two economic recessions in the last six years, it still faces strategic competition

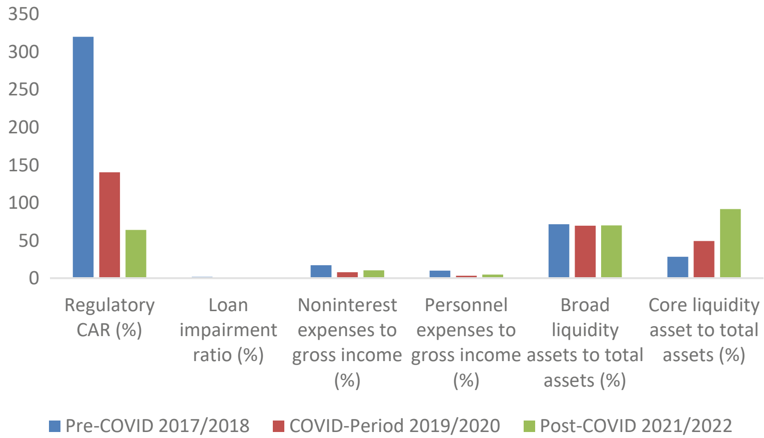

Fig. 3.9 Financial performance indicators—Pre-COVID, COVID period, and post-COVID lockdowns (*Sources* Authors' computations based on DBN Annual Integrated and Statutory Report [2017–2022])

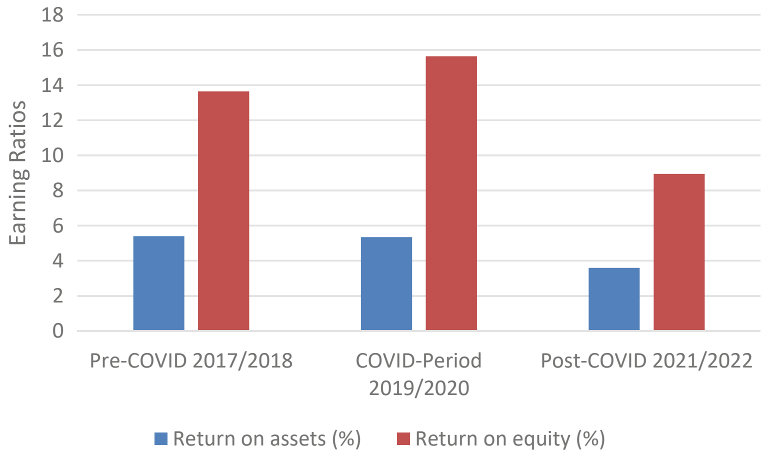

Fig. 3.10 Profitability indicators—pre- and post-COVID lockdowns (*Sources* Authors' computations based on DBN Annual Integrated and& Statutory Report [2017–2022])

as it operates in an environment awash with several alternative development financing options from the multitude of DFIs and CBN schemes available in the economy. The Bank has a corporate governance culture that complies with international corporate governance best practices but with a slant towards the German and Japanese corporate governance models by prioritising stakeholder representation on its board.

The Bank is exposed to many risks not limited to operational, credit, market, liquidity, information security, strategic, reputational, and compliance risks. However, the Bank has enterprise-wide risk management that helps monitor, evaluate, and mitigate these risks. The risk management guidelines and impact assessment of all implemented projects aligned with the Basel are vital to addressing credit risks and strengthening the Bank's developmental legacy. The CBN is mandated by the Bank and Other Financial Institutions Act, the Central Bank of Nigeria Code of Corporate Governance for Development Financial Institutions, the Bank's Code of Business Ethics, and the Director's Code of Conduct to regulate and supervise DBN accordingly.

The Bank operates the wholesale, second-tier lending model, differentiating it from retail first-tier lending that engages directly with end customers. It provides wholesale financial products on at least 80% of its lending activities through eligible participating financial institutions (PFI) to on-lend to MSMEs. The Bank's main funding sources comprise equity funds from shareholders, retained earnings, and debt from international financial institutions and development partners, including the World Bank, KFW, and AFD.

Although, on average, DFIs are not very profitable and tend to exhibit a very low average ROA and ROE of no more than 2%, the Bank experienced an average ROA of 12% and ROE of 30% per annum despite the slump in profitability in the 2020/2021 financial year following the COVID-19 pandemic. The Cost-to-Income Ratio (CIR) measures the Bank's operational efficiency averaging 14.2% per annum over the past five years. The relatively low CIR sharply contrasts private commercial banks' 70%, which signals efficient management of the Bank because of the wholesale business model that the Bank operates, which does not require a large network of branches across the country. The trajectory of key performance indicators of DBN has displayed a positive and robust growth pattern, with assets and equity expanding significantly by over 1200% during the fiscal year 2021/2022.

As part of its achievement, the Bank can boast of incorporating a wholly-owned subsidiary that provides wholesale credit guarantees to MSMEs. Further, the Bank has implemented programmes and policies to achieve the SDGs and, thus, demonstrated its commitment to sustainability and climate change by incorporating environmental, social, and governance considerations into its investment decisions. Notwithstanding its achievements, the Bank faces critical challenges. These challenges include price distortions in the market space, creating an uneven playing field of lending operations. The proliferation of development finance intervention funds may exacerbate strategic credit demand risk. The inadequate knowledge of wholesale lending restricts the Bank's ability to fulfil its mandate. Additionally, the Bank faces other obstacles, such as an unstable macroeconomic and policy environment, including high inflation and a volatile exchange rate. Political influence concerning the board and management succession and achieving financial self-sufficiency are other sources of challenge.

Addressing these challenges necessitates concerted efforts from various stakeholders. Market reforms can create a more favourable lending environment, while macroeconomic stability measures, including inflation control and exchange rate management, can enhance the Bank's operating environment. Strengthening banks' capacity and knowledge of wholesale lending through training and capacity-building initiatives can improve credit access. Moreover, ensuring competent and transparent board appointments is crucial for board effectiveness and long-term value creation.

Appendix: The System of National DFIs and Development Finance Schemes in Nigeria as at Year End 2022

Name	*Est.*	*Assets/fund size (US$ bn)*	*Key mandate*
Bank of Industry Ltd	1964	5.3	Retail lending to the industrial sector
Bank of Agriculture Ltd	1972	Nil	Retail lending to agricultural and agro-allied value chain activities

(continued)

(continued)

Name	*Est.*	*Assets/fund size (US$ bn)*	*Key mandate*
Federal Mortgage Bank Ltd	1973	0.47	Wholesale lending to mortgage institutions
Nigerian Export–Import Bank Ltd	1991	0.42	Credit guarantee and export credit insurance facilities to retail clients
The Infrastructure Bank Plc	1992	Nil	Infrastructure project financing and investment banking solutions
Nigerian Agricultural Insurance Corporation	1993	Nil	Agricultural risks insurance coverage to Nigerian farmers
FHA Mortgage Bank Ltd	1997	Nil	Mortgage financing to homeowner clients
Asset Management Corporation of Nigeria Ltd	2010	Nil	Factoring services to eligible financial institutions
Nigerian Incentive-Based Risk-Sharing System for Agricultural Lending Plc	2013	0.50	Redefine, measure, re-price, and share agribusiness-related credit risks
Nigerian Mortgage Refinance Company Ltd	2013	0.21	Capital market mortgage-bonds issuance and refinancing
Development Bank of Nigeria Plc	2014	1.2	Wholesale lending to micro, small, and medium-sized enterprises
Infrastructure Corporation of Nigeria Limited	2021	2.6	Infrastructure financing and execution
Subsidiaries of the Bank of Industry			
BOI Investment Trust Company Ltd	1987	Nil	Investment and financial services
LECON Financial Services Ltd	1989	Nil	Lease financing services
BOI Insurance Brokers Ltd	1991	Nil	Insurance and consultancy services
BOI Microfinance Bank	2002	Nil	Microfinance services to MSMEs
Subsidiary of Nigerian Incentive-Based Risk-Sharing System for Agricultural Lending Plc.			
NIRSAL MFB	2019	Nil	Microfinance services to eligible retail clients
Subsidiary of Development Bank of Nigeria Plc			
Impact Guarantee Ltd	2019	Nil	Wholesale credit guarantee to MSMEs

(continued)

(continued)

Name	*Est.*	*Assets/fund size (US$ bn)*	*Key mandate*
Subsidiaries of Public Security Agencies			
Nigerian Navy MFB	2014	Nil	Microfinance services prioritising electronic banking
Nigerian Prisons MFB	2011	Nil	Microfinance to MSMEs and low-income households
Nigerian Police Force MFB	1993	0.076	Banking services to serving and retired police officers and the general public
Subsidiaries of Public Educational Institutions			
Ahmadu Bello University MFB	1993	Nil	Microfinance services to the university and host community
Abubakar Tafawa Belewa University MFB	2015	Nil	Microfinance services to the university, host community, and other disadvantaged groups
Bayero University Kano MFB	2014	Nil	Microfinance banking services to private entrepreneurs
Adeyemi College Staff MFB	2018	Nil	Microfinance services to the MSMEs and other disadvantaged groups
BIDA Polytechnic MFB	2018	Nil	Microfinance services to the polytechnic and host community
Federal Polytechnic Nekede MFB	2013	Nil	Microfinance services to the polytechnic and host community
Federal Polytechnic Nasarawa MFB	2008	Nil	Banking services to the polytechnic and host community
The Federal University of Technology Minna MFB	2011	Nil	Microfinance services to the university and host community
Federal University Technology Owerri MFB	2018	Nil	Microfinance services to MSMEs in Owerri
Federal Polytechnic Ilaro MFB	2008	Nil	Micro credits and other microfinance services to the public
Kaduna Polytechnic MFB	2019	Nil	Microfinance services to clients
Obafemi Awolowo University MFB	2008	Nil	Microfinance services to the university and host community
Federal Polytechnic Unwanna MFB	2010	Nil	Microcredit to MSMEs and low-income households
University of Agriculture Abeokuta MFB	2008	Nil	Microfinance services to low- and middle-income earners
University of Ibadan MFB	2012	Nil	Microfinance services to MSMEs across all sectors

(continued)

(continued)

Name	*Est.*	*Assets/fund size (US$ bn)*	*Key mandate*
University of Calabar MFB	1993	Nil	Microfinance services to the university, host community, and the general public
The University of Lagos MFB	2020	Nil	Microfinance banking services to MSMEs beyond the university community
University of Ilorin MFB	2008	Nil	Microfinance services to the university, MSMEs, and low-income households in the host community
University of Maiduguri MFB	2008	Nil	Microfinance services to MSMEs
University of Uyo MFB	2009	Nil	Microfinance services to MSMEs
University of Benin MFB	Nil	Nil	Microfinance services to MSMEs
University of Nigeria Nsukka MFB	1993	Nil	Microfinance services to MSMEs in rural and urban areas
CBN Development Finance Schemes			
Agricultural Credit Guarantee Scheme Fund	1977	0.03	Agricultural credit guarantees up to 75% of the amount in default
Agricultural Credit Support Scheme	2006	1.6	Lending to smallholder farmers and agro-allied entrepreneurs
Commercial Agricultural Credit Scheme	2009	1.4	Lending to large-scale commercial farmers
SME Credit Guarantee Scheme	2010	1.3	Credit guarantees to banks for SME and manufacturing sector lending
SME Equity Investment Scheme (SMEEIS)	1999	0.29	Equity investment or lending to SMEs
Youth Entrepreneurship Development Programme	2016	Nil	Lending to young entrepreneurs and start-ups

Note LECON, FHA, MFB, and SME denote Leasing Company of Nigeria, Federal Housing Authority, Microfinance Bank, and Small and Medium-sized Enterprises, respectively. Values for DFIs refer to asset size, while values for funds refer to fund size at the creation or recapitalisation date. The asset and fund values for NMRC, Nigerian export–import bank, ACGSF, and SMEEIS are for 2021, 2020, 2001, and 2009 financial years. Assets are valued based on the Central Bank of Nigeria's official exchange rate at the specific year-end

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CHAPTER 4

Development Banking in Côte d'Ivoire: The Case of the Banque Nationale d'Investissement

Christian A. Aboua, Charles Odoom, and Jules F. Konan

4.1 Introduction

Prior to independence, under the push of the colonial authority, Côte d'Ivoire devoted close attention to agricultural financing, with the goals of not only ensuring food self-sufficiency and job development, but also generating financial resources for the State budget. This led to the creation of the Caisse Centrale de Crédit Agricole Mutuelle (CCAM) in 1926. The financing deficit in three key sectors of the economy—namely agriculture, industry, and commerce—also encouraged the establishment

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of Credit of Côte d'Ivoire (CCI) in 1955. Significant loan defaults by these financial institutions led to their bankruptcy and the creation of the Caisse Nationale de Crédit Agricole (CNCA) in 1959 (Djato, 2001). At the same time, the Caisse Autonome d'Amortissement (CAA), which decades later became the Banque Nationale d'Investissement (BNI), was created. After independence in the 1960s, in response to failures in the financial sector, the government rethought its approach to finance the agricultural sector. The government set up the National Bank for Agricultural Development (BNDA), equipping it with a network of some sixty branches throughout the country. This enabled it to fully participate in the fight against poverty as well as to contribute significantly to the acceleration of peasant and informal sector (MEF, 2009). Other banks with predominantly state-owned capital were subsequently created. Unfortunately, the 1980s–1990s were marked by serious banking crises in developing countries, particularly in the WAEMU region, and all these banks went bankrupt (Powo, 2000).

Today, Côte d'Ivoire has four National Development Banks (BND): the Banque de l'Habitat de Côte d'Ivoire (BHCI), the Banque Nationale d'Investissement (BNI), the Banque Populaire de Côte d'Ivoire (BPCI), and Versus Bank. All of these banks have undergone several restructurings as a result of serious mismanagement.[1] Has the restructuring of these banks affected their mandates and practices? Has the restructuring of these banks been influenced by changes in economic development concepts and political influence? The case of the Banque Nationale d'Investissement will be highlighted in particular.

4.2 Overview of Development Finance Institutions in Côte d'Ivoire

Evolution of Development Finance Institutions in Côte d'Ivoire

The colonial administration created the Caisse Centrale de Crédit Agricole Mutuelle (CCCAM) in 1929 to operate as a financial development institution in Côte d'Ivoire. The mandate of this institution was to

[1] The restructuring plan adopted by the Council of Ministers on May 5, 2014 provided for keeping three (3) banking establishments in the public domain, out of the seven (7) banks wholly or partially owned by the State (Direction Générale du portefeuille de l'Etat).

finance farms as well as create rural tracks, market agricultural products and build houses. The lack of financing in three key sectors of the economy—agriculture, industry, and commerce—also led the colonial administration to set up Credit of Cote d'Ivoire (CCI) in 1955. The failure of these two financial development institutions in 1957 (CCCAM) and 1959 (CCI) due to credit defaults, with rates of 47% and 36%, respectively, encouraged the creation of the Caisse Nationale de Crédit Agricole (CNCA) in 1959 (Djato, 2001). Another financial institution, the Caisse Autonome d'Amortissement (CAA) that became decades later Banque Nationale d'Investissement, was created in 1959 too. This institution will be discussed in more detail in later sections.

Following Côte d'Ivoire's independence in 1960, the state relied on the CNCA to modernise agriculture, the backbone of Ivorian economic prosperity. Due to credit default estimated at 23%, this entity was dissolved in 1968 and replaced by the country's first national development bank, the Banque Nationale pour le Développement de l'Agriculture (BNDA) (Améthier, 1989). This bank made a substantial expansion with 2000% credit growth after seven years of operations during the "Ivorian economic miracle" of the 1970s, mainly from the development of agriculture (coffee, cocoa, and wood) (Djogo, 1994).

In the 1970s, several national banking and non-banking development entities arose. The Banque Nationale d'Epargne et de Crédit (BNEC), the Banque Ivorienne du Bâtiment et des Travaux Publics (BIBTP), and the Banque Ivoirienne d'Epargne et de Développement des Postes et Télécommunications (BIPT) are among them. These institutions were designed to finance specific industries. Unfortunately, the 1980s and 1990s economic and banking crises in Cote d'Ivoire, like other developing economies, bankrupted all of these financial organisations. All national development banks failed (Powo, 2000). CAA was the only surviving national financial development institution. That is why, in 1993, the Ivorian government set up the Banque pour Habitat de Cote d'Ivoire (BHCI) to satisfy the country's economic and housing funding demands. The government also established the Caisse d'Epargne et des Chèques Postaux (CECP) in 1998. The Decree No. 98-378 of June 30, 1998 gave this non-bank institution the mission of collecting savings from and financing the rural and urban population excluded from banking or financial services.

During the 2000s, the two non-banking development financial institutions mentioned above, CAA and CECP, evolved into banking organisations with expanded purposes. During this time, Banque Régionale de Solidarité (BRS), Banque pour le Financement de l'Agriculture (BFA), and Versus Bank, other development banking institutions, were established. These institutions are presented below.

The CAA's mandate is clarified and completed by Decree No. 2004-188 of February 19, 2004. It becomes the Banque Nationale d'Investissement (BNI). Unlike the CAA, the BNI is focused on small and medium-sized enterprises (SMEs), banks and financial institutions' refinancing, and capital market development. Similarly, Decree No. 2004-566 of October 14, 2004 converts the CECP into the Caisse Nationale des Caisses d'Epargne (CNCE) and broadens its mandate. Its new mission is to finance SMEs. The Banque Régionale de Solidarité arose from the Central Bank of West African States' (BCEAO) intention to supplement the services of decentralised financial systems and improve finance for the rural sector (BCEAO, 2002). This bank is created in the eight WAMU countries, with each state holding a majority stake. It was established in Côte d'Ivoire in 2002. To cover a void in agriculture finance, the government established a new bank, the Banque pour le Financement de l'Agriculture, in 2004. Versus Bank, founded in 2003 as a private commercial bank, was taken over by the government in 2009 to enhance medium-sized enterprises/medium-sized industries (SMEs/SMIs) funding.

The 2010s were marked by the failure of development of financial institutions in Cote d'Ivoire. Five of the six banks became insolvent. These were Banque de l'Habitat de Cote d'Ivoire, Banque Régionale de Solidarité, Banque pour le Financement de l'Agriculture, Caisse Nationale des Caisses d'Epargne, and Versus Bank. Only Banque Nationale d'Investissement felt relatively better. In 2015, Banque pour le Financement de l'Agriculture and Banque Régionale de Solidarité were liquidated, while the other insolvent banks underwent major restructuring (appointment of new Board of Directors and CEO, reduction of the government share in the capital, change in denomination…).

Côte d'Ivoire now has five development financial institutions, four of which are banks. BHCI, BNI, BPCI (previously CNCE), and Versus Bank are the four banks. The Caisse des Dépôts et Consignations (CDC-CI) is a non-bank development financial institution established by law n° 2018-574 enacted on June 13, 2018. Its aim is to gather and ensure the management of public and private funds or deposits (consignments, collateral securities whether legal or not, dormant assets of bank depositors, etc.). The major goal of this fund, which should be emphasised, is to house dormant assets of bank depositors in compliance with the WAMU's regulatory regulations. Today, all of these development finance institutions are working to promote the State's 2030 objective of economic emergence.

Challenges and Failures of Development Finance Institutions in Côte d'Ivoire

Failures of Development Finance Institutions (DFIs) in Côte d'Ivoire in the 1980s were mostly attributed to the country's difficulties as a result of a drastic drop in agricultural raw material prices. Agricultural raw commodities enabled the government to undertake important development programmes when their prices were high in the early 1970s. The fall in prices in the late 70s has resulted in a number of issues that had substantially affected the operations of an already diverse and complex financial system. These factors include poor economic performance and the failure of some significant bank customers (including the State which was one of the banks' main debtors) to satisfy their obligations. To this must be added a weak agricultural sector structuring, a lack of financial system monitoring and control, and poor administration and management of public institutions (Caprio & Klingebiel, 1996, 2003; Daigne, 1998; Honohan, 1993). For example, the government put pressure on the financial sector at the beginning of the 1980s in order to get loans for public firms or state-sponsored initiatives. The banks had suffered enormous losses as a result of the mismanagement of these enterprises and projects.

The banking sector is facing today many challenges that can be divided into two categories: financial challenges and governance challenges. With regard to financing, the analysis must be carried out on both the supply and demand sides. In terms of the supply of financing, public banks have not developed new products such as long-term loans intended for more fragile players like SMEs. Also, financing agriculture remains a challenge due to the lack of land documents that could be used as guaranties on the one hand, and on the other, to the failures encountered by public banks dedicated to its financing (BNDA, BFA) in the past. The State should therefore elaborate and enforce a fair land registration and identification policy. In terms of demand for financing, SMEs need to be structured (legally formal, financial statements producing…) to facilitate their financing. As for governance, bank management must work free of negative political interference and in conformity with the State's mandate. It is worth emphasising that operating a public bank in Côte d'Ivoire without political interference is challenging. Indeed, the Board of Directors is made up of a majority of officials from the government's ministries who select a CEO whose political impartiality is currently questionable. Fortunately, the Basel 2 and 3 governance and banking risk management standards in force since 2018 in the WAEMU reduce political influence on both Directors and CEO of banks (CBU, 2017a, 2017c).

4.3 Profile and Historical Background of Banque Nationale d'Investissement in Côte d'Ivoire

In order to support Côte d'Ivoire's development, the government established the Caisse Autonome d'Amortissement (CAA) in 1959. This fund's missions were as follows: (i) research and mobilisation of internal and external resources to support the country's development; (ii) public debt service; and (iii) management of deposits of national public enterprises.

The CAA became a bank with the status of a state entity in 1998, after receiving banking establishment approval from the WAMU Banking Commission and the BCEAO. The CAA's name is changed to "Banque Nationale d'Investissement (BNI)" by Decree No. 2004-188 on February 19, 2004, and its share capital is increased to FCFA 2.5 billion, which is completely owned by the state.

According to the statute that established it, the BNI now has the following missions: (i) banking accessibility and financialisation of the economy; (ii) SME financing; (iii) state support on financial issues; and (iv) capital market growth.

BNI has established two subsidiaries as part of its objective to develop the capital market: BNI-FINANCES (in 2004) and BNI-GESTION (in 2008). BNI-FINANCE is a stock exchange management and intermediation firm. BNI-GESTION creates and manages funds by collecting savings from investors (including individuals) and investing on their behalf.

Since 2020, in response to the new WAMU prudential framework, which forbids concentration risk in banks (BCEAO, 2016), the capital of the BNI is no longer controlled entirely by the Ivorian government. The National Social Insurance Fund (CNPS) owns 17% of the capital, while the state of Côte d'Ivoire retains the remaining 83%. Legally, it is no longer a state corporation, but rather a company with majority public involvement or a company owned by the state. It is now governed by the Ivorian law n° 2020-886, enacted on October 21, 2020, governing firms with public financial participation.

In accordance with Article 26 of the aforementioned law, since 2019, the state has entered into a performance contract with the bank which establishes "quantitative objectives to be achieved periodically". This performance contract is part of the contractual control that allows the bank to better assist public policy in terms of economic financing. It makes the legal mission entrusted to the bank much more explicit than before. For example, in its SME financing mission, the contract stipulates that loans granted to SMEs represent at least 15% of the bank's total loans. Another duty for the bank is to subscribe to bonds issued by the state on the regional financial market at least up to CFA 20 billion every year.

4.4 Political Economy and Institutional Context

BNI, like the Ivorian national development banks, exists to promote governmental policy. This mission is outlined in the performance contracts that bind state-controlled Ivorian institutions to the government. In the past, political influence in the management of these banks did not encourage good management of bank credit risks. Banks have suffered massive losses as a result of bad debt accumulation. Over the last decade, the BNI has alternated between losses and earnings. Despite its losses, it is nonetheless financially sound, having shareholders' equity of FCFA 17 billion and a share capital of FCFA 25.5 billion in 2020.

The SMEs that the bank aims to finance are financially fragile, governance deficient, devoid of guaranties, and, more often, legally informal and unstructured. To facilitate their financing by national development banks such as BNI, the government has set up a framework conducive to their financing. This framework is made up of a guarantee fund for SME financing, an SME Agency that supports and trains SMEs, and a share of public procurement contracts aimed at SMEs. It is worth pointing out that public procurement in Côte d'Ivoire annually amounts to between FCFA 2000 and FCFA 3000 billion.

The individuals, especially the young people whom these national development banks must finance, are unemployed. To ensure their financing, the Youth Employment Agency (AEJ) has been set up. It is responsible for financing training (internships) for young people, youth entrepreneurship, and female entrepreneurship. Because AEJ is not a bank for evaluating the performance of young entrepreneurs, BNI has signed an agreement with AEJ to manage its funds. The BNI is now responsible for directly financing these young entrepreneurs whose credit guarantees or sureties correspond to the Agency's funds the bank holds.

In addition, as part of its purpose to assist the government in dealing with climatic and environmental issues, the BNI is seeking a relationship with an international organisation to profit from green funding. These funds can be utilised to support projects that benefit environmental protection at a lesser cost. In addition, the BNI has an annual budget line dedicated to aiding cancer-fighting NGOs as well as particular farmer cooperatives in need.[2] These are the social aspects of the mandate that the bank, financially more solid than most other national development banks, is carrying out, and its impact on populations is direct and measurable.

The Ivorian economic context in which BNI operates is characterised by encouraging macroeconomic indicators for banks. Despite the COVID crisis, the country's economy grew by 1.8% and 7%, respectively, in 2020 and 2021. Although public deficits have increased, the IMF forecasts that the State will return to the 3% norm by 2023. There are therefore relatively robust macroeconomic indicators, which are having a positive impact on banking activity. It is useful to underline that this macroeconomic upturn is being strongly driven by infrastructure development (roads, Universities, stadiums for the organisation of the African Cup of Nations in 2024, rural electrification). For example, the road network is expanding throughout Côte d'Ivoire. This is an opportunity for businesses, companies, and banks and creates a synergy that affects the economy as a whole.

[2] The Deputy Managing Director of the National Bank of Investment (BNI), Jérôme Ahua, in the name of his Managing Director officially presented on Thursday, November 17, 2022, a check for one million six hundred and forty thousand CFA francs (1,640,000 Fcfa) at the National Cancer Control Program (PNLCa) in Abidjan-Plateau., *Source* Abidjan News.

4.5 Corporate Governance Arrangements

Government authorities, a Board of Directors, and bank management are all involved in the governance of Ivorian national development banks, particularly the BNI.

The Ministry of Economy and Finance and the Ministry of Budget offer financial and technical oversight at the government level, respectively. These ministries ensure that the strategic orientations of the national development banks are consistent with those specified by the state. A Board of Directors governs the BNI, as is the case of all Ivorian national development banks. Its Board of Directors consists of four (4) independent directors out of a total of twelve (12) directors. Article 10 of WAMU Circular 01-2017/CB/C specifies that "to reinforce the impartiality and objectivity of its decisions, one-third of the members of the Board of Directors must be independent directors" (CBU, 2017a). This regulation rule, which has been in effect in the WAMU since 2018, attempts to restrict political influence on the boards of directors of public banks.

The process for appointing administrators or directors in Ivorian national development banks is as follows: a decree names ministries and specifies the number of administrators that each ministry must nominate. Following that, each ministry's delegates are appointed by decree. BNI ministerial administrators are from the Ministry of Economy and Finance, Ministry of Budget, Ministry of Trade and Industry and are in charge of promoting Small and Medium Enterprises. In addition, as with other national development banks, an administrator is appointed by the presidency of the republic and serves as the head of the Board of Directors of BNI. In terms of independent directors, some are appointed by bodies under state oversight but with some autonomy, such as the Chamber of Commerce and Industry. These structures are named first by decree. Each structure then selects a representative, who is then appointed by decree. Other independent directors are appointed by the Board of Directors based on their qualifications. It should also be highlighted that, according to the above-mentioned circular, the Chairman of the Board of Directors does not hold the role of CEO at BNI. Furthermore, the bank's Board of Directors has both an Audit and Risk Committees whose role is particularly "to analyse specific subjects in depth, in order to enlighten the decisions of the Board of Directors (Cf. art. 12 of the circular above). It is worth emphasising that the Board of Directors collectively benefits from a diverse set of skills, particularly in economics, banking, finance, law, management control, and audit. All of this complies with the Basel 2 and 3 governance standards that have been in effect in the WAMU since January 2018 to ensure the effectiveness of the Board of Directors' supervisory and control roles.

In terms of management, it appears that the CEO of BNI was appointed by the Board of Directors prior to the Council of Ministers' appointment approval decree. Article 26 of Law No. 2020-626 of August 14, 2020, governs the selection of the CEO of Ivorian state corporations. This article of the law does not contradict Article 13 of the aforementioned Banking Commission circular, which states that the CEO of a WAMU bank must be nominated by the Board of Directors. In practice, however, the process for appointing CEOs of Ivorian public banks remains opaque. As for BNI's operational managers, they are proposed by the CEO to the Board of Directors for approval.

In short, since 2018, the implementation of the current banking regulations on bank governance does not favour political influence in national development banks. In the past, BNI was plagued by serious problems of political influence, to the point of eroding its equity between 2011 and 2018. The new guidelines now offer the national development banks' management considerable autonomy to implement the strategy set out by the Board of Directors.

4.6 Risk Management Practices

Banking rules primarily identify three forms of risk: credit risk, operational risk, and market risk (BCEAO, 2016). A Higher Credit Committee (CSC) has been established within the Board of Directors of Ivorian national development banks with the goal of limiting excessive credit risk taking by their management. This committee makes decisions on loans exceeding a particular amount. For direct loans, the BNI has set an FCFA 300 million barrier. In the past, the absence of such a committee in the bank enabled embezzlement and, under political pressure, major credit risk taking by the management.

Concerning operational risk, the BNI has always had a control and audit department. This department is responsible for carrying out the bank's permanent control on the one hand and assuring the unannounced and periodic audit of the activities at the bank's headquarters and branches on the other. Permanent control is concerned with the establishment of internal control tools (procedures, surveillance cameras, data access codes, etc.) and mechanisms as well as the monitoring of their implementation or functioning. Regarding the audit function, it ensures the effectiveness of control tools and mechanisms through random or periodic checks. The new Basel 2 and 3 banking risk management rules have clarified these two functions, which are often difficult to separate. They are now separated, and the audit function oversees the permanent control function as well as the banks' other operational functions (CBU, 2017b).

Regarding market risk, its management does not represent a major challenge for Ivorian national development banks. Like BNI, they generally invest in treasury bills and bonds issued by WAMU member states. These assets are riskless. The present expansion of the sub-regional financial market, however, with the appearance of new companies and financial products, may increase market risk.

As a result, banks must identify, measure, and manage market risks, as well as credit risk and operational risk, under the new requirements (CBU, 2017c). In this regard, BNI, like the WAMU banks, is developing a risk map. This map presents and evaluates all banking risks as well as mitigation strategies for the main risks.

The new banking risk management guidelines have made practices for managing the different types of risk much more precise. Their implementation since 2018 could strengthen the effectiveness of national development banks such as BNI.

4.7 Regulation and Supervision

The West African Monetary Union (WAMU) directs the regulation and supervision of Ivorian banks. Following their independence, the French-speaking West African states established WAMU. Côte d'Ivoire, like the majority of member countries, signed the WAMU treaty in May 1962, indicating its commitment to the monetary union. WAMU establishes the regulatory and institutional framework for member countries' banks and financial institutions. In this context, it is motivated by a desire to preserve depositors' deposits and promote sound intermediation. To do this, the WAMU's bodies and institutions put together various levels of authority and intervene in the creation, implementation, and supervision of banking regulations (UMOA, 2010).

The Conference of Heads of State and Government, the Council of Ministers, the Banking Commission, and the Regional Council for Public Savings and Financial Markets are WAMU's organs. The Central Bank of West African States (BCEAO) and the West African Development Bank (BOAD) are the institutions that make up this Union.

The Union's top authority is the Conference of Heads of State and Government. It defines the key policy orientations of WAMU. It also decides on any issues that have not been resolved by the WAMU Council of Ministers through unanimous agreement. It brings together the Heads of State and Government of the member countries at least once a year. The Union's management is ensured by the Council of Ministers. It oversees the implementation of the Conference of Heads of State and Government's general guidelines and decisions. It is in charge of defining the regulatory environment in which the WAMU financial system operates. To that purpose, it is specifically empowered to enact regulatory requirements concerning minimum capital and banking management standards. It brings together the ministers of economy and finance from the Union's member countries. The Banking Commission is the Union's banking system's overseer. It manages the organisation and administration of credit institutions within the Union. The Regional Council for Public Savings and Financial Markets is in charge of organising and supervising the public call for savings as well as authorising and controlling participants in the regional financial market.

In terms of WAMU institutions, the Central Bank of West African States has sole authority to issue money. It is charged with missions, including establishing and implementing monetary policy and guaranteeing the stability of WAMU's banking and financial system. As a result of its duty of supervising the Union's banking and financial system, it develops standards (laws, instructions, directives, and announcements) (BCEAO, 2010). WAMU's development bank is the West African Development Bank. Its mission is to support the member states' balanced development and to contribute to their economic integration.

Along with the texts drawn up by the WAMU's organs and institutions in their role of organising, supervising, and controlling the banking system, Côte d'Ivoire's national development banks, like companies controlled by the state, are subject to the guidelines of the state and the Organisation for the Harmonisation of Business Law in Africa (OHADA). Within the framework of the state's guidelines, it is necessary to note the law n° 97-519 of September 4, 1997, defining and organising State companies, which was replaced by two laws in 2020: law n° 2020-626 of August 14, 2020, defining and organising state companies, and Law No. 2020-886 of October 21, 2020, relating to companies with public financial participation. Within the scope of OHADA rules, the Ivorian state ratified the amended Uniform Act pertaining to the legislation of commercial companies and economic interest groups in 2014.

4.8 Monitoring and Evaluation, and Impact Evaluation Practices

The monitoring, evaluation, and impact assessment of Ivorian national development banks is carried out by the WAMU supervisory and banking control authorities (BCEAO, Banking Commission) on the one hand, and the state of Côte d'Ivoire on the other.

Monitoring or checks are carried out in WAMU banks by the BCEAO and the Banking Commission to ensure compliance with banking regulations. The Banking Commission audited BNI last year, in 2022. Recommendations have been made, and timelines for implementing them have been established. Non-compliance by the bank with these dates may result in penalties, which were amended in 2018 (BCEAO, 2018). Bank capital indicators (share capital, capital ratios, etc.) and bank liquidity indicators (liquidity coefficient, portfolio structure ratios, etc.) are also used by banking supervisory and regulatory bodies to analyse banks' prudential norms compliance. In addition, when deemed appropriate, the BCEAO conducts impact assessment studies to assess the impact of new guidelines. The research sample is then made up of banks or other entities.

The monitoring and evaluation of national development banks is committed to the Ivorian State's Ministries of Economy and Finance and Budget, which offer financial and technical oversight, respectively. As previously stated, "the supervisory ministries ensure that the State company's strategic orientations are consistent with those defined by the State for the sector in which it operates" (Article 45 of Law No. 2020-626 of August 14, 2020). Thus, when they believe it essential, the supervisory ministries conduct or have conducted an audit at BNI, like any company with public financial participation, in accordance with the Law No. 2020-886 of October 21, 2020.

Furthermore, public banks are expected to follow the terms of a performance contract that links them to the technical supervisory ministry (Ministry of Budget). This contract, which has been in effect at Ivorian public banks since 2019, varies depending on the missions of the banks. In addition, the financial supervisory ministry examines the performance of public banks in reference to their aims, missions, and historical performance every year during the Annual General Meeting. This performance is measured from certified financial statements, a governance report, statutory auditor reports, and other documentations deemed useful by the supervisory authority.

However, there are no actual practices in Côte d'Ivoire for measuring the impact of government initiatives or policies in favour of national development banks.

4.9 Business Model of Banque Nationale d'Investissement

Although they must perform their contractual commitments to the state, Ivorian national development banks operate on a commercial bank model. The BNI houses the state and public entities' finances and primarily collects demand deposits on the Ivorian financial market. Among these funds are state funds to assist SMEs, sectoral funds such as the fund for environmental preservation, the "youth employment" fund, and many others. The "youth employment" fund, for example, is projected to be worth roughly FCFA 50 billion every year.

The BNI converts these resources into loans, generally short-term loans to businesses and people as well as financial investments. According to the bank's performance contract with the government, it must also finance certain public projects and subscribe to Ivorian bonds and treasury bills worth at least FCFA 20 billion every year. It does not operate within a single industry. It also makes money via service operations (credit card management, …) and other commission-generating activities (signature commitments, guarantees). Furthermore, it engages in cash management which allows it to earn commissions and interest on financial investments (treasury bonds, …). Because of the COVID-19 pandemic, the Central Bank issued financial securities last year to assist WAMU member states. The bank's purchase of these assets, known as "Bons COVID-19", allowed it to mitigate the negative impacts of the crisis on its net income.

4.10 Main Achievements and Challenges

Large-scale initiatives have been carried out by Ivorian national development banks. For example, since 2019, the BNI has subscribed to State bonds totaling roughly FCFA 40 billion. These bond subscriptions give liquidity to the state for big development initiatives. The BNI is not to be outdone in the building and public works sector, which is flourishing in Côte d'Ivoire. Within it, a department named "Call real estate" has been established in 2020. Its goal is to actively finance real estate while emphasising social housing. In addition, for the past two years, BNI has financed businesses for youth with funds from the Agence Emploi Jeune, as a guarantee. Moreover, the bank fulfils one of its contractual commitments with the State every year, offering at least 15% of its loans to SMEs.

Concerning the issues facing the BNI, they are the same for all Ivorian national development banks. These are SME and agricultural financing, governance, and the development of new financial products.

In terms of governance, the bank's CEO, like those of the other Ivorian public banks, must be properly appointed by the Board of Directors through a rigorous selection process, namely through a call for candidates. Thus, the CEO of the bank could be shielded from political interference. In the context of SME financing, these players are generally fragile, informal, and not guaranteed. Plus, the COVID-19 pandemic has damaged these structures' ability to self-finance. As far as agriculture is concerned, the food crisis in the first half of 2021, as well as the inflation it created in Côte d'Ivoire, highlight the necessity for the BNI to strengthen its financing of this sector. Long-term funding must be also made available to participants such as SMEs in order to promote their financial solidity.

Furthermore, COVID-19-mandated teleworking pushes the BNI, like other banks, to develop online banking operations with their customers. To prevent hacking, the expansion of "call centres" and mobile applications that accompany the entire digitisation and dematerialisation process must be accompanied by increased vigilance from banks.

4.11 Financial Performance

From 2010 to 2019, the bank's deposits show an irregular but upward trend (Fig. 4.1). The lack of information on the detail of deposits (demand deposits and term deposits) after 2016 is justified by the fact that deposits are no longer itemised in banks' balance sheets under the new banking chart of accounts in force in WAMU since 2018.

In terms of assets, loans granted by the bank increase steadily from 2010 to 2016. Between 2016 and 2017, they fall before rising again from 2017 to 2019. As for financial investments, they undergo an overall downward trend from 2010 to 2016. They rise in 2017 and grow slightly between 2017 and 2019. The regular growth of the Ivorian economy from 2011 to 2019, averaging 7%, could justify this overall growth in credit. The reduction in credit in 2017 to increase risk-free financial investments (treasury bills and bonds) mainly is surely dictated by the banks' compliance with the Bale 2 and 3 regulatory guidelines that began in early 2017.

Before 2018, BNI's market share in Côte d'Ivoire for collecting deposits and lending (Fig. 4.2) declined steadily. Deposit market share was estimated at 9.3% in 2011 and followed a year-on-year decline until 2018 (4.4%) before rising to 5.9% in 2019. In terms of the credit market, the BNI's share hit an all-time high of 7.9% in 2013. It dropped to 3.9% in 2018 before rising to 4.5% in 2019. This decline in market share can be explained by the fact that the fragile economic performance of the bank

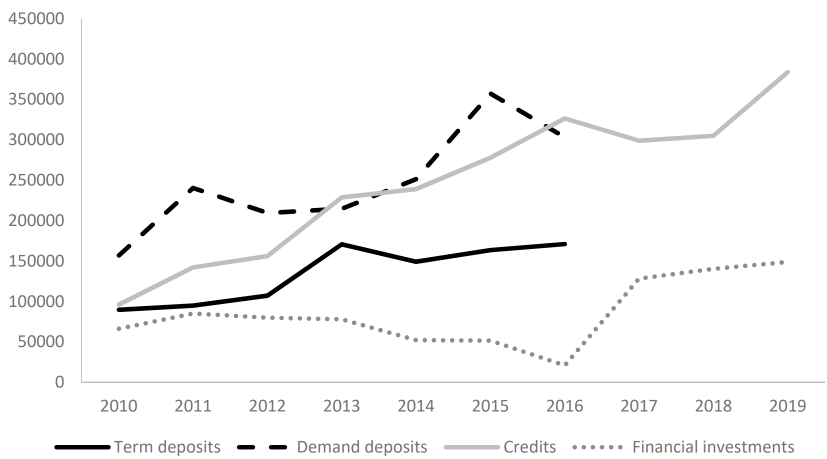

Fig. 4.1 Evolution of assets (black colour) and liabilities (grey colour) of BNI (in millions of FCFA), 2010–2019 (*Source* Authors, based on the financial statements of banks published by BCEAO)

before 2018, sometimes positive, sometimes negative, did not encourage depositors to entrust their money to the bank. The quasi-effective implementation of new governance and risk management requirements at the BNI since 2018 may, in part, explain the encouraging increase in all banking metrics (loans, deposits, market shares) examined thus far.

The evolution of BNI's net non-performing loans ratio (Fig. 4.3) backs up the previous results and analyses. The bank's credit operation resulted in a net non-performing loan ratio significantly higher than the national average (NPLR CI). This ratio is calculated by dividing loan depreciation by total loans lent to customers. As of 2018, however, the degradation of the bank's credit portfolio is approaching zero, as is the national average.

From 2013 to 2018, BNI's management resulted in an economic performance that was lower than the Côte d'Ivoire average (ROA CI) (Fig. 4.4). Nevertheless, the bank came close to and exceeded the national average after 2018.

The following factors explain the BNI's and, in general, Ivorian national development banks' poor performance in comparison to the other banks (private banks), mainly before 2018:

- "Governance issues: these are highlighted in particular by the State's interference in the management of public banks, which impedes

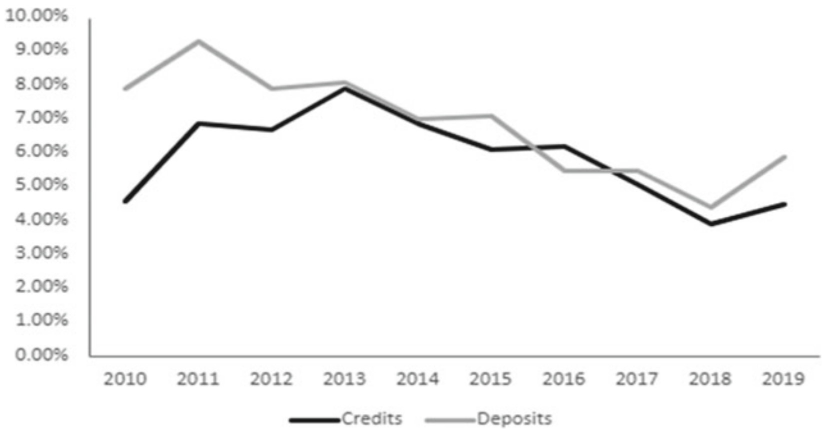

Fig. 4.2 Evolution of BNI'S market share, 2010–2019 (*Source* Authors, based on the financial statements of banks published by BCEAO)

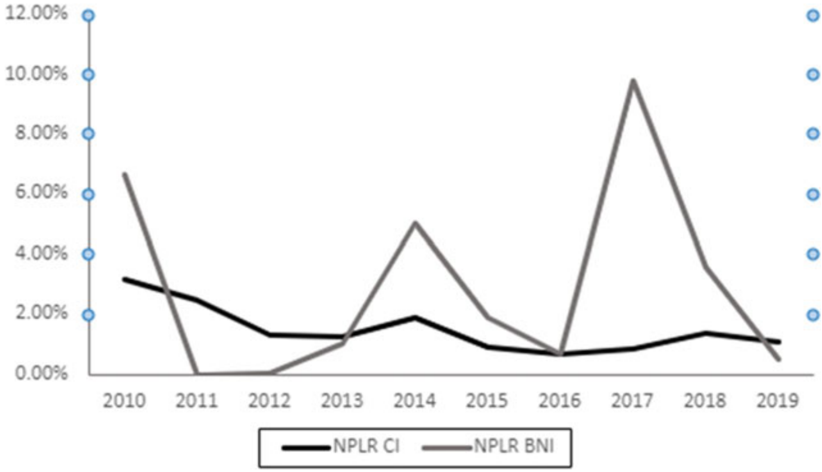

Fig. 4.3 Evolution of the net non-performing loan ratio (NPLR) of BNI, 2010–2019 (*Source* Authors, based on the financial statements of banks published by BCEAO)

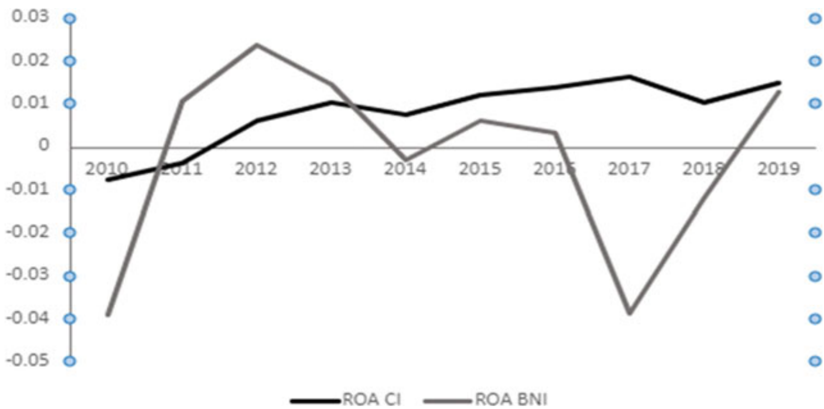

Fig. 4.4 Evolution of the economic performance (ROA) of BNI, 2010–2019 (*Source* Authors, based on the financial statements of banks published by BCEAO)

their performance". A large public bank, for example, refused to finance a very important and high-risky project. "The CEO was forced to finance the project because of the influence of a state political authority. Obviously, the debt was not paid back, and the bank suffered a massive loss".[3]

- Risk management issues: the goal and objectives of public banks do not favour optimal risk management. Their purpose is to assist the government in financing sectors or players that are not eligible for financing from private commercial banks. Because of their risks, some sectors or players do not match the profitability standards of private banks. The government has no such a profit objective. National development banks' profitability standards are also lower than those of commercial banks. In the event of a crisis, they rely on the government for recapitalisation. They assume too much risk because of the implicit governmental insurance.

4.12 Conclusion and Recommendations

Finally, the BNI like the Ivorian national development banks, has had governance and credit risk management issues in the past, which may have been exacerbated by political involvement. The bank suffered enormous losses as a result. Today, the bank functions in a more favourable political, institutional, and regulatory context for carrying out its mandate. Above all, the application of Basel 2 and 3 requirements might grant the Board of Directors and bank management significant autonomy and competence, as well as sound risk management. However, challenges that are common to all Ivorian national development banks must be addressed, particularly in terms of governance, SMEs financing, agriculture finance, and new financial products.

Therefore, the following economic policies are required:

- The Ivorian government must let to the Board of Directors the duty for appointing the CEO of every national development bank through a formal and rigorous process, such as a call for candidates. That was the case in some public financial institutions in Cote

[3] Information collected from high-level officials at the Ministry of Economy and Finances in Cote d'Ivoire.

d'Ivoire (the Treasury, Taxation, and Customs) between 2000 and 2010.

- The government must encourage and support the SMEs to be legally formal and more structured (producing financial statements annually, getting assurance policy). This could make these players less risky and promote their funding.
- To address the demands of fragile players such as SMEs, national development banks, like some private banks in Côte d'Ivoire, must turn to new products, notably long-term resources. Multilateral development institutions such as the African Development Bank (ADB) and the European Investment Bank (EIB) could provide these funds.
- The Ivorian State shall support agricultural financing by incorporating a financing floor dedicated to agriculture in the NDB performance contract. The creation of a national agricultural bank remains however the best policy. To prevent the mistakes made by such highly specialised institutions in the past, a diversification strategy must include all agricultural products (food products, export products) and livestock. This bank should also finance the full agricultural value chain.
- Although support funds for SMEs are available, its fair management is questionable. The government must promote and control the funds' sound management.

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CHAPTER 5

Development Bank of Ethiopia: A Catalyst for Economic Growth and Development

Ashenafi Beyene Fanta and Habtamu Berhanu Abera

5.1 Introduction

Ethiopia has a long history of development finance in Africa. The first development bank was established at the onset of the nineteenth century following the drive to achieve economic development by building institutions that serve as building blocks of a modern economy. The Société Nationale d' Ethiopie pour le Développement de l' Agriculture et de Commerce (The Ethiopian National Society for Agriculture Development and Commerce) was established in 1906 to promote agriculture and trade activities in the country. The bank has since undergone several changes in its mandates and name before taking the name the Development Bank of Ethiopia (henceforth DBE) with the mandate to promote economic

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development by supporting projects in the agricultural, industrial, mining, and other sectors through short and long-term loans.

In its journey for more than a century, the bank played a crucial role in financing development projects critical for economic growth and transformation. Large farms introduced during the early years of its operation proved vital for providing the basis for agricultural development in the country. Its financing of industrial projects helped the country establish textile, steel, and cement factories in various parts of the country. The largest breweries in the country were also funded by the bank. However, considering the massive development backlog in the country, the bank could only play a sub-optimal role due to various constraints.

This chapter aims to present the evolution of the bank since its establishment, highlight its key achievements, and comment on areas that require improvement. Subsequent sections of the chapter delve into a comprehensive examination of the Development Bank of Ethiopia by shedding light on its historical origins, critical role in the country's economic development, and performance over time. As a state-owned development finance institution, DBE has played a crucial role in accelerating Ethiopia's economic progress by providing critical financial support to a variety of sectors. Its history depicts a journey marked by important milestones and adjustments in response to the changing needs of the Ethiopian economy.

The chapter also presents a thorough examination of DBE, deconstructing its mandate, aims, functions, and diverse activities. This scrutiny extends to the institution's regulatory structure and corporate governance systems, which are critical to guaranteeing its successful functioning and adherence to national financial norms. Furthermore, the chapter delves into a thorough examination of the numerous financial products and services offered by DBE to various sectors. More importantly, the chapter presents a thorough examination of DBE's impact on Ethiopia's economic growth and development. We focus on examining DBE's critical contributions to key aspects of the nation's prosperity, such as improving food security, igniting industrialization, enabling job creation, and encouraging entrepreneurship. DBE plays an important role in maintaining food self-sufficiency by providing financial assistance to agricultural projects. This improves the nation's overall food security. Furthermore, the institution's strategic investments and financial programmes have been critical in pushing industrialization projects, fostering economic diversification, and promoting the development of essential industries.

DBE's function as an enabler of entrepreneurship is also examined, as it actively promotes job creation through its financing initiatives and fosters an entrepreneurial culture among Ethiopians. Nonetheless, the study addresses the obstacles and opportunities encountered by DBE in the pursuit of its goal, shining light on the complexities and potential avenues for further refinement in its contribution to Ethiopia's economic growth and development path.

The chapter concludes by drawing on key insights to provide a set of incisive recommendations targeted at bolstering DBE's role as a catalyst for supporting economic transformation in the country. These recommendations are based on a thorough assessment of DBE's past accomplishments, current operations, and issues. They emphasize the importance of strategic refinements and modifications to the bank's policies, operational procedures, and financial products to better fit with Ethiopia's changing economic landscape. Measures to increase the efficiency of DBE lending processes, improve risk management, diversify financing sources, and strengthen collaboration with other financial institutions and government agencies may be included in the proposals. Furthermore, the paper may underline the need to encourage innovation and embrace emerging technology for DBE to remain agile and responsive to ever-changing economic dynamics.

5.2 Historical Overview of the Development Bank of Ethiopia

The establishment of the Development Bank of Ethiopia dates to the onset of the twentieth century when the Société Nationale d' Ethiopie pour le Développement de l' Agriculture et de Commerce—SNEDAC was established in 1906 to promote agriculture and trade activities in the country (DBE, 2023). SNEDAC came to being after the dissolution of the Bank of Abyssinia—the first bank in Ethiopia established in 1905 by the British in response to a call from Emperor Menelik II for assistance in introducing banking services in the country (Mauri, 2003). The emperor's disenchantment with the Bank of Abyssinia, which had both commercial and central bank roles as a subsidiary of the Bank of Egypt, led to its dissolution and the establishment of new banks, namely, the Bank of Ethiopia and SNEDAC. SNEDAC's primary objective was to promote the modernization of the economy by supporting agriculture and trade activities. The bank has since undergone various changes including a change in its name and mandates.

The bank had been fulfilling its mandates until the Italian invasion in 1935 when the fascist forces established Italian Banks after the local banks had gone out of operation. After the reinstatement of the Imperial government following the defeat of the Italian fascist regime, the Ethiopian banking sector was re-established. This brought about a new development bank by the name Agricultural Bank of Ethiopia formed in 1945 to promote economic development through the provision of short-term and long-term loans to the agriculture sector. The bank played an important role in transforming the agriculture sector that heavily depended on smallholder farming by promoting large-scale agricultural activity. The bank's mandate expanded due to a need to support other sectors of the economy such as trade, and this led to a broadening of its scope and a subsequent renaming of the bank as the Agricultural and Commercial Bank of Ethiopia. Yet, another change was introduced a few years later after further expansion of the scope of the bank in response to a need to provide loans to the nascent industrial sector. As shown in Table 5.1, the Bank was renamed as Development Bank of Ethiopia Share Company with 100% ownership by the Ethiopian government. During the same period, the Investment Bank of Ethiopia was established to drive public investment activities in various sectors.

For two decades, the Development Bank of Ethiopia Share Company played a dual role as a development finance institution and a commercial bank. This changed later in 1970 when the Agricultural and Industrial Development Bank Share Company (AIDB) was established, taking over the operations of the Development Bank of Ethiopia Sc and Investment Bank of Ethiopia (Harvey, 1996). The new bank, a true development finance institution, had its primary focus on the provision of short-term and long-term loans to the agricultural and industrial sectors. This gave rise to large industrial and agricultural plants of which some were owned by the state while others by private sector investors. This period saw the emergence of several textile plants, breweries, and large state farms. The political change in 1974 that led to the demise of the imperial regime and the establishment of a socialist government left the bank without major amendments to its mandate except that the bank had to support state-owned enterprises following the nationalization of private farms and firms. In fact, the suffix "Share Company" had to be removed from its name

Table 5.1 Evolution of the Development Bank of Ethiopia (1906 to present)

Period	*Official name*	*Mandates*
1906–1935	Société Nationale d' Ethiopie pour le Développement de l' Agriculture et de Commerce	Provision of short and long-term loans to the agriculture and trade sectors
1945–1949	Agricultural Bank of Ethiopia	Provision of short and long-term loans to the agriculture sector
1949–1951	Agricultural and Commercial Bank of Ethiopia	Provision of short and long-term loans to the agriculture and trade sectors
1951–1970	Development Bank of Ethiopia Share Company	Provision of short and long-term loans to the agriculture, trade, and industrial sectors
1964–1970	Investment Bank of Ethiopia	Established to drive economic growth through public investment
1970–1979	Agricultural and Industrial Development Bank Share Company	Provision of short and long-term loans to the agriculture and industrial sectors
1979–1994	Agricultural and Industrial Development Bank	Provision of short and long-term loans to the agriculture and industrial sectors
1994–present	Development Bank of Ethiopia	Provision of short and long-term loans to the agriculture and industrial sectors

Source Based on data from DBE, 2023

for its reflection of a capitalist rather than a socialist sentiment. During this period, the bank was governed by cadres of the socialist party who made sure loans were directed towards sectors that were aligned with the regime's economic policy. The bank supported the establishment of new state-owned plants in the textile, agriculture, mining, and other sectors.

The political change in 1991 led to the establishment of a mixed market economy in which incentives were provided for private investment in various sectors of the economy previously controlled by the state. Following this, the bank was re-established in 1994 through Council of Ministers Regulations No. 200/1994 as the Development Bank of Ethiopia, expanding its support beyond state-owned enterprises to provide loans to private sector investment in agriculture and industrial sectors. A decade later, the bank was further re-established in 2003 through the Council of Ministers Regulations No. 83/2003 to mobilize resources from local and international markets, provide loan guarantees, and issue debt securities, as well as provide technical and managerial services. The move was aimed at allowing the bank to expand its financial muscle without being constrained by equity contributions from the federal government. The bank has been providing short-term and long-term loans to the industrial and agriculture sector over the last two decades. Most of the loans are extended to projects in the industrial sectors with agricultural projects receiving only a small fraction.

While the bank's portfolio mainly included loans to industrial and agricultural projects, this changed in 2018 when other sectors such as mining, leasing to SMEs, women entrepreneurship programmes, and market development for renewable energy & energy efficient products were added to its portfolio. While some of the new projects were driven by a need to address the pressing development needs of the country others were initiated by multilateral donors. Notably, the bank is playing a crucial role in promoting entrepreneurship by supporting small and medium enterprises and entrepreneurship among women. The last seven years proved the most challenging period in the bank's history with multiple shocks induced by political instability in the country as well as a Covid-19 pandemic. The shock led to a build-up of the massive amount of non-performing loans caused by projects going bankrupt due to security-related incidents in various parts of the country.

5.3 DBE's Corporate Governance Arrangements

The DBE is a specialized state-owned development finance institution, and consequently, it is subject to supervision by three entities, namely the National Bank of Ethiopia (NBE), Public Enterprises Holding and Administration Agency (PEHAA), and the Financial Public Enterprises Agency (PFEA). The National Bank of Ethiopia regulates the financial institutions in the country ensuring the stability and soundness of the system. Through its regulatory oversight, the NBE ensures that the DBE is adequately capitalized, maintains the required level of liquidity, and exercises prudent lending practice ensuring a reasonable level of the quality of its portfolio.

Financial Public Enterprises Agency (PFEA) supervises the bank to ensure that the institution is efficient, competitive, and modern to facilitate the implementation of the country's economic development policies. The bank is also supervised by the Public Enterprises Holding and

Administration Agency, and according to Regulation No. 445/2019 (FDRE, 2019), it is responsible to:

- ensure that the bank has developed strategic and annual plans, approves such plans, supervises, and monitors implementation of same, and takes corrective measures.
- Approve audit reports of the bank and ensure that corrective measures are taken on audit findings.
- develop modern corporate governance and financial management systems to improve the performance and competitiveness of the bank.
- establish a system to ensure that the bank is managed by individuals with the right skills, expertise, experience, and qualifications.
- submit recommendations to the government on potential new investment areas and expansion of existing investments and implement same upon approval.
- submit recommendations to the government on dissolution, amalgamation, or division of the bank and implement same upon approval.
- develop dividend policy, submit a recommendation to the Ministry on the amount of the state dividends to be paid to the government in each financial year, and follow up the implementation of same.
- Provide advice to the Ministry of Finance on issues pertaining to the write-off of the accounts of the bank and follow up on the implementation thereof.
- develop a system of tracking the aggregate performance of the bank as a portfolio of investment; submit an overall performance report to the Ministry of Finance by closely monitoring the financial utilization, acquisition, and repayment of loans by public enterprises.
- facilitate conditions under which the bank allocates sufficient budget for research and innovation and disseminates findings of the research.

As shown in Fig. 5.1, at the institutional level, the board of directors is responsible for overseeing the bank's operational activities and has a board of directors Management (BOM) consisting of seven senior government officials and experts drawn from various sectors that oversee, direct, and control the Bank. The president of the Bank also attends the regular meetings of the BOM as a non-voting member. The two top bodies, PFEA and BOM are, among others, responsible for issuing major policies of the

Bank, approving its strategic and operational plans as well as monitoring the Bank's operations.

The top Executive Management Committee (EMC) consisting of the president and five vice presidents is directly responsible for carrying out operational activities of the Bank. The president chairs the EMC and acts as an official representative of the Bank. Middle-level managers are, on the other hand, responsible for the day-to-day management of the Bank's operational activities.

The Bank's BOM has Compliance and Risk Management as well as Internal Audit Directorates for monitoring the effective implementation of policies and procedures. The Bank also has an Ethics and Grievance Management Office under the direct supervision of the president (DBE, 2017). DBE has ten directors on its board including the Board Secretary. The Board is composed of people with various expertise, and professional and educational backgrounds. While the board had been dominated by male directors for many years, its diversity had increased recently with the appointment of two female directors.

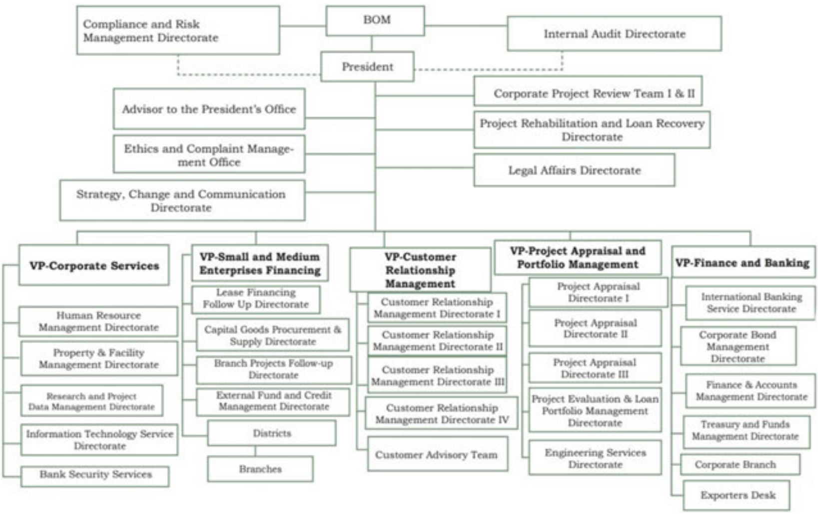

Fig. 5.1 DBE's organizational structure (*Source* DBE Annual Report, 2017)

5.4 Risk Management Practices

Risk management is an integral part of the bank's corporate governance practice, and it is also at the centre of its daily operational activities. At a corporate level, DBE's board has a risk and finance sub-committee responsible for ensuring that the bank has a reasonable exposure to operational and financial risks. The bank also has a compliance and risk management unit whose principal responsibility is to ensure the bank's risk exposures are appropriately addressed by designing various mitigation strategies.

The bank is also governed by policies of the National Bank of Ethiopia that exercise regulatory oversight as a regulator of the financial sector. The NBE supervises DBE as an investor and lender to the bank. The bank is also supervised by the Public Enterprises Administration Authority.

Recently, the DBE has strengthened its risk management system to increase the bank's resilience in the face of undesirable socio-economic conditions in the country. It has a risk management directorate accountable to the president of the bank and it evaluates risk indicators and submits a report to the executive management.

5.5 Regulation and Supervision

As a state-owned development finance institution, the DBE is under the auspices of three institutions with different objectives. As part of the financial system, DBE is subject to NBE's regulations that cover capital adequacy, liquidity, and asset quality. The bank must demonstrate compliance with the national bank's requirements through periodic reporting. Like other banks, DBE applies a modified Basel I framework for capital adequacy. In response to a build-up of a large amount of non-performing loans between 2016 and 2021 as well as the government's desire to boost the bank's lending capacity, DBE's capital increased by 280% in 2023 to ETB 28.5 billion (approx. USD 506 million) from ETB 7.5 billion (approx. ETB 135 million) in 2022. The bank is also subject to supervisory oversight by two state institutions, namely, the Public Enterprises Holding and Administration Agency (PEHAA) and the Financial Public Enterprises Agency (PFEA). While PFEA is responsible for ensuring that the institution is efficient, competitive, and modern to facilitate the implementation of the country's economic development policies, PEHAA plays a more pronounced role in driving the institution in the desired direction. The latter is also responsible for appointing directors and approving DBE's strategic plans, dividend policy, and other critical aspects of its operations.

Most of the banks have better control and operational guidelines, and their efficiency is visible at the same time. The experience of other development banks may be different, but in the current situation, especially in the past few years, important regulations and supervision have been implemented by the current management, which has made the bank efficient. This can also be confirmed by looking at the annual performance reports of the bank.

In addition to prudential regulations, the bank also adheres to best practices as prescribed by the Association of African Development Finance Institutions (AADFI). There was consent between AADFI and DBE regarding prudential standards, guidelines, and rating systems on self-assessment through the acknowledgement of the Public Financial Enterprise Agency and the Public Enterprises Holding Administration Agency.

5.6 Business Model of DBE

This section presents the bank's business model, specifically, its mandate, funding sources, lending models, and financial products and services.

Mandate and Objectives

As a policy bank, DBE facilitates economic development through the provision of medium and long-term loans to the priority sectors. Its mandates are determined by government proclamations issued for its establishments and they are overseen by supervisory agencies and the board of directors. The bank currently provides loans to agriculture, industry, mining, and energy as well as SMEs. To grow its lending capacity, the bank mobilizes resources from the local and international markets, and it achieves this by issuing bonds, as well as borrowing from local and international lending institutions. In addition to direct lending, the bank also provides credit guarantee services to increase the role of commercial banks in financing development projects.

Target Sectors and Priority Areas for Financing

Agriculture and industrial projects are the principal sectors supported by the bank owing to the importance of the two sectors for the economic development of the country. Although the two sectors have been the primary recipients of funding for a considerable period, a recent expansion of the scope of the bank led to the coverage of the mining and service sectors. Currently, the bank provides loans to the following priority areas:

- Commercial agriculture projects,
- Agro-processing industries,
- Manufacturing and extractive industries, and
- Lease Financing Service for Small and Medium Enterprises.

Recognizing the role of small and medium enterprising in job creation, the bank also supports the SME sector through lease financing. It provides SMEs access to capital goods through leasing, enabling the firms to engage in industrial activities that demand large amounts of investment in industrial goods. In addition, the bank introduced export credit guarantee schemes and a rural financial intermediation programme in 2013. This aimed at expanding financial access to the rural population by supporting microfinance institutions, rural saving and credit organizations, and unions. Later in 2018, the bank introduced two new programmes, namely, Women Entrepreneurship Development Programme and Market Development for Renewable Energy & Energy Efficient Products. While the aim of the former was to empower women by supporting entrepreneurial activities, the latter was to increase the utilization of renewable sources of energy that are critical for achieving sustainable development.

Sources of Funding

The DBE has been a wholly state-owned development finance institution since its establishment more than a century ago. The Bank was re-established four times through Proclamation no 25 of 1992 and Proclamation no 200 of 1994. The first re-establishment took place in 2003, with the Bank authorized capital of ETB 600 million. The second and the third re-establishments were in 2005 and 2015 with capital of ETB 3 billion and ETB 7.5 billion, respectively. However, the bank remained undercapitalized—being unable to meet a large demand for development financing in the country. Consequently, its capital was further increased to ETB 28.5 billion. At the same time, to enhance its lending capacity the bank is encouraged through regulation to mobilize resources from the local and international financial markets, including accepting deposits from specific institutions and individuals (IMF, 2020). Recently, the National Bank of Ethiopia, through Directive No. SBB/81/2021, made it compulsory for commercial banks in the country to invest at least 1% of their outstanding loans in DBEs bonds that mature in three years paying interest that is 2% above the minimum interest on deposits. This led to the broadening of its funding beyond equity contributions from the government to include the following additional sources:

- Loans from the National Bank of Ethiopia.
- Government saving bonds.
- DBE bonds.
- International loans from MDBs.
- Loans from China Development Bank.

The 2021 financial statement shows that most of the funding comes from government saving bonds, borrowing, and equity contributions. The bank sells savings bonds on behalf of the government which is used to finance the construction of the Great Ethiopian Renaissance Dam (GERD). About 80% of the debt comprises loans from the Ministry of Finance and the National Bank of Ethiopia at concessional rates.

Lending Model

For the most part of its operational life, DBE has been using a retail lending model where it provides loans directly to its clients. However, it has started wholesale lending since the introduction of rural financial intermediation programme in which credit is channelled to the rural population through microfinance and other institutions such as agricultural cooperatives, rotating saving and credit associations, and credit unions. In general, most of its portfolio comprises loans created through direct lending transactions.

Financing Instruments and Programmes

As a development finance institution, DBE promotes economic development through the provision of finance to firms and projects in the agriculture and industrial sectors. Recently, the bank has started playing an instrumental role in financing mining projects. The bank also provides credit guarantee facilities and lease financing services to facilitate the mobilization of resources to drive economic development in the country.

To achieve its function as a catalyst for economic development in Ethiopia, DBE has been implementing various instruments and programmes presented in the next two sections.

Financial Products Offered by the DBE

The bank's core activity is funding development-oriented projects in various sectors of the economy regardless of whether they are implemented by the private or public sector. As discussed in the ensuing paragraphs, the bank finances projects, provides working capital, and assists SMEs through direct lending and lease financing.

Project Finance—involves funding in the absence of collateral and is mainly based on project cash flows. This has played an important role in promoting agricultural transformation and industrial development in the country. Ventures that were established many years ago as projects are now playing a vital role both in the agriculture and industrial sectors.

Working Capital Financing—The bank supports projects, commercial farms, and industrial firms through working capital financing that ensures the smooth operation of business activities.

Lease financing—provides SMEs access to capital assets that are beyond their reach due to financial constraints. Lease financing was introduced recently to promote the development of the private sector by supporting SMEs that serve as a breeding ground for entrepreneurship.

SME financing—aims to support the SME sector that is often disenfranchised by the financial market due to lack of collateral. The bank responds to the needs of the sector by providing loans to support operations and growth.

Export Credit Guarantee—This facility was introduced to promote the development of the export sector by meeting the financing needs of export-oriented firms. The facility allows commercial banks to lend to exporters on the back of a guarantee from the bank.

DBEs' Programmes
Besides the financial instruments presented above, the bank runs a few programmes—each targeting specific development goals including expansion of financial inclusion in rural areas, promoting entrepreneurship among women, and the use of renewable energy sources.

Rural Financial Intermediation Programme—Introduced in 2013, the main aim of the programme is to expand financial inclusion among people living in rural Ethiopia. This has been achieved by funding semi-formal and formal financial institutions with a wider outreach in rural areas including saving and credit associations, cooperatives and unions, and microfinance institutions.

Women Entrepreneurship Programme—Female-owned businesses are particularly excluded from the financial sector due to cultural biases. The programme, introduced in 2018, aims to promote entrepreneurship among women by financing female-owned micro and small enterprises. The bank channels the loans through microfinance institutions due to their rich experience working with micro and small businesses.

Market Development for Renewable Energy and Energy-Efficient Products—The bank is playing an important role in climate finance by collaborating with various international institutions to provide funding to associations and individuals that work on green economy programmes and renewable energy and energy-efficient products. The bank also has a department established to facilitate the provision of loans to Private Sector Enterprises (PSE) and Microfinance Institutions (MFIs) to support renewable energy and energy-efficient products in the field of Green Economy Programmes and Projects Fund Management. Besides, in collaboration with the Ministry of Water and Energy, the bank is working on various energy projects/programmes and providing financial and technical support to qualified private sector enterprises, small financial institutions, and rural energy service cooperatives. Among the above, the Carbon Fund in connection with Clean Development Mechanism's Certified Emission Reduction Purchase Agreements, the Environmental Forestry and Climate Change Commission designated DBE as a coordinator and managing entity for the carbon credit administration of two Clean Development Mechanisms, namely, Ethiopian Off-Grid Renewable Energy Initiative Program and Ethiopian Clean Cooking Energy Program.

5.7 The Role of DBE in Facilitating the Implementation of the National Development Strategies

Since its establishment over a century ago, DBE has been instrumental in the implementation of national development plans. Its support to the agriculture sector was critical in the imperial attempt to modernize the sector. During the same period, the bank also mobilized public resources to support the nascent private sector to ensure an increased role of the sector in economic development. The imperial attempt to introduce state-owned enterprises such as Sugar factories, Breweries, and large state farms would not have been possible without DBE's funding.

During the military regime (1974–1991), the socialist government nationalized private firms and established state farms and enterprises to implement its command economic policy. Consequently, DBE's operation had to be reconfigured to support state-driven projects in various sectors. More breweries, cotton farms, sugar plants, and textile factories were introduced during this period mainly financed by the DBE.

DBE's role further evolved when the Ethiopian People's Revolutionary Democratic Front (EPRDF) took power in 1991 after overthrowing the military regime. EPRDF pursued an economic policy aligned with a market economy where the private plays a greater role in driving economic development. This was manifested through the denationalization of several state-owned farms and enterprises as well as the opening of sectors hitherto controlled by the state to private investors. The government introduced a series of development strategies including Agriculture Led Industrialization (ADLI), Growth and Transformation Plans I and II. DBE, therefore, extended credit facilities to projects sponsored by the private sector. Consequently, it has played a vital role in the growth of private sector investment including attracting foreign investors. The bank's strategy is also aligned with sustainable development goals and Africa Agenda 2063.

Recently, the bank has launched new projects that are aligned with the sustainable development goals (SDGs) including gender equality, sustainable infrastructure, and reducing poverty and inequality. In 2013, the bank implemented the Rural Financial Intermediation Programme to expand financial inclusion to the financially excluded segment of the population in the rural areas of the country. Through the programme, the bank supports microfinance institutions and rural saving and credit associations with the aim to help them expand their outreach thereby providing financial access. Aimed at promoting female entrepreneurship, the bank introduced in 2018 the Women Entrepreneurship Development Programme wherein businesses owned by women are supported financially. To help the country effectively manage its energy transition, the bank launched a programme on Market Development for Renewable Energy & Efficient Products.

DBE's activities are also aligned with AU's agenda 2063. One of the Agenda 2063 goals aims "to increase modern agricultural production and productivity", underscoring the importance of agricultural growth for economic transformation. However, low agricultural development is linked to inadequate investments in the sector to stimulate sustained growth, calling for the intervention of development finance institutions such as the DBE to support the sector to increase its contribution to growth. DBE also actively works to address sustainability and problems like biodiversity loss and climate change with support from development partners.

5.8 Role of the DBE in Providing Long-Term Financing for Development Projects

As the sole development finance institution in the country, DBE has been an important driving force behind the development of agriculture and industry in the country. Its persistent support of the two sectors led to the establishment of large farms, and industrial firms in the steel, food & beverages, and textile sectors. As shown in Fig. 5.2, DBE loans have been steadily increasing over the 10 years, and a sharp increase has been recorded from 2019 to 2021. Remarkably, its lending has increased from a little more than ETB 10 billion in 2012 to more than ETB 50 billion in 2021. A look at sectoral distribution shows that most DBE loans have been directed to the industrial sector in pursuit of the national development goals that hold industrialization as the critical avenue to economic transformation.

Since 2018, DBE has expanded its lending to mining and energy projects. Moreover, the bank has introduced new areas of activity including lease financing that is directed towards supporting small and medium enterprises (see Table 5.2).

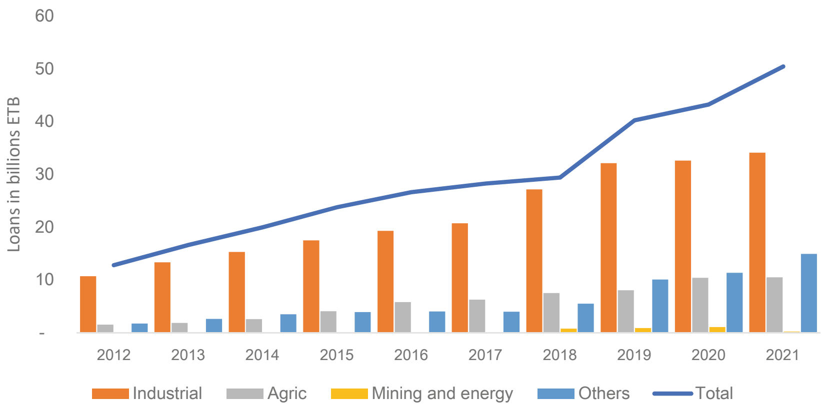

Fig. 5.2 Trends in DBE loans from 2012 to 2021 (*Source* Authors based on DBE's audited financial statements from 2012 to 2021)

Table 5.2 Selected Projects Financed by DBE

Sector	*Sub-sector*	*Projects*
Agriculture		Coffee and tea farms
		Floriculture farms
		Cotton farms
		Commercial farms
		Vineyard
Industry	Manufacturing	Pesticide factory
		Food processing plants
		Dairy products processing plants
		Textile factories
		Breweries
		Vehicle assembly plant
		Tannery
		Tantalum mining
		Cement factory
		Pharmaceutical industries
		Ceramic factory
	Healthcare	Hospitals
	Mining	Gold mines
	Hospitality	Hotels
	Housing and real estate	Shopping mall

Source Authors based on DBE annual report for the year 2013

5.9 Analysis of Financial Performance

This section presents the financial performance of the bank across four parameters: liquidity, asset quality, capital adequacy, and profitability.

Liquidity

Deposit-taking institutions are exposed to a liquidity risk due to a mismatch between the maturity of their assets and liabilities. Consequently, they are required to maintain a certain percentage of liquid assets that include cash and cash equivalents, reserves at the national bank, and deposits held at foreign financial institutions. The liquidity requirements are not static as they are dictated by changes in market conditions and as such the National Bank of Ethiopia issues directives prescribing the required liquidity banks must maintain. The latest NBE directive No SBB/57/2014 requires commercial banks to keep 15% of their current liability in liquid assets. However, the above liquidity requirement applies only to commercial banks, which means the liquidity of the Development Bank of Ethiopia is determined based on an internal assessment of the overall risk exposures of the institutions.

While the ratio of liquid assets to current liabilities is the right measure to capture the liquidity of a deposit-taking institution that has a bulk of current liabilities in the form of demand deposit, the same rule might not apply to a development finance institution that relies on long-term debt as a source of funding. Consequently, we assess the liquidity of DBE based on the ratio of liquid assets to total assets. As shown in Fig. 5.3, from 2012 to 2017, between 30 to 40% of the bank's assets were liquid, and the approx has risen to about 50% from 2016 to 2021, implying retrained lending activities which might be due to a lack of attractive investment projects.

Capital Adequacy

Capital serves as the ultimate buffer against any risk with the potential to drain the value of the bank's assets. Therefore, the NBE requires commercial banks to maintain at least 8% of risk-weighted assets. For DBE, its capital is viewed more as a signal for its lending capacity than a buffer against insolvency due to an implicit guarantee from the government. However, from 2012 to 2015, the bank has endeavoured to keep

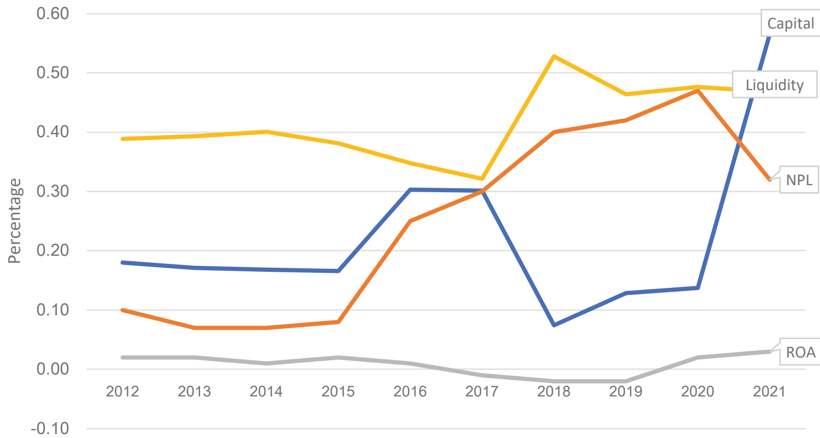

Fig. 5.3 Key financial ratios 2012–2021 (*Source* Author based on DBE's audited financial statements from 2012 to 2021)

capital that is almost 20% of the risk-weighted assets, and the ratio further increased to 30% from 2016 to 2017 before a sharp fall over the next three years. A significant decrease in the capital adequacy ratio is mainly driven by a rise in non-performing loans caused by borrower defaults following the political unrest in which industrial firms were vandalized. The government responded by beefing up the bank's capital by injecting ETB 21 billion (approx. USD 378 million) increasing the capital adequacy ratio to more than 50%.

Asset Quality

The ability of lending institutions to maintain a reasonable amount of healthy loans is an important performance indicator because deterioration in the quality of the loans is a precursor of financial difficulty. Consequently, loan quality always receives significant attention from the regulatory and supervisory bodies. As shown in Fig. 5.3, DBE maintained a Nonperforming Loan (NPL) ratio of below 10% from 2012 to 2015 until it skyrocketed in the following five years reaching more than 40% in 2020. This was mainly driven by political instability in various regions and later the war in Tigray started towards the end of 2020, followed by the bankruptcy of some projects. The capital injection that took place in 2023 was aimed at keeping the resilience of the bank considering significant losses due to the write-off of bad debts.

Profitability

Although the DBE does not operate like commercial banks with profit as its major goal, profitability is still important to ensure sustainability. The bank has been generating a positive return on assets for the most part of the period under analysis except from 2017 to 2019 when it reported losses driven by write-offs of bad debts.

5.10 Analysis of the DBE's Impact on Economic Growth and Development in Ethiopia

This section discusses the development impact by highlighting key projects with significant impact on the country's growth.

As the sole development finance institution for over a century, the Development Bank of Ethiopia has had a perceptible impact on the country's development. Although the role of the bank in the country's development is wide, our focus would be on the four important areas presented below.

Contributing to Food Security Through Agricultural Development

Ethiopia's economy is rooted in the agriculture sector with the sector remaining the dominant contributor to national output until recently when it was taken over by the service sector. Consequently, investment in agriculture has effects that go beyond value addition to contribute to food security in the country where cycles of famines affect millions. During its early days of operation, DBE supported the establishment of large commercial farms which played an important role in the supply of grain to the local market. Recently, many agriculture-based industrial firms such as dairy product processing plants and poultry farms entered the market financed by the bank.

Building a Modern Economy Through Industrial Development

DBE was behind the emergence of state-owned and private industrial firms in the country. The development of the textile industry in the first half of the twentieth century and in the 1990s is attributed to funding from the bank. The bank also played an important role in the food and beverage industry by supporting food processing firms and breweries. The bank also financed cement factories that were established to fill the shortage of cement in the booming construction industry. Since the early 2000s, the bank played an instrumental role in financing the floriculture sector which turned out to be an important source of foreign currency.

Job Creation and Poverty Reduction

The bank played a catalytic role in job creation by financing the implementation of projects in the agriculture and industrial sectors that opened employment opportunities for unskilled, semi-skilled, and skilled labour. Notably, the coffee and tea plantations as well as floriculture farms provided employment opportunities for thousands who are unlikely to find jobs in the traditional job market. Recently, mushrooming textile factories in the capital and some regional cities created job opportunities mostly for the youth.

Promoting Entrepreneurship by Supporting Small and Medium-Sized Enterprises

DBE's introduction of lease financing is aimed at stimulating the development of the SME sector and its programme on women entrepreneurship was crucial in promoting entrepreneurship in the country.

5.11 Challenges of the Development Bank of Ethiopia

The bank witnessed various changes in the country's socio-economic and political environment since its establishment at the onset of the twentieth century. Its mandate and governance structure have been amended many times following changes in government. In this section, we focus on the challenges the bank faced that impeded its wider impact on the socio-economic development of the country as well as highlight the opportunities presented to the bank. The primary challenge of the bank lies in the lack of political stability in the country affecting its business and governance. We discuss the fundamental constraints that have a significant impact on its institutional performance and economic impact.

Limited Skills in Project Design and Implementation

Project-based lending that DBE uses entails borrowers' skills in putting together viable development projects. A lack of project development skills increases the bank's exposure to credit risk caused by ill-designed projects where the projections are removed from reality. Even when a project is well-designed with future socio-economic conditions sufficiently factored in, problems might arise due to a lack of capacity during implementation. More specifically, implementation delays occur due to failure to provide allowance to such requisites as permits, access to utilities, and availability of the desired technology. Moreover, borrowers sometimes fail to build a robust implementation team to realize project goals due to a lack of project management skills, which makes it imperative for the bank to verify the suitability of personnel assigned to a project.

Political Interference

As a wholly state-owned development finance institution, DBE's mandates and governance structure are determined by the government in power. The state exercises control over the institution in many ways including through the supervisory agencies that dictate such important matters as appointment of directors, strategic plans, priority sectors, etc. While state oversight is necessary to ensure the bank's strategy is aligned with the development goals of the nation, politically motivated appointments of directors and members of the executives may not be in the best interest of the country. Driving such an important institution in the right direction requires merit-based appointments where people with the right qualifications and experience in the local and international development finance market are brought on board.

Political interference is also manifested through frequent changes in its governance structure—including institutional structure, the directors, and chief executive officers. The bank had three directors with an average tenure of three years each. The tenure of the chief executive officers is even more frequent averaging a little over two years. One also notes frequent changes in the bank's institutional structure wherein new corporate departments are created, some removed, and others merged to form a new department. Between 2013 and 2021, the institutional structure changed five times; initially expanding from four departments between 2012 and 2015 to six in 2016 with the addition of lease financing and project financing. Both departments were closed in 2018 and a new department for SME financing was introduced. In 2021, the bank has only two departments, namely, corporate services and project appraisal & portfolio management. The instability of the top management of the bank and frequent changes in the structure are likely to restrain the bank's ability to pursue a medium to long-term strategy that strengthens the bank's contribution to socio-economic development in the country.

Political Instability and Low Borrower Base

Political instability coupled with limited experience in project finance among borrowers poses a serious threat to the bank's sustainability. The country has witnessed political instability in the Oromia region since 2016 and later a war in Tigray from 2020 to 2022. The bank sustained significant losses caused by the bankruptcy of several projects following vandalism by rebel groups and this was particularly the case in the Oromia and Tigray regions that account for more than half the bank's loan portfolio. Moreover, the borrower's limited experience in project finance increases the administrative burden on the bank first to resolve the selection problem before loan approval and a moral hazard after disbursement of the loan.

Foreign Currency Shortages

As a country that heavily relies on imports with limited export earnings, mostly from the export of primary goods, the country has been experiencing foreign currency shortages for many years. The pandemic coupled with the war in the northern part of the country made things worse, severely constraining the operations of the banking system in the country. The DBE is among the worst affected due to its financing of projects that rely on imported capital goods, raw materials, and supplies. While improvements in the external balance through increased export activities provide the ultimate solution, the bank can also boost its foreign currency holdings by floating foreign currency-denominated debt securities in the international financial markets.

Unlocking the Potential: Future Pathways for DBE's Excellence

The bank had a remarkable impact on economic development in the country despite capital and operational constraints. As the sole development finance institution in the country, the bank enjoys full attention from the state which it can leverage to build a sustainable business model by tapping into local and international capital markets. The recent injection of additional capital is crucial in bolstering its position as a financier of development projects in the country. Moreover, the national bank's directive that requires all commercial banks to invest in DBE's bonds at 2% above the deposit rate allows the bank to tap into the local debt market, strengthening its ability to fund bigger projects.

5.12 Conclusions and Recommendations

The Development Bank of Ethiopia, one of Africa's oldest development finance institutions, has a long history of assisting many sectors of the economy, particularly agriculture and manufacturing, through medium and long-term loans and other financial instruments. The bank's mandate has changed over time in response to a change in the country's political and economic climate, and its current mandate is to promote economic development and transformation.

By supporting projects and programmes in priority areas such as commercial agriculture, agro-processing, manufacturing, mining, energy, SMEs, women empowerment, and renewable energy, the DBE has contributed to Ethiopia's food security, industrialization, job creation, and entrepreneurship. The DBE is confronted with some obstacles, including borrowers with limited project design and implementation skills, political interference in its governance and operations, and a high proportion of non-performing loans due to political instability and borrower defaults.

The DBE has some opportunities to enhance its role as a catalyst for economic growth and development in Ethiopia by strengthening its capital base, diversifying its funding sources, improving its risk management practices, expanding its outreach and impact assessment, and collaborating with other development partners.

We recommend the following considering the foregoing conclusions.

Broaden Funding Sources—The bank has been heavily depending on state funding, but this is likely to inhibit its contribution to economic development when there is pressure on public resources due to emergencies. This calls for a quest for broadening its funding sources mobilising resources from the domestic and international financial market.

Mobilize Capital Through Innovative Financing Techniques—The bank supports projects through direct lending that requires a strong capital base. To utilize capital more efficiently, the bank can provide guarantee facilities which will be crucial in mobilizing private capital through the intermediation of commercial banks. Besides, the bank can introduce such innovative financing techniques as future flow securitization that increase its impact by recycling capital.

Pursue a Strategy Synchronized with the National Development Plan—The bank's strategy should be strongly tied to the national development plan, making it easier to gauge its impact on economic transformation. The national development plan also provides clarity of direction to which the bank's operational plans can be linked.

Support the Establishment of Other Development Finance Institutions—Considering the development backlog in the second most populous country in Africa and the diversity of interventions needed, it would be challenging for a single development finance institution to address the development finance needs of all the sectors. Currently, the bank's service spans all sectors of the economy including industry, agriculture, infrastructure, SMEs, mining, export, and others that require specialized skills. It is therefore imperative for the state to consider establishing one or two specialized development finance institutions that can complement the contribution of the bank.

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CHAPTER 6

The Development Bank of Rwanda: Contributions and Challenges

Daniel Ofori-Sasu, Joshua Yindenaba Abor, and Frank Abaho Gakwaya

6.1 Introduction

The history of Rwanda's financial sector is somehow connected to the colonial administration and to commercial markets in the Belgian Congo and Burundi. In 1927, the Bank of the Belgian Congo was established, and its currency issuing authority was extended to Ruanda-Urundi. In 1944, the National Bank of Belgium assumed the responsibilities of exchange rate regulation and control of other financial operations in the region and around this time, some banks had started operations in

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the Congo. The Bank of the Belgian Congo no longer functioned as the bank of banks (BNR, 2018a, 2018b; BRD, 2014). In 1952, the Central Bank of Belgian Congo and Ruanda-Urundi was established, taking over the responsibilities of the Bank of Belgian Congo. In 1960, Congo gained independence and Banque d'Emission du Rwanda et du Burundi (BERB) began operations as an issuing bank in Rwanda and Burundi. Both Rwanda and Burundi also gained independence in 1962. The central bank, the National Bank of Rwanda (BNR), was also established in 1964 with the objective of maintaining financial and monetary stability and to facilitate economic development. It was responsible for monitoring financial institutions in Rwanda. While the BNR made the effort to increase its mandate, the banking sector lacked the capacity to provide financial support for macro-economic development. The Development Bank of Rwanda (BRD) was subsequently established in 1967 with the mandate of complementing the efforts of the BNR in providing financial support to the various sectors of the Rwandan economy, thereby ensuring the stability of the macro economy (BNR, 2021a).

The BNR, since its establishment, has enacted many financial sector reforms to stabilize the financial sector, which focused on inflation targeting, financial inclusion, and regulatory best practices based on the Basel financial standards (BNR, 2021b, 2021c). For instance, BNR took the initiative to implement the Basel II and III with the purpose of achieving financial stability in the Rwandan economy.

The rationale for establishing the BRD by the Rwandan government was to promote both economic and social development goals (BRD, 2018, 2014). In achieving these goals, the Bank acts as a catalyst for financing national development projects and for offering long-term financing for sustainable development goals. The Bank does not only support projects that the private sector is unwilling to finance. It is expected to create new market niches, develop innovative schemes to attract private sector resources for large-scale infrastructure projects, build the capacity to link the actors in the public and private sectors, and fund strategic projects within the national context. As part of the broader mandate of global sustainable development goals, it is important to understand the contributions and challenges faced by the BRD.

This chapter provides a case of the national development bank in Rwanda, BRD. The chapter presents the profile and a brief history of BRD; the political economy and institutional context of BRD; BRD's corporate governance arrangement; the regulation and supervision of

BRD; the monitoring and evaluation, and impact evaluation practices of BRD; BRD's business models; the contributions and challenges of BRD; and the operations and performance of BRD.

6.2 Profile and Brief History of Development Bank of Rwanda

The BRD is Rwanda's national development bank with the vision to be an innovative and sustainable provider of development finance for socio-economic impact (ACET, 2022). It operates as a public company limited by shares with a capital base of about Rwf 65.3 billion (approximately US$ 63.6 million) as of May 2022 (BRD, 2021a). The Bank has been involved, over the past fifty years, in Rwanda's economic development through the provision of long-term financing to various sectors of the economy as well as playing an advisory and partnering role in financing development projects (ACET, 2022).

The BRD was established on August 5, 1967, with the sole aim of providing long-term financing for the different sectors of the economy. However, it had no projects to finance, particularly in the period 1968–1970. The Bank, in the 1970s and 1980s, was mandated to provide preferential interest rates and long-term financing for strategic projects (Abor, 2023; ACET, 2022). But most of its investments were mismanaged and could not yield the benefits intended. The Bank embarked on a four-year aggressive lending to different sectors of the economy—leading to the extension of over 500 operations and employment creation. During the period 1988–1994, the bank funded projects through lines of credit, equity shares, and investments. The priority areas for the distribution of the loans were agro-industries like tea and coffee, increasing exports to fill export gaps and expanding manufacturing companies, SMEs in agribusiness, artisanship, and micro-projects. The Bank's original mandate was to finance projects in the transport and industrial sectors as directed by the government. During this period, Rwanda's post-independence development agenda could only be supported by the provision of long term, affordable financing through appropriate financial institutions. The Bank was only able to achieve its original objective in 1994, when the government shifted its focus to financing investment projects in key sectors of the economy (Abor, 2023; ACET, 2022).

The history of the Bank could be traced to the 1994 genocide against the Tutsi—where few commercial banks and specialized banks operated in Rwanda with few underdeveloped branches. The war paralyzed many rural areas of the economy which had a severe impact on the financial sector, leading to the closure of the national bank and financial institutions. After the 1994 genocide against the Tutsi, the Bank was faced with more than half of its loans constituting non-performing loans. The revitalization of the 1994 genocide focused on the secondary and tertiary sectors of the economy. It also focused on building the capacity to provide basic infrastructure, expanding businesses to create employment opportunities among Rwandans, and consolidating resources. In the post-genocide period, the number of banks began to increase as the market was open to the domestic and international markets. In addition, the post-2000 period was characterized by the financing of projects in priority sectors of the economy, including agriculture and agro-processing, exports, manufacturing, energy (renewable and clean), education and housing, and infrastructure (ACET, 2022).

The Bank, on April 26, 2011, officially acquired the Banque de l'Habitat du Rwanda with the primary objective to achieve sustainable growth by making BRD to be better positioned in providing long-term loans, housing loans, mortgage refinancing, and other financial services to finance the Rwandan economy. The BRD was incorporated on July 7, 2011, as a public company limited by shares and received its banking license from the BNR on August 11, 2009 (with a licensing n° 003) (BNR, 2021a; BRD, 2021). The Bank plays a significant role in providing financing and technical support to savings and credit cooperatives (SACCOs). Over the years, BRD has been the sole provider of long-term finance and was recognized to facilitate the development of different productive enterprises within the private sector (BNR, 2021a; BRD, 2021).

6.3 Political Economy and Institutional Context

Over the past decade, Rwanda has achieved significant political stability and some level of political inclusivity. This includes undertaking major policy reforms that have led to significant economic gains, largely through the financial sector and donor support. Rwanda has achieved remarkable progress in rebuilding the core institutions of the state over the past decades. After the establishment of the BRD, there was a clear delineation between the "growth" initiative and the "social objectives" phase. However, there has been a sudden change in the mandate of the institution, from supporting national development goals to helping achieve sustainable development goals (World Bank, 2015). In view of that, efforts have been made to understand the political and institutional climate within which the Bank functions to achieve these goals. Although the BRD is established in a fragmented political system with frequent political interventions, the Bank is commended for its professional independence. The independence of the BRD depends crucially on the interplay of strict institutional constraints anchored in the political system and political structure. In particular, neither institutional constraints nor the strong political structure alone guarantees a sufficient degree of autonomy for the BRD. Without a strong political structure or leadership, institutional arrangements (including checks and balances) can result in excessive veto points in decision-making (Huang et al., 2020).

On the political front, the government of Rwanda provides huge support for the development of the economy through the BRD. Political drive and the availability of funds are key elements in achieving the BRD targets and building momentum toward achieving the SDGs in Rwanda. "BRD is experiencing a trade-off between risk reduction and much-needed support for development sectors such as SMEs, agriculture, international trade, tourism, energy, infrastructure, housing and the environment" (ACET, 2022). The Bank's ability to assume such risks and interpret its role also depends on the political mandate with which they are associated. The Bank helps in reducing perceptions of political risk and plays an important role as a conduit that can translate political objectives into economic action. While the BNR does not impose sectoral lending targets, it defines strategic growth sectors.

On the institutional front, the BNR has a crucial role to play in ensuring there is economic and financial stability in the country. It is responsible for conducting monetary policy to achieve low and stable inflation through a clear policy framework. The Central Bank of Rwanda has managed to keep inflation low and stable (Ingabire, 2016). The BNR has started implementing accommodative monetary policy (keeping interest rates low) since June 2013, contributing to the recent good performance of the BRD at a time when the global economy is facing challenges. The BNR has helped deliver high economic growth of over 7% per year over the past five years, while annual inflation has remained below 5%. BRD is the front-line force when it comes to implementing monetary policies, and because of this, the Bank is most heavily influenced by the actions of the country's monetary authority. The BNR has been very instrumental in the use of capital account reserves by the BRD to support private sector demand for foreign exchange in the market, thereby smoothing out local currency depreciation. Thus, the BNR stabilized the level of bank reserves to support its dovish monetary policy.

Box 6.1: Interview Responses from BRD's Stakeholders

"In 2019, BRD financed a significant part of the investments in the country through small, medium and large projects by focusing on development sectors - notably agriculture, housing, education, infrastructure, exports and energy - which are noted to play a key role in the development of the country. In addition to providing financial resources, BRD's mandate includes technical support during implementation and consulting services. The Rwandan government's resource constraint and agenda have negatively impacted the Bank's operations over the years, despite the significant benefits reaped by the government, including access to credit for investments in SMEs.

Interviews and discussions revealed that BRD is a professionally known company that has been managing mutual funds for the last few years. In addition, the government of Rwanda has intervened through BRD to support SMEs and provide entrepreneurial opportunities to young people. Government agencies that have supported these initiatives include the Rwanda Development Council, the Business Development Fund, National Agricultural Export Development Board for SMEs in the Agricultural Sector, National Agency for Industrial Research and Development to support SMEs in the Industry, Rwanda Cooperative Agency and Rwanda Agriculture Board.

In addition, the study finds that, at the national level, BRD is seen not only as an instrument for addressing the long-term funding gaps, such as the lack of provision of patient capital due to the risks and uncertainties involved, but also as a crucial tool to support a proactive development strategy. The BRD has become an important part of the long-term financing of economic development and has continuously adjusted the focus of its activities to ensure that it maintains its mandate. In its early years, immediately following the 1994 Tutsi genocide, BRD focused on meeting the financing needs of small businesses in core industries, and the government had a responsibility to fund a larger percentage of its source of capital. Having recognised the advantages of BRD operating as an autonomous entity, the government changed the Bank's business status in 2011 from a purely public institution to a corporation (i.e., a public limited company). This model helped the Bank obtain financing from international and private financial institutions. However, as a financial institution, BRD is regulated by Rwanda's central bank, the BNR" (BNR, 2021a).

6.4 BRD's Corporate Governance Arrangements

The role of the BRD in supporting national development, particularly, in mainstreaming governance decisions to deploy funding to complement these efforts remains crucial. The experiences of the Bank have shown that the governance policies that assist developmental projects and finance of the various sectors may be technically sound, but may fail to deliver expected results for reasons connected to the poor governance system. Good corporate governance is crucial to the success of BRD (Abor, 2023). This describes the process and structure for overseeing the direction and control of the Bank so that it effectively fulfills its mission and purpose. The board of directors ensures that the "Bank adheres to the principles of good corporate governance and high ethical standards, as enshrined in the applicable laws and regulations (i.e., the Bank's statutes of the Board of Directors)." The board of directors is subject to the BNR's corporate governance regulations and other international corporate governance guidelines.

In terms of regulations, the board is governed based on corporate governance requirements, responsibilities of the board of directors, and operational structure of the Bank (Abor, 2023). These regulations are designed to strengthen the main components of corporate risk governance. It also defines and describes the powers, responsibilities, and prohibitions of shareholders (see, BNR, 2018a, 2018b). "The Articles of Association of the Board of Directors are regularly reviewed to ensure compliance with new corporate governance standards, the Bank's strategic direction, and shareholder interests and best corporate governance practices." In 2018, the Bank transferred ownership from the Rwandan government and the National Agricultural Exports Board (NAEB) to a new shareholder—the Agaciro Development Fund, which acquired 23,690,298 common shares. The transfer was approved by the Board of Directors in accordance with shareholder motions and subsequently approved by the BNR. The ownership and control structure of the BRD can be complex as it involves many government appointees on the board. When the BRD's mandate is formulated in general terms, senior government officials and elected politicians have more flexibility to influence the Bank's direction and activities. The Bank may become vulnerable to political interference unless its institutional structure is strong enough to withstand political pressure. BRD's board is essentially composed of government appointees.

Table 6.1 presents the current structure of BRD's board. The Bank currently has a board size of eight members, made up of all non-executive directors. The non-executive directors are made up of three members representing the government and five independent directors with the board chairman who is also an independent non-executive director. Out of the current nine (9) board members, two (2) are females, while seven (7) are males. The board has different committees that report on various issues to the board which include the Audit Committee, Risk Management Committee, Credit Committee, Corporate Social Responsibility Committee, Investment and Management Committee, Nomination and Remuneration Committee, and IT & Strategy Committee.

In accordance with the board's charter, the Board seeks to work together to promote good corporate governance practices at the Bank. The board strives to maintain corporate governance to the best of its ability through best practices that advance the long-term interests of shareholders, customers, stakeholders, and partners, and to build public trust in the Bank (BNR, 2021a; BRD, 2021).

Table 6.1 BRD's board structure

Board characteristics	*Number*
Board size	9
Executive directors	0
Non-executive directors	9
Female directors	2
Male directors	7
Executive Committee members	8
Females on the Executive Committee	2
Males in the Executive Committee	6
Number of committees	7

Box 6.2: Interview Responses from the Board of Directors—Corporate Governance

"From the interviews, Rwanda demonstrates good governance practices and focuses on fundamental tools such as accountability, transparency, the rule of law and government involvement in its operations. The design of the Bank's governance systems and structures reflects a holistic approach to sustainable development. It takes into account not only poor people, but also sustainable measures to combat poverty, which must be consistently linked to the establishment of strong and deep forms of democratic governance at all administrative levels.

Over the years, government participation in DFIs to reduce the tax burden has not involved private sector actors or international financial institutions. The Bank complies with international corporate governance standards, and it is evident that the Bank operates within the governance framework of the global governance standards. The members of the board of directors are dominated by independent directors, appointed at the general assembly, and nominated based on their international success, skills and experience.

The law governing companies in Rwanda, the banking law and the regulations of BNR on corporate governance for banks – clearly set out the responsibilities of the board of directors, and that they are responsible for promoting "corporate culture and values." They have the responsibility to administer, implement, establish and monitor the Bank's vision, mission and strategy for the interests of the shareholders. The board chairperson is appointed by the shareholders at the general assembly for at least a three-year renewable term. The appointment and renewal of the directorship are subject to the approval of the BNR."

Source BRD (2021), BNR (2021a).

6.5 Regulation and Supervision

Rwanda's financial sector is regulated by the BNR, which regularly updates its laws, regulations, policies, and guidelines to create an enabling environment for the operations of the banking sector. The BNR strengthens the financial system by applying the international principles and standards governing the financial sector. Rwanda has designed its legal and regulatory framework to ensure compliance of financial institutions with regulatory standards and to protect customers and the system as a whole. These are periodically reviewed by international organizations like the IMF and the World Bank.

BRD is registered at the Officer of the Registrar General under the company code no 100003547 and supervised by the BNR with the license no 003. The Bank complies with the sets of regulations under the Basel II and III with the purpose of achieving financial stability in the Rwandan economy. The BNR sets regulatory standards, obtains and analyzes financial data covering areas such as liquidity risk, market risk, credit risk, operation risk, deposit taking, lending, capital adequacy, large exposures, related party exposures, credit limits, and structure.

BRD's problems with capital and liquidity may affect its ability to extend long-term financing to sectoral projects. In some cases, specific capital adequacy requirements set by the regulator and aligned with Basel III requirements have been recognised as an impediment, though such requirements are seen as necessary to ensure liquidity over time. Trade associations (i.e., partnerships with additional banks) or public co-funding (i.e., receiving grants or concessionary loans) from NDBs or multilateral institutions have been highlighted as solutions to fill potential funding gaps and provide cheaper loans with longer maturities. However, tighter regulation also underpins the strength of capital markets, and in turn, well-developed capital markets can offer institutional investors – both domestic and foreign – opportunities to use development finance for different types of investments (short-term, long-term). In particular, regulations like Basel III can support 'patient' long-term investors like pension funds, which generally prefer to invest in long-term funds and equities.

Box 6.3: Interview Responses from the Stakeholders—Regulation and Supervision

"Government supervision is carried out through the enactment of laws, directives, guidelines and legal frameworks. The BNR publishes annual Financial Stability Reports, which show the BRD's performance. For instance, the 2021 report shows that the BRD has performed well over the years and successfully contributed to corporate growth as well as the development of key sectors of the economy. BRD collects credit information from financial institutions and strongly warrants the accuracy and reliability of the information and maintains it in a public credit registry database – for regulatory and statistical purposes.

It was revealed that the legal and regulatory framework aims to ensure that the Bank and other financial institutions comply with regulatory and public protection standards.

The BNR also supervises the private credit reporting agency and acts as an intermediary for credit information sharing among financial institutions.

The head of research at the National Bank explained in an interview that the BRD should not be regulated according to the requirements of Basel I and II, such as the liquidity ratio, capital adequacy, etc. From the interview, he indicated that BRD needs to collaborate with the Ministry of Finance and the central bank (regulator) to issue separate regulations."

6.6 Monitoring and Evaluation, and Impact Evaluation Practices

Sound M&E practices and disclosures allow investors to properly understand and price risk. One of the biggest obstacles to investing in green finance is often the lack of clear and widely accepted methodologies for assessing risks related to the adverse impacts of climate change. Case studies have shown that, in some economies, standard ESG disclosures may not be sufficient to build robust models. In this context, recent proposals have emerged in line with credit ratings, based on the principles of the "probability of default" (i.e., the probability that an investment will not be able to repay the principal borrowed) and "loss due to default" (i.e., assets that could be lost) in green investments, particularly in larger project financing and listed venture capital firms. This aims to expand assessments beyond liquidity and traditional ESG, differentiate the extent of corporate sustainability, and provide more transparency in assessing the costs of climate-related risks. The creation of more robust models will support the realignment of pricing in relation to estimated risks (credit, financial, and technical). This can be useful for a national development bank to assess the suitability of the instruments it offers and the level of concessions it can provide in a given transaction.

Against this background, various approaches to impact evaluation are advocated—many accompanied by experts of development institutions that there is the best way to decide what BRD hopes to get out of an evaluation, and how it relates to the kinds of policies or initiatives they are involved in (Gill et al., 2014; UNICEF, 2011). For instance, BRD has included monitoring and evaluation in their funded projects to assess the achievement of specific targets (Kararach et al., 2022). This initiative is needed to better capture the results and lessons of policies, programs, and projects of the Bank. For instance, the Bank has committed to increasing the use of evidence-based approach from impact evaluation in project design.

Increased awareness of impact evaluation initiatives of BRD can boost resource mobilization and the quality of development through transparency and accountability. The role of BRD in supporting national development, particularly, in mainstreaming impact evaluation in the projects they fund and governance decision to deploy resources to complement these efforts remains, therefore, crucial. To ensure that the Bank's mandate is consistent with transparency, accountability, and legal framework for development, efforts for maintaining good governance practices should not be overlooked.

6.7 Business Models of BRD

The BRD was established to act as the financial arm of the government in achieving the national development agenda. The information obtained by the BRD sets the national government's agenda regarding the Bank's business models and investment priorities (see, Abor, 2023). BRD was created to play a role in financing projects in priority sectors of the economy, including agriculture and agro-processing, exports, manufacturing, energy, education, housing, and infrastructure. In executing its business models, the Bank offers low interest rates on loans and other investments. The Bank, in its quest to fundamentally transform the country into a middle-income country, has developed a business model that covered these sectors of the economy. The main delivery channels of these models include direct lending (private sectors), financial institutions (commercial banks, SACCOs, and MFIs), and implementing agencies (Government of Rwanda Agencies, Development Partners, and Private Sector Federation [PSF]).

Policy Mandate

BRD has a specific mandate to provide financial support to the priority sectors (i.e., agriculture and agro-processing, exports, manufacturing, energy, education, housing, and infrastructure) in order to achieve the

National Development Agenda. In addition, it acts as an outlet for private investment financing. While foreign direct investment (FDI) is encouraged, the BRD-supported domestic business category remains a critical component of development. BRD provides the capital needed for private sector development and for risky and long-term investments. "As part of its mandate, BRD engages in all types of negotiable and financial instruments, with its funding coming from internally generated resources (interest income), as well as from the international DFIs, government of Rwanda (with funding for projects and specific beneficiaries); and other institutions, such as the World Bank, play a very important role in raising capital for the Bank."

Sectors Served

Throughout the six-year strategic plan, 2018–2024, BRD's new business model focused on the priority sectors, including exports based on their strategic objectives. BRD finances traditional export crops (tea, coffee, pyrethrum, etc.) as well as non-traditional export crops such as vegetables and flowers. From 2016, the export sector received a further boost with the launch of the Export Growth Facility (EGF) to help export-oriented SMEs access finance through interest rate subsidies, grants, and loan insurance. So far, Rwanda has funded several projects in the export sector, mainly in the production and processing of coffee and tea, as well as other non-traditional crops such as flowers as industries producing import substitutes (BNR, 2021a; BRD, 2021). For instance, the gross loan portfolio distribution of the Bank, based on 2018 report, includes 42% to special project and infrastructure, 35% export, 10% agriculture, 6% education, 4% energy, and 3% housing. In line with BRD's business model, it targets private borrowers and increases accessibility of shipping facilities, which greatly strengthen the Bank's scope of financing to improve rural development and better living conditions of smallholder farmers across the country. The delivery channels of the various sectors include direct lending through the private sector, financial institutions like the commercial banks, SACCOs, and MFIs, and the implementing agencies like the Government of Rwanda Agencies, Business plan competition, Fund/Private Sector Federation (PSF), Rwanda Social Security Board (RSSB), and development partners (BRD, 2021).

Funding Sources

The main objective of BRD as a development bank is to raise the needed funding to provide loans to the priority sectors of the economy. The Bank relies on various sources of funding, including borrowing from the international capital markets and other financial institutions, receiving official development assistance from international financial institutions such as the World Bank, IMF, loans from state-related agencies such as the Rwanda Social Security Board, and other regional development banks. The Bank diversifies its funding sources to lower its high funding costs. In partnership with several lenders such as African Development Banks (AfDB), Banque de Development des Etats des Grands Lacs (BEDGL), loans increased by 5% due to credit lines drawn during 2017. Loans and advances by the Bank are mainly from its borrowing activity. "As the quality and performance of the Bank's loan portfolio improved in 2019 and beyond, lending is expected to increase significantly in subsequent years at more favorable interest rates to fund the growing development needs projects and programmes with the mandate of the central bank. The Bank's strategic partnerships are also opportunities that allow companies to gain a competitive advantage through access to knowledge and project financing. This approach allows the Bank to penetrate the private sector and continue to act as a catalyst for third-party involvement in development finance. The Bank maintains a flexible funding strategy based on balancing dual requirements to optimise funding costs, while keeping funding risk within acceptable limits. At the same time, there are ongoing efforts to diversify funding sources. The Bank's strategy includes one of the main initiatives to create a pathway to access green finance through the Green Climate Fund (GCF) (BRD, 2021). The GCF has a Private Sector Facility (PSF) with the mission of engaging the local and global private sector to support mitigation and adaptation projects in developing countries."

Lending Models

BRD mainly adopts a mixture of retail and wholesale lending models, but it uses the wholesale lending model for very large portfolios. With the wholesale lending model, BRD channels its loans through groups (cooperatives and companies), commercial banks, MFIs, government agencies, and development partners, which it then online to the target

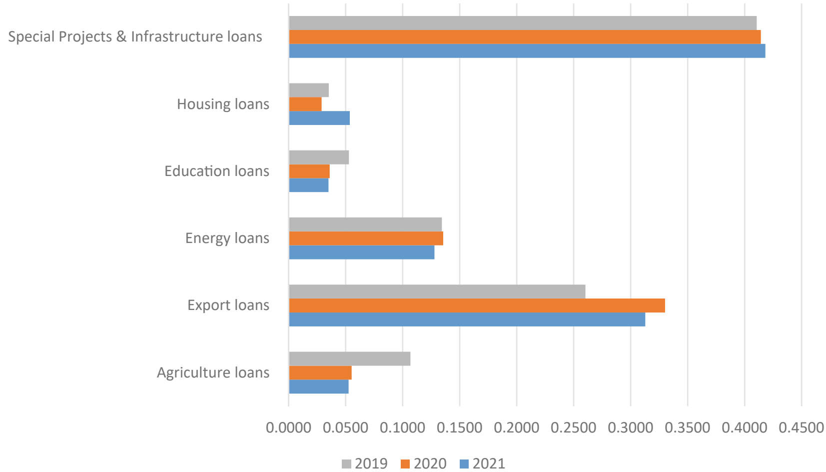


Fig. 6.1 Gross loan distribution to various sectors (*Source* Authors' computation based on data from audited report of BRD)

borrowers. In relation to the group-based lending, the Bank encourages actors in the value chain to form groups, find methodologies to share resources, achieve economies of scale, negotiate prices, and address common financing problems. Figure 6.1 shows the gross loan distribution to various sectors of Rwanda's economy over the period 2019–2021. It is observed during this period that the Bank allocates more funds to the special projects and infrastructure sector, followed by the export, energy, and agriculture sectors. The education and housing sectors tended to receive the lowest proportion of loans over the same period.

Pricing of Loans

The pricing of loans provided by BRD reflects the short-term interest rates of the BNR. The Bank develops hedonic behavior of pricing that includes a number of variables related to accessibility, location, cultural factors, timing of sale, and property size. The BNR raised its policy rate by 100 basis points to 6% during its August 2022 meeting. It was the second-rate hike so far in 2022, pushing borrowing costs to their highest levels since November 2017, and they remain high, mainly due to disruptions in the global supply and lower domestic agricultural production. Headline inflation in Rwanda rose to an almost 13.5-year high of 19.6% in July 2022 and is projected to average around 12.1% in 2022 and is expected to decelerate in the second half of 2023.

Interest income is recognized in accordance with the International Financial Reporting Standard for all financial instruments measured at amortized cost using the effective interest method (EIR). The effective interest rate is the rate that accurately discounts estimated future cash receipts over the expected life of the financial instrument. The effective interest method is a method of calculating the amortized cost of a financial asset or financial liability and allocating interest income or expense over time. When calculating the effective interest rate, the Bank estimates the cash flows considering all contractual terms of the financial instrument (e.g., prepayment options) but does not consider future credit losses. All fees and points paid or received between the parties to the contract that are part of the effective interest rate, transaction costs, and any other premiums, bonuses, or discounts are included in the calculation (BNR, 2021a; BRD, 2021).

Products and Services

BRD offers a wide range of financial products and services that go beyond loans. This includes short-medium, and long-term financing to small, medium, and large enterprises at attractive rates through debt, equity, and mezzanine instruments. It also offers loan guarantees, private equity and venture capital and custody accounts, debt collection, micro-insurance, and real estate and asset brokerage services. The Bank offers trade finance products such as export credits, guarantees, and import credits, as well as infrastructure finance instruments such as loans, guarantees, and public–private partnerships. The Bank offers loan guarantees that have lines of business that include export, import, or access to finance for micro, small, and medium-sized enterprises. BDR also provides some key services, including Investment Promotion, Export and Special Economic Zones Development, Investment Deals Negotiation, Tourism & Conservation, Skills Development, and One Stop Center services (business and investment registration, visa facilitation, Environment Impact Assessments, and tax incentives). From the interview, the Bank's key products and services are debt (loans), equity, guarantees, technical assistance, matching grant, investment catalysts, export guarantee facility and advisory, and the managed funds like export growth fund, renewable energy fund, and affordable housing and education funds (ACET, 2022).

6.8 Main Contributions of the Development Bank of Rwanda

BRD, as Rwanda's only development bank that promotes social and economic development, has, since its establishment, contributed significantly to Rwanda's economic growth (see BRD, 2021). The Bank has supported many enterprises and transformed different sectors of the economy of Rwanda, including energy, agriculture, manufacturing, export, and affordable housing.

The Energy Sector

The Bank has invested heavily in the energy sector through research and development. It has contributed to the country's economic growth through financial and non-financial investments in key growth areas over the years. BRD is committed to supporting energy investments, which are essential to Rwanda's efforts to attract foreign investment. The Bank has contributed toward Rwanda's efforts to leveraging green energy to reduce carbon emissions and to mobilizing various funds through the Renewable Energy Fund (REF) to finance the renewable energy sectors. The World Bank, in partnership with BRD, provided an assistance in scaling up renewable energy program under the strategic climate fund. The Bank established a relationship with the World Bank to expand the Rural Electrification Program (SREP), which provided energy financing for solar and off-grid solutions to bring sustainable energy access to the masses. Over the years, BRD has become a market leader in the long-term financing of high impact and development projects—managing renewable energy funds, export growth funds, and affordable housing funds. These projects have increased access to reliable, affordable, and clean energy; connected to the national power grid, giving access to electricity for more than 747,430 families in Rwanda; contributed to the creation of SMEs; created employment opportunities. Since 2015, the Bank has committed to managing and reducing any adverse impacts of investment activities on the use of energy resources and has focused on improving renewable energy resources.

The Agricultural Sector

BRD's contributions to agriculture cover all parts of the value chain. It has taken the lead in financing primary agriculture, mainly in tea, coffee, cassava, corn, and others, an area underserved by commercial banks, through cooperatives and microfinance institutions. The Bank has successfully provided technical support and advisory services to SMEs and provided extension services to farmers. BRD's investments in the agriculture sector have improved the living conditions of smallholder farmers and enhanced food sustainability in Rwanda. For instance, in the year 2021, it supported the agriculture sector with a loan totaling Rwf 0.93 billion, creating jobs along the agriculture and agro-processing value chain. In 2020, the sector benefited from loan approval of Rwf 2 billion. In addition, agriculture and agro-processing loans, based on the year 2020s key development impact indicators' performance, accounted for 49% of the Bank's SMEs portfolio, which consists of modern poultry and chili farming projects with over 20 SMEs benefiting from the Export Growth Fund on-lending window. In 2019, BRD launched a comprehensive agricultural financing and agro-processing development programs—and injected about $230.9 million to support the sector. The Bank continues to engage various partners to identify and attract funds to support business opportunities in agriculture such as de-risking mechanisms and refinancing institutions to deepen financial inclusion and improve the livelihood of smallholder farmers.

The Bank implemented an Agricultural Transformation Strategic Plan for the period 2018–2024 to promote the agricultural sector as a key driver for Rwanda's economic transformation through private sector investment in agro-processing and value creation of the agricultural value chain. The Bank has transformed the coffee and tea sub-sector and prioritized the financing of the export sector. In 2017, the Bank made significant contributions to unlock agriculture financing and maximize agricultural sector potential in 2017. In 2016, BRD partnered with USAID to champion the Private Sector Driven Agriculture Growth Project (PSDAG) to promote agriculture in Rwanda and provide capacity building to struggling SMEs in the agricultural sector (BNR, 2021a; BRD, 2021). In the same year, the Bank financed projects worth over Rwf 7 billion, categorized under poultry, crop production, livestock, agro-industries, post-harvest infrastructure, agri-vet trade finance, and cattle farming. In addition, the Bank approved about Rwf 3 billion to refinance microfinance institutions that assist smallholder farmers. Similarly, in the year 2015, BRD injected Rwf 12.684 billion into 22 projects in poultry, piggery, and fish farming. Its support through livestock farming projects contributed to a tremendous increase in egg production all over the country. This has had a positive impact on farmers' incomes and purchasing power as well as promoting modern farming methods.

Manufacturing and Export Sector

BRD has contributed to high impact lending to the private sector (SMEs and corporate companies) with a focus on offering working capital and investment credit lines in the manufacturing sector—hence, helping to alleviate poverty and to maintain sustainable financial growth and economic transformation in Rwanda. Over the decade, the Bank has set up a number of funds, such as the Export Growth Facility project to promote exports in the country. In 2021, the Bank committed an amount of Rwf 62.3 billion with the largest share of loans to the exports and manufacturing sectors to support a "Made in Rwanda" program. This has facilitated increased access to affordable long-term finance for the manufacturing and export sectors. The Bank approved Rwf 14.5 billion loan to the export and manufacturing sector in the year 2020. To enhance export promotion and manufacturing, the Bank, in 2019, created awareness of the Export Growth Fund to increase exports of high value services and value-added goods. In 2018, the Bank financed manufacturing industries to produce high quality products/materials to boost domestic production and reduce imports. Similarly, in the period 2017–2018, the Bank's financing was focused on enhancing the growth of domestic production and exports in order to generate foreign exchange, reduce imports, and improve balance of payment. The Bank has invested in the export and manufacturing and created the opportunity for low-cost financial resources available to SMEs. The major exports in 2016 included coffee, tea, and the minerals niobium, tin, and tungsten—which was supported with Rwf 8.3 billion extended to projects categorized in manufacturing. During the year 2015, the Bank maintained its focus on financing projects in the manufacturing industry, which created over 940 jobs in the country. In general, most financing projects in manufacturing by the Bank were focused on processing or producing for export.

Affordable Housing

BRD has offered affordable housing to Rwandans and set up the Rwanda Housing Finance Project (RFP) to provide financial support to households in Rwanda. In the past years, the Bank has been able to mobilize funds to finance affordable housing. For instance, in 2021, it provided a long-term finance to expand housing finance, and this was equivalent to a total of $117 million. It also facilitated the provision of $30 million to support infrastructure and promote eligible, decent, and affordable housing. In the year 2020, about 2299 mortgagors had access to affordable financing (totaling Rwf 52.3 billion) in the housing and infrastructure sector. The Bank constructed about 48 affordable housing in 2019 and, in collaboration with the World Bank, funded a $150 million affordable housing project. In 2018, the Bank committed $191.7 million to increase the supply of affordable housing, offer home loan products to members of the SACCO cooperatives, and design an affordable housing development program. It can be seen that BRD has implemented a strategic priority to provide affordable housing by providing creative financing solutions that have lessened the supply and demand constraints.

6.9 Challenges of the Development Bank of Rwanda

It is also important to identify some of the challenges affecting BRD. The Bank has had challenges in its operations, especially in line with inadequate information provided by borrowers. Some borrowers are unable to provide sufficient information in the preparation of business plans and this makes the assessment and evaluation of such customers' creditworthiness very difficult. In many instances, the Bank provides resources in the form of technical support in order to minimize the probability of default (see BRD, 2021).

BRD has always financed mega-projects that require professional leadership in management. However, on a year-on-year basis, the Bank is faced with project implementation challenges in the priority sectors. For instance, BRD does not have the full skills and knowledge to analyze projects and fill all management gaps (BRD, 2021). In financing the agricultural value chain, the Bank faces operational challenges arising from the supply of raw materials and the use of its processing capacity. With a wholesale approach, BRD has always sought to lend to rural farmers through MFIs and rural commercial banks. However, post-harvest losses and changes in climatic conditions have affected their financing efforts. In the export and manufacturing sector, the Bank faces the challenge of a perception by customers that financing costs are too high and expensive. BRD's new business models associated with the promotion of exports, import substitution, job creation, affordable housing, and energy have presented many challenges, including high exposures, and imbalanced and illiquid portfolio. In 2017, BRD's investments in hotels and the hospitality industry have become a major challenge but a major contributor to the Bank's NPL position. In financing the affordable housing sector, the Bank is faced with limited access to funding, limited educational infrastructure, non-compliance to loan repayment, as well as frequent changes in policies and regulations. High construction costs, combined with high borrowing costs and limited technical support available to implement some mortgage products, have made affordable housing almost unsustainable.

Over dependence on the credit lines predominated in foreign currency created a currency challenge associated with the devaluation of the Rwandan franc. In addition, the BDR's efforts to be largely dependent on international borrowing and capital injections resulted in currency mismatch, currency losses from foreign exchanges, and a higher net open position. This has resulted in low capitalization constraints which have affected their capacity to borrow for on-lending. In 2018, the adaption to the International Financial Reporting Standard (IFRS) 9 and the Basel II/III was a significant challenge for BRD with a development finance institution mandate in comparison to commercial bank operations, which had adequate collateral and shorter loan tenors.

The Bank continues to face old and emerging risks that have affected their performance metrics, and their inability to consistently comply with prudential requirements has affected new business models and new regulatory regimes as well as market-driven conditions. For instance, the Bank, in the period 2017–2018, was unable to secure in time additional capitalization from 7 to 50 billion as approved by the shareholders. This significantly crippled the Bank to borrow and lend in 2017. During the same year, the Bank faced liquidity challenges and undercapitalization. Loan impairments have been the biggest challenge of the Bank in 2017 while in 2018, it recorded an increase in foreign exchange losses by 66% driven by the US$ liability net open position. In 2016, there was an increase in credit losses mainly resulting from additional impairment provisions of Rwf 4.8 billion and the written off of loans due to over Rwf 8.5 billion non-performing loans. In the same year, the Bank became aware of new challenges like mobilization of funds that were aligned with the new mandate; negotiation of an appropriate regulatory framework; capital extension to create the necessary space for credit into agreed economic sectors; the devaluation of the Rwandan franc, with its currency effects on operations; and building the capabilities the Bank needed for the new mandate (BRD, 2018).

The Bank has been challenged with the reduction of export sales and flower losses during the lockdown period due to the pandemic. There were immense challenges as a result of the pandemic, leading to disruptions in international trade supply chains, and rising inflation. During the COVID-19 pandemic, the Bank faced challenges like capacity constraints and decelerating export growth, the difficulty of ensuring sustained improvements in living standards, problems associated with facilitating the expansion of SMEs including improving their access to international markets, and challenges in spurring SME's productivity and stimulating growth-enhancing investments (see BRD, 2021). Further, the Bank, to some extent, experienced cash flow challenges arising from disruptions to its operations, higher operating costs, or decrease in demand for its products, which resulted in loss of profits—during the COVID-19 pandemic.

6.10 Financial Performance of BRD

BRD is a financial institution tasked with promoting economic development, and it does so primarily by providing long-term financing or facilitating financing for projects that generate positive net present value (NPV). This usually takes into account the goals of the national agenda or the government's strategic plan. BRD's mandate to fill the funding gap for long-term investments in the country required patient and cheaper sources of capital to be made available to the Bank. The Bank's operations focus on pressing solutions and financing in housing, construction, energy (Energy Generation, Efficiency, and Renewable Energy), export growth, and agriculture financing.

Financial Performance Highlights

The BRD has renewed confidence over the 2015–2021 period, against the backdrop of a very challenging picture of the recent COVID-19 pandemic. The focus of the Bank, over the period 2015–2021, has been to steadily and progressively improve its operations and performance. This has been noticed on account of key performance metrics like operational performance, capital adequacy, asset quality, management efficiency, earnings, and liquidity assets (see Table 6.2).

Capital Adequacy

In Fig. 6.2, regulatory capital ratio, which measures the total risk-weighted asset ratio (Tier 1 + Tier 2 capital ratio), decreased from 30.81% in 2015 to 12.8% in 2017, but it increased steadily to 27.6% in 2021 and decreased to 19.35% in the second quarter of 2022. This implies that the capital adequacy ratio for both Tier 1 and 2 has increased over the period 2017–2022. The increasing trends in the capital adequacy over the period can be attributed to the reduction in the risk-taking activities of their total assets in the year 2022.

Asset Quality

The non-performing loans for BRD stood at 19.34% in 2018, which was a consistent improvement from 2015 to 2017. However, it shows a decreasing trend from 19.34% in 2018 to 3.11% in 2022 due to improved economic conditions and write-offs of loan outstanding non-performing loans (see Fig. 6.3).

Liquidity Asset

In the new business model of BRD, they ceased to be a deposit taking institution since 2017. The Bank depends largely on international borrowing and equity injection. Figure 6.4 shows the different measures of liquidity including its broad liquid assets and the core liquid asset ratios. Despite its mismatch in currencies from international borrowing and equity injection that has created foreign exchange losses, the Bank

Table 6.2 Financial performance indicators

		2015	*2016*	*2017*	*2018*	*2019*	*2020*	*2021*	*2022*	*Average*	*SD*
Capital adequacy	Regulatory CAR (%)	30.81	22.30	12.80	17.93	19.03	23.90	27.60	29.14	22.94	5.77
	Regulatory Tier 1 CAR (%)	20.52	16.20	8.10	13.01	14.04	18.99	22.71	24.05	17.20	5.04
Asset quality	NPL to total gross loans (%)	5.35	9.41	16.34	19.34	7.52	6.37	4.49	3.11	8.99	5.46
Liquidity assets	Broad liquidity assets to total assets (%)	94.17	94.61	94.65	93.82	93.99	92.60	93.78	95.63	94.15	0.82
	Broad liquidity assets to short-term liabilities (%)	154.71	144.12	127.77	135.58	135.17	142.34	149.91	158.53	143.52	9.84
	Core liquidity asset to total assets (%)	76.85	75.56	81.85	81.19	79.38	80.69	81.44	87.85	80.60	3.47
	Core liquidity asset to short-term liabilities (%)	126.27	115.09	110.49	117.34	114.17	124.03	130.20	145.64	122.90	10.64
Management efficiency	Noninterest expenses to gross income (%)	33.82	30.52	24.33	25.78	30.96	22.57	25.58	26.46	27.50	3.59

		2015	*2016*	*2017*	*2018*	*2019*	*2020*	*2021*	*2022*	*Average*	*SD*
	Personnel expenses to gross income (%)	17.79	16.65	17.40	17.55	19.67	13.32	14.33	13.64	16.29	2.13
Earnings	Return on assets (%)	1.78	1.47	−7.62	−1.38	−0.29	1.45	0.94	1.12	−0.32	2.93
	Return on equity (%)	6.20	5.73	−43.54	−5.13	−1.12	4.83	2.96	4.90	−3.15	15.70
	Interest margin to gross income (%)	57.36	47.84	43.62	41.75	40.09	53.68	51.34	53.76	48.68	5.93
Operational performance	Portfolio Yield (%)	1.46	1.09	0.86	0.98	0.99	0.72	1.48	1.29	1.11	0.26

Source Authors' computation based on data from audited report of BRD

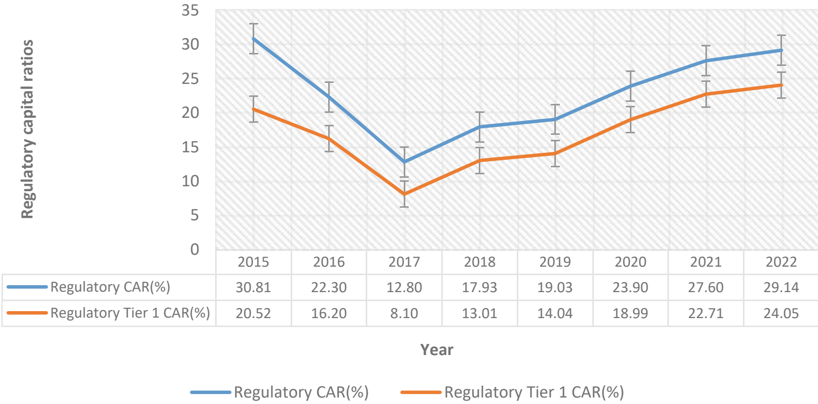


Fig. 6.2 Regulatory capital (*Source* Authors' computation based on data from audited report of BRD)

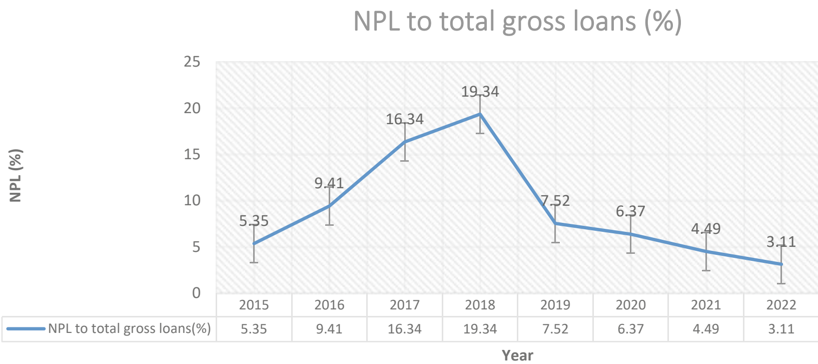


Fig. 6.3 Asset quality (*Source* Authors' computation based on data from audited report of BRD)

has been able to stabilize their liquidity positions over the period 2015–2022. This is confirmed by the general stable trends from 2015 to 2022, as indicated in Fig. 6.4.

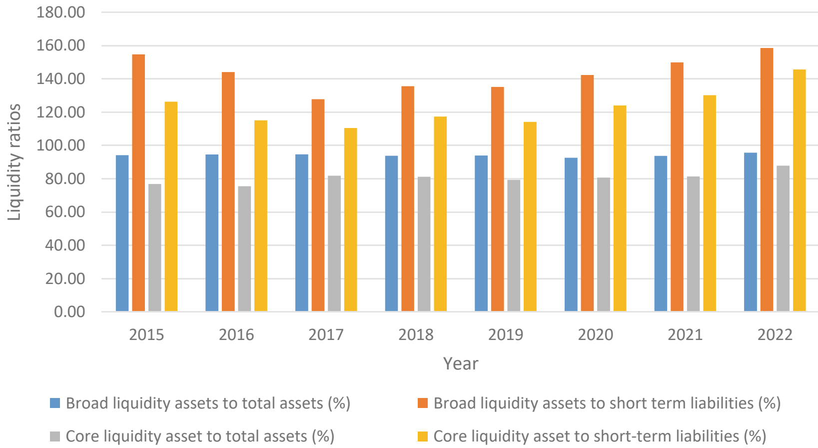


Fig. 6.4 Liquidity ratios (*Source* Authors' computation based on data from audited report of BRD)

Management Efficiency

Management efficiency measures the effectiveness of BRD in the management of their operating costs. In Fig. 6.5, management efficiency ratios, which measure the non-interest expenses to gross income and personnel expenses to gross income, have been unstable over the entire period of 2015–2022. In particular, the Bank experienced severe losses between 2017 and 2019, despite the changing trends over the same period. This can be attributed to the challenges the Bank faced in maintaining non-interest operating expenses (like employee or managers' compensation, other entitlements, directors' remuneration, and other costs) within the set limits.

The Bank's profitability measures (i.e., interest margin to gross income, return on asset (ROA), and its return on equity (ROE) show an interesting trend over the period 2017–2020 but were stable after COVID-19. For instance, the interest margin to gross income ratio of the Bank decreased steadily from 57.36% (in 2015) to 40.09% (in 2019), but it increased to 53.68% (in 2020) and began to decrease to 51.34% (in 2021) due to the impact of the COVID-19. Although the Bank made losses in the period 2017–2019, it made a lot of recoveries, based on the relatively

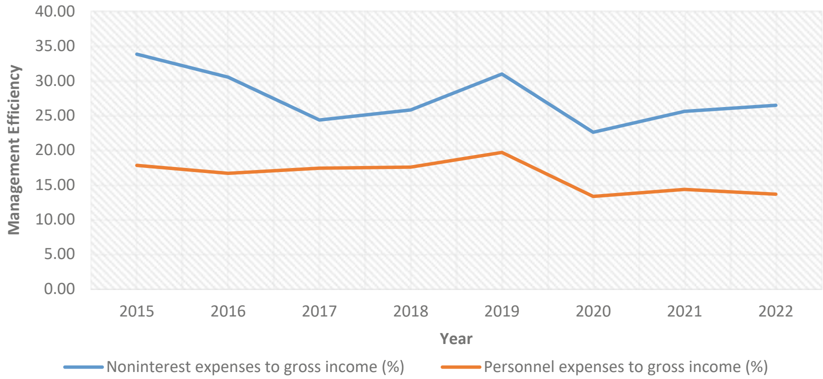
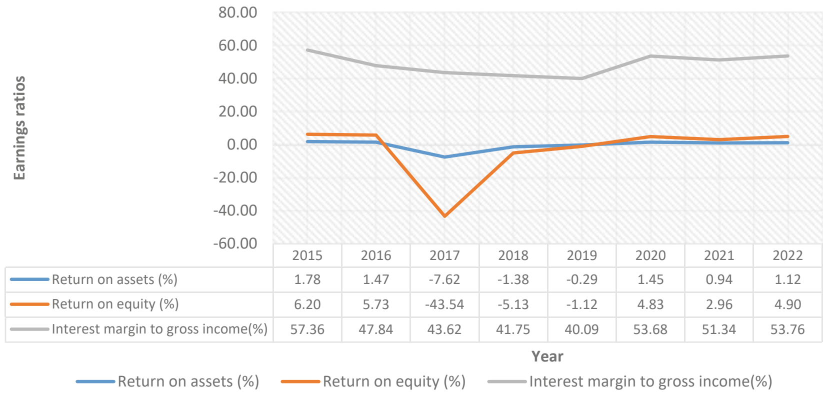


Fig. 6.5 Management efficiency (*Source* Authors' computation based on data from audited report of BRD)

stable trends of ROA and ROE on a yearly basis, from 2018 to 2022 (see Fig. 6.6).



	2015	2016	2017	2018	2019	2020	2021	2022
Return on assets (%)	1.78	1.47	-7.62	-1.38	-0.29	1.45	0.94	1.12
Return on equity (%)	6.20	5.73	-43.54	-5.13	-1.12	4.83	2.96	4.90
Interest margin to gross income(%)	57.36	47.84	43.62	41.75	40.09	53.68	51.34	53.76

Fig. 6.6 Earnings/profitability ratios (*Source* Authors' computation based on data from audited report of BRD)

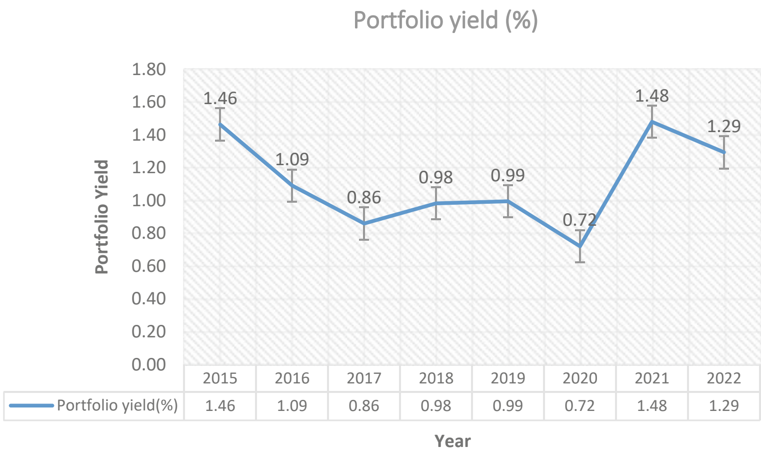


Fig. 6.7 Portfolio yield (*Source* Authors' computation based on data from audited report of BRD)

Operational Performance

Figure 6.7 shows the trends in the operational performance of BRD over the period 2017–2022. The portfolio yield indicates BRD's ability to generate cash on the gross loan portfolio and it explains the percentage of investment income generated from loans over the pool's invested asset portfolio of the Bank. In Fig. 6.7, the portfolio yield of BRD has decreased from 1.09 in 2016 to 0.72 in 2020; then it rose to 1.48 in 2021 and declined to 1.29 in 2022. Thus, though the Bank developed the capacity to generate more cash from its loan portfolio post-COVID-19, recoveries were not sustainable in 2022.

BRD's Performance Indicators—Pre- and Post-COVID

It can be seen that the average NPL pre-COVID-19, over the period 2015–2018, was relatively higher than when the pandemic hit the country between 2019 and 2020, as well as the post-COVID-19 period. This suggests the Bank's ability to write off outstanding non-performing loans and effective management of the loan portfolio during the COVID-19 and the post-COVID-19 periods (see Fig. 6.8). The average regulatory capital ratio during the pre-COVID period was relatively lower than both the COVID-19 and the post-COVID-19 periods. This implies that the Bank maximized the amount of capital in its reserves to handle a certain amount of losses during those periods. Further, the Bank spent more on management, staff, and non-interest assets during pre-COVID compared to both the periods the pandemic hit the country and the post-COVID-19. In addition, the Bank performed relatively better during post-COVID-19 periods, based on the interest margin to gross income ratio, compared to the pre-COVID-19 and COVID-19 periods. Despite the challenges faced by the Bank during the COVID-19 period, it was able to maintain a stable liquidity over the two periods (see Fig. 6.8).

In Fig. 6.9 the averages of return on asset and return on equity of BRD were relatively higher during the post-COVID-19 period compared to the pre-COVID-19 period. The implication is that the Bank benefited more from the impact of COVID-19 due to the intervention programs implemented during the COVID-19.

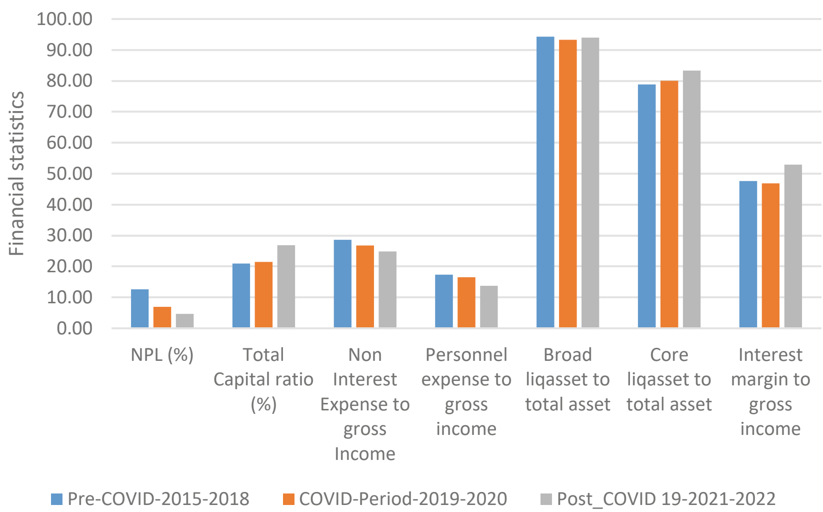


Fig. 6.8 Financial performance indicators—pre- and post-COVID-19 (*Source* Authors' computation based on data from audited report of BRD)

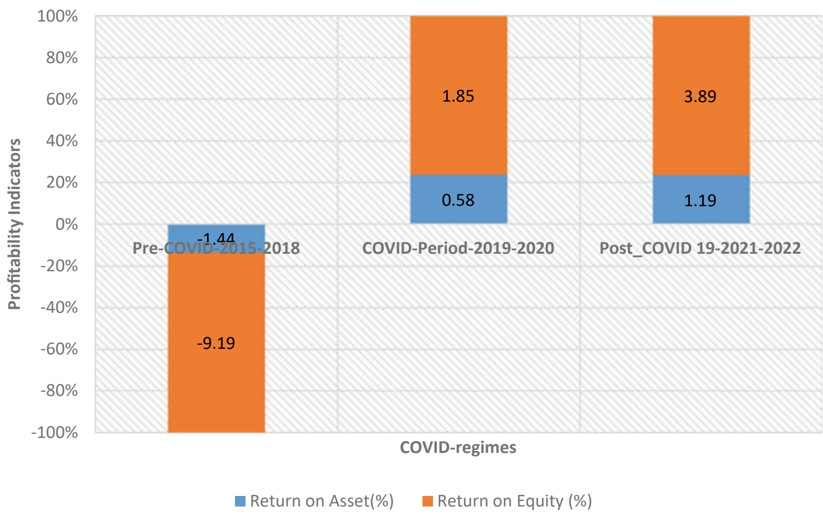


Fig. 6.9 Profitability indicators—pre- and post-COVID (*Source* Authors' computation based on data from audited report of BRD)

6.11 Conclusion

The chapter has discussed the political economy, institutional context, corporate governance arrangement, regulation and supervision, monitoring and evaluation, impact evaluation practices, business models, contributions, challenges, and financial performance of BRD. The study shows that BRD collaborates with the Ministry of Finance and the central bank (regulator) to issue separate regulations. Although it is established in a fragmented political system with frequent political interventions, the Bank is praised for its professional independence. The board of directors ensures that the Bank adheres to the principles of good corporate governance and high ethical standards, as enshrined in applicable laws and regulations (i.e., the Bank's statutes of the Board of Directors). The board composition of BRD is made up of government appointees. The study reveals that the government of Rwanda has built a very strong governance structure for the banking sector and that BRD has always operated within this framework. In fact, no direct political influence on the part of government authorities in BRD was found. However, BRD has a need to improve its risk management capabilities and provide technical and advisory services to stakeholders. BRD offers a wide range of financial products and services that go beyond loans.

BRD commits to working with development partners and stakeholders to design programs in priority sectors to attract blended funds in agriculture, energy, housing, and SME development. It provides state equity contributions and has supported many enterprises—hence, transforming different sectors of the economy. This includes agriculture, energy, manufacturing, and affordable housing. BRD has committed to supporting investments in energy through the establishment of the Renewable Energy Fund (REF) to finance the renewable energy sectors.

Although BRD has made significant contributions to the social and economic development of Rwanda, the Bank is faced with many projects implementation challenges in the priority sectors. Examples include operational challenges arising from supply of raw materials and utilization of their processing capacity, post-harvest losses and changes in climatic conditions, infrastructure challenges in the agriculture sector, non-compliance to loan repayment, over dependence on credit lines predominantly in foreign currency, inability to consistently comply with prudential requirements, reduction of export sales and flower losses during the lockdown period due to the pandemic, as well as liquidity challenges and undercapitalization. In addition, the Rwandan government's resource constraint and agenda have negatively impacted the Bank's operations over the years, despite the significant benefits reaped by the government.

On the financial performance front, BRD's performance has increased due to its ability to effectively manage capital adequacy, management efficiency, and internal liquidity coverage though the non-performing loan ratio of the Bank has reduced the profitability of the Bank.

The government and various stakeholders must design models and frameworks that deepen financial intermediation and drive sectoral growth. They should take economic changes into account and regularly consider adapting the BRD mandates to national initiatives to ensure sustainable social, economic, and financial development.

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CHAPTER 7

Kenya Development Corporation as an Instrument of Economic Growth

Peter W. Muriu and Victor Murinde

7.1 Introduction

Mobilization of long-term capital is one of the major obstacles to economic development for emerging economies. Long-term investment is a precursor to economic transformation, which is vital for the expansion of productive capacities and for infrastructure development. Development Finance Institutions (DFIs) fill the void left by retail commercial banks which view long-term projects as risky (Lemma, 2018). DFIs finance medium- and large-scale projects in prioritized sectors with lengthy maturities which require long-term funding. They provide lending and equity participation which entails close monitoring of projects which is important for relationship banking (Luna-Martinez & Vicente, 2012; Savoy et al., 2016).

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Although there is a growing literature on the role of development banks in accelerating economic growth (Attridge et al., 2019), the literature on DFIs performance, corporate governance, regulation and policy options in Africa remains scant. DFIs have been in existence in Kenya since the 1960s. That notwithstanding, there still exists a development financing gap. This chapter uncovers the evolution and role of DFIs in the development discourse paying special attention to Kenya Development Corporation. The chapter illuminates the profile, potential contribution to development outcomes, challenges encountered as well as policy options.

Kenya is not necessarily a representative of DFIs activities in Africa, but an interesting laboratory for investigation for the following reasons: even though East and Central Africa economies are at different stages of financial, institutional and economic development, Kenya is the main financial hub with the highest concentration of DFIs. Second, the financial sector is largely bank oriented (Mwega, 2014). Policies that promote DFIs may, therefore, have implications on the overall financial stability. This study is, therefore, timely with regard to how access to a firm's long-term finance may affect economic growth, employment and other development outcomes, especially among small and medium enterprises (SMEs). Findings from this case study may also ignite policies relevant to the development of appropriate institutional framework that can enhance DFIs investments.

The remainder of this chapter is structured as follows. The next section provides an overview of development finance institutions in Kenya, taking cognizance of the historical context, ownership, sources of financing and challenges. Section 7.3 contains the profile of KDC. Section 7.4 discusses the political economy and institutional context. Corporate governance is covered in Sect. 7.5. In Sect. 7.6, we present a discussion on regulation and supervision. Issues of monitoring and impact evaluation are covered in Sect. 7.7. In Sect. 7.8, we examine risk management, while the business model is covered in Sect. 7.9. Major achievements and current challenges are discussed in Sect. 7.10, while Sect. 7.11 concludes with our reflections on policy.

7.2 Overview of Development Finance Institutions in Kenya

Historical context

Before Kenya gained independence, the banking sector could not serve the interest of Africans, particularly with regard to long-term finance for investments. In 1954, Industrial and Commercial Development Corporation (ICDC) was established as the first DFI. The objective was to offer loans to small and medium-scale African entrepreneurs to enable them to acquire businesses from non-citizens. Within the spectrum of industrial loans, the entrepreneurs were also offered loans to acquire SMEs dealing with leather processing, clothing and woodwork (Barbara, 1987). Shortly after independence, the government established several DFIs with the responsibility of providing SMEs with equity and long-term finance that retail banks were not willing to offer (Popiel, 1994). In 1964, Development Bank of Kenya (DBK) was established with the sole aim of providing long-term capital to medium and large industrial projects. ICDC invested in equity in DBK together with foreign institutions as partners.

From establishment, the objectives of ICDC and DBK overlapped in the targeted areas of investments. Further duplication of roles was witnessed in 1973 when ICDC formed Industrial Development Bank as a subsidiary which later became IDB Capital Limited. In 1965, ICDC established another subsidiary Kenya National Trading Corporation (KNTC) with the objective of providing finance to small-scale commercial ventures focusing on property and industrial machinery. Further in 1967, ICDC started yet another subsidiary (Kenya Industrial Estates, KIE), which duplicated the same roles. By 1976, KIE's loan book was riddled with several bad and doubtful loans which had been advanced by ICDC. Agricultural Finance Corporation (AFC) was formed in 1969 to provide agricultural loans and advisory services to agro-industries. Earlier in 1966, Agricultural Development Corporation (ADC) was established to acquire British-owned large-scale farms and lease them to local farmers.

In their quest for development capital, DFIs have used diverse business models which hamper an evaluation based on performance indicators. This has also been reflected in the duplication of roles. With the exception of ADC whose activities are mainly on managing state and private farms on contract, the rest of the DFIs were established with the sole aim

Table 7.1 Development finance institutions in Kenya

Institution	*Acronym*	*Year*	*Activity*
Industrial and Commercial Development Corporation	ICDC	1954	Equity and loans in medium- and large-scale industrial and commercial projects. Loans for small-scale projects
Development Bank of Kenya	DBK	1964	Equity and loans in medium- and small-scale projects, mostly manufacturing
Agricultural Development Corporation	ADC	1965	Management of government and private farms. Quality seed to farmers. Equity and loans in agro-industries
Tourism Finance Corporation	TFC	1965	Loans and equity in tourism and hotel management
Kenya National Trading Corporation	KNTC	1965	Support Micro, Small & Medium Enterprises through loans, supply of raw materials and identification of markets for their products
National Construction Corporation[1]	NCC	1966	Build capacity in the construction industry through training and financial assistance
Kenya Industrial Estates	KIE	1967	Development of Small and Medium Industries with focus on rural industrialization
Agricultural Finance Corporation	AFC	1969	Agriculture loans, managerial and technical assistance to farmers
IDB Capital Limited	IDB	1973	Equity and loans in medium- and large-scale Industrial projects, establishment, expansion and modernization of medium- and large-scale industrial enterprise
Kenya Development Corporation	KDC	2020	Long-term loans, working capital loans, syndicated loans, business start-up loans, bridge or short-term loans, trade and infrastructure finance and advisory services

Source Government of Kenya Development Plans, (various issues)

[1] NCC collapsed in 1988 and was replaced with National Construction Authority in 2012.

of encouraging private sector investments. Table 7.1 shows the year of establishment and the scope of activities of DFIs in Kenya.

Ownership

The work by Laeven and Levine (2009) shows that a bank's ownership concentration determines the relationship between restrictions on bank activities, deposit insurance, risk and capital regulations. At the onset, DFIs were established as private entities and operated largely on government funding. However, over time they changed ownership and became public institutions to take advantage of World Bank lending to state-owned DFIs (Mayer, 1989). Though governed through the State Corporations Act, DFIs derive their operational mandate from different statutes. The government is the majority shareholder which is similar to the Industrial Development Corporation (IDC) of South Africa, which is also owned by the state. Since ICDC and KIE were established, the government has held 100% shareholding. When IDB Capital Limited was established, ICDC invested 32% of total equity. However, over time the Ministry of Finance (national treasury) has scaled up ownership to majority shareholding.

Although ownership of DFIs is concentrated in the government, some shares are held by foreign institutions partly because most were established with the assistance of development partners. For example, DBK was established with equal shareholding of ICDC, German Development Bank and Commonwealth Development Corporation. DFIs cannot make critical decisions without consulting the relevant government ministries. This creates several layers of bureaucracy which slow down decision making processes.

Sources of Financing

Sufficient funding is important for the sustainability of DFIs. DFIs heavily rely on government funding which is mainly through grants and loans drawn from the Consolidated Fund, but which must be approved by parliament. DFIs have also relied substantially on external financing from regional and international institutions such as the European Investment Bank, East African Development Bank, African Development Bank and World Bank. Development partners that have funded DFIs include the governments of Belgium, Germany, Netherlands, Britain, India, South

Korea, Switzerland, Saudi Arabia and China. For example, ADC was established through grants from British and the Netherlands governments. Since their inception, the government has guaranteed most of the external finance which was withdrawn in early 1990s due to high defaults. There are also some DFIs that have received funding from insurance companies and commercial banks which illustrates the importance of contractual savings.

Due to dwindling funding from the government, DFIs such as IDB capital and DBK converted to commercial banks in the1990s in order to mobilize deposits; but this was short-lived. They violated lending limits coupled with concentration risk on lending which translated to high non-performing loans and excess foreign exchange exposure. Prudential regulation is important for banking stability (Atellu et al., 2021). Since IDB capital and DBK were unable to comply with prudential requirements, they re-converted back to DFI status in the early 2000s. Non-compliance with prudential requirements also arose from non-conformity to their core mandate which was long-term lending.

Challenges

One of the major challenges facing most DFIs has been autonomy in raising funds. Although the statute that established DFIs allows them to borrow, with approval from the National Treasury, this has been hampered by the capping of below-the-market lending rate. The perennial loan defaults by farmers have made it difficult for AFC and ADC to seek external or even government financing due to low creditworthiness and bad reputation of lenders in the agricultural sector. Although DFIs offer loans at lower interest rates than regular banks, the uptake of loans has been on a downward trajectory as reflected by the average loan size. This status of balance sheet, coupled with development partner fatigue due to DFIs' historical performance, has hampered the institutions' ability to source funds. Another challenge has been loss of funds that were invested in collapsed commercial banks. For example, over time and without adhering to financial regulations governing surplus funds, AFC and KIE lost colossal sums that were deposited in the banks that collapsed such as Trust Bank. This necessitated the upscaling of provisions for losses on equity investments and loans but with a detrimental impact on the quality of assets.

DFIs have made several poor equity investments, mainly under specific instructions from the government. Several of the investments have not paid dividends due to poor performance. Some have invested on concessionary terms and suffered large losses or even negative returns. For example, investment decisions which should be made by ADC and Tourism Finance Corporation (TFC) are often made by the parent ministries without due consideration of the input by these DFIs. These poor investments have impacted negatively on their performance. It is worth noting that some investment decisions have been politically influenced, without considering their viability. This has led to poor allocation of financial resources. DFIs have also invested outside their core mandate, which leads to the misallocation of funds meant for loans.

7.3 Brief Profile of Kenya Development Corporation

Kenya Development Corporation (KDC) was established on 20 November 2020 as a merger of previously existing Industrial and Commercial Development Corporation (ICDC), Tourism Finance Corporation (TFC) and IDB Capital Limited. It commenced operations on 1 July 2021 with a mandate to play a catalytic role in the country's socio-economic development by providing long-term funding and advisory services to medium- and large-scale firms. KDC is, therefore, a non-bank financial institution (NBFI) since the corporation does not have a banking licence and cannot mobilize deposits from the public. It is the largest DFI in Kenya. KDC establishment consists of 114 workers, 14 of which are in management. The government holds 100% of the corporation's equity interest and provides full guarantee to all long-term lenders, both domestic and external. At the cabinet level, KDC is represented by the Cabinet Secretary for the National Treasury and Planning, who is also in charge of strategic direction and policy.

To achieve its strategic objectives, the corporation focuses on 8 out of the 16 government priority sectors. These are post-harvest management, health, energy, climate change, manufacturing, blue economy, ICT and tourism. It, therefore, plays a critical role in filling long-term financing gaps that, due to duration and related risks, are avoided by commercial banks. The institution has been effective in delivering its core mandate over the two years of operation. The structure of the corporation from inception has continuously supported its core mandate though this has been affected by the political, economic and structural reforms.

7.4 Political Economy and Institutional Context

With regard to national development strategies and framework/agenda, the institution constantly reviews its strategic plan for it to be in tandem with the government's medium-term plans. To enhance performance, various socio-economic policies have been embraced. KDC requires a development budget to enable it to undertake risky investments that are not attractive to the conventional banks. The global political economy and development agenda which most often are characterized by value chain disruptions have also affected the corporation. This has impacted negatively the performance of investee companies thereby worsening the institution's portfolio at risk. That notwithstanding, the global development agenda has created opportunities through which KDC can channel development capital. Africa's agenda to create development partnerships will boost inter-African trade which in turn raises the demand for development capital (Geda & Yime, 2022).

The role of institutions in establishing an enabling environment for banking activity and for investment has been documented by North (1990). Institutions affect banks' performance because they raise or lower the costs of transactions (Aron, 2000). Further, existing literature shows that countries in Sub-Saharan Africa are characterized by weak institutions (Anayiotos & Toroyan, 2009) and bank account penetration is driven by the institutional environment (Muriu, 2021). It might be the case that there are constraints unique to the operating environment that may hinder the corporation's performance. Although KDC is not regulated by the central bank, existing laws and regulatory environment governing the operations of the corporation may have implications on its performance. Within the ecosystem of the DFI are legal barriers arising from the laws around which the corporation was established that hinders its core mandate of offering financial services as an NBFI.

There is an avenue/platform for a formal engagement with key actors where a number of memoranda of understanding have been signed with key actors besides holding stakeholder engagement forums. Having started operations in 2021, there have not been major changes in the regulatory front that would impact the regulatory responsibilities of the DFI. However, the political transition that happened during the

August 2022 general elections had an impact on the senior management. The corporation does not have a substantive CEO since December 2022 which could create interruptions and instability emanating from uncertainty in decision making (Xiaoxiao & Zhu, 2020). That notwithstanding, existing banking literature shows that CEOs who are politically connected could use their political power to influence the lending decisions through the relaxation of lending standards (Chen et al., 2018; Djebali & Zaghdoudi, 2020).

7.5 Corporate Governance Arrangement

In terms of corporate governance, banks have two related characteristics that stand out relative to nonfinancial firms. First, they are more opaque coupled with greater information asymmetries. Second, they are heavily regulated. Effective corporate governance practices ensure that banks mobilize and allocate funds efficiently. This translates to a lower cost of finance for firms. Thus, weak corporate governance reverberates throughout the economy (Levine, 2004).

KDC adheres to high standards of corporate governance. Besides laying emphasis on financial returns, the institution upholds responsible corporate behaviour to avoid reputational risk that may emanate from poor governance. The board has a minimum of 7 and a maximum of 9 members. Existing corporate governance literature shows that board size significantly determines profitability. Gender diversity negatively affects performance (Athar et al., 2023). The board ensures that the composition complies with requirements in the constitution and any applicable legislation and at least one member is a financial expert in financial management and accounting. The Director General, who is also the CEO, sits on the board but as an ex-officio member. Board members are appointed by the Cabinet Secretary of National Treasury while the chairperson is appointed by the president. A third of the board directors are independent. For the case of Ethiopian banks, Berhe (2023) shows that bank performance is positively associated with a rise in the proportion of independent directors.

The corporation has decoupled roles for the board chair and CEO. There is an audit committee in place which comprises four members, two of whom are independent. One of the major challenges of corporate governance arrangements within KDC is lack of competitive recruitment of board representatives. The president appoints the CEO and this has implications for board independence in decision making. The board chairperson and directors are appointed through a Kenya Gazette Notice. The board is responsible for the preparation of financial statements, which must conform to International Financial Reporting Standards (IFRS).

The management team is hired through a structured recruitment process. The corporation operates on approved manuals on governance policies and procedures that align with operational practices and governance standards such as board/committee charter. Its operations are also guided by Mwongozo code of governance for state corporations which entails ethical leadership, accountability, risk management, internal controls, transparency and disclosure and good corporate citizenship. Information disclosure and transparency are publicly available in the audited financial statements and the corporation's website. The political class/actors influence the activities of the corporation through the appointment of the board of directors and CEO.

7.6 Regulation and Supervision

Regulatory mechanism positively and significantly influences bank performance (Bernadette & Corina, 2015). KDC is not under a specific legislative instrument. It derives its authority from the State Corporations Act, Public Finance Management Act 2012, the Companies Act 2015 and the subsequent Articles of Association. The regulation and supervision are fairly effective though not ideal for the nature of business transacted by the corporation. Within the regulatory environment, there are several government institutions that have oversight and regulatory control over the institution. That notwithstanding, to some extent, direct government control is necessary in order to deliver the national development agenda/mandate.

The government may also drive the national developmental agenda through the development of a national policy on DFIs. Due to political influence, one of the challenges faced by KDC is interference with board decisions and inability to execute its mandate as per the strategic plan. The institution has subscribed to Association of African Development and Finance Institutions (AADFI) and Sustainability Standards & Certification Initiative (SSCI) global governance standards. The institution has an internal audit department which reports to the board and administratively to the CEO.

On the regulatory front, KDC has adopted AADFI guidelines and public entity regulations which are anchored in the State Corporations

Act. The statute is a major hindrance to commercial investments as the law puts too many controls. The corporation is not regulated by the central bank since it is not a commercial bank and therefore does not apply the Basel Framework in its risk management. Under the State Corporations Act, KDC is regulated by the National Treasury & Economic Planning Ministry (Ministry of Finance). Although KDC activities are growing, it, nevertheless, lacks the regulation and supervision that are subjected to financial institutions that undertake banking activities.

Supervisory and regulatory capacity matters. In the current post-COVID era which has been characterized by high inflation and tight monetary policy, supervision and regulation of the corporation are critical. However, this capacity is limited at the ministry level. Placing KDC supervision under the Central Bank of Kenya (CBK) could augur well for financial stability. Although the corporation is regulated and supervised by the Ministry of Finance, it is worth noting that as long as the corporation's core mandate is to provide long-term funding and advisory services to medium- and large-scale firms, there is no government agency or ministry that is capable of regulating and supervising its operations other than CBK. Further, CBK is the most appropriate supervisory authority since over the years it has demonstrated, with success, risk-based supervision, even on NBFIs (some of which have converted into banks) by ensuring that they meet the minimum prudential requirements, which includes liquidity, capital adequacy and asset requirements.

Coordination between CBK and the Ministry of Finance is necessary in order to identify risks and to evaluate regulatory and supervisory deficiencies. Since the launch of MPESA in 2007, CBK has partnered with Communications Authority of Kenya in providing regulatory oversight. The instituted regulations imply that the MPESA transactions are keenly monitored, hence improving the environment for anti-money laundering regime and combating the financing of terrorism. The same synergies could be extended to KDC.

7.7 Monitoring and Impact Evaluation

Decision makers, particularly the board of directors, require well-informed evidence so that they can allocate resources to sectors with the greatest impact and to learn about "what works and what doesn't and why". The importance of both monitoring and evaluation (M&E) and impact evaluation (IE) in predicting project outcomes holds true across all major program areas (Raimondo, 2016). KDC undertakes close project monitoring. It also nominates directors to sit on the boards of the companies in which it has an equity stake. The corporation monitors its performance using balance scorecard method. Development impact is evaluated using social return on investment metrics. Strategy and performance management department is tasked with monitoring and evaluation. The department has four members of staff, and their qualifications are in line with the career guidelines.

M&E is not carried out for every project financed. Besides M&E, the corporation does not carry out impact evaluation on the projects financed. There is no framework enshrined in the corporation's establishing/legislative instrument for measuring development impact, and the institution has not subscribed to any global standards for measuring impact. It appears that at the moment there exist no internal user guidelines on how to internalize impact evaluation in the design of the financed projects. The corporation should put to best use IE and M&E in order to obtain information on project performance and to improve on future performance.

7.8 Risk Management

Due to the nature of banking activities, KDC is exposed to a variety of risks that include credit, interest rate, currency, liquidity, operational, compliance, reputational, political and strategic risks. Since changes in the business environment are unpredictable, the corporation sets acceptable levels of risk in order to minimize adverse effects that such risks can have on its performance. As per the corporation policies, only customers with an established credit history obtain credit. The corporation has put in place a robust risk management system. Since the board is responsible for investment decisions, it ensures compliance with relevant banking regulations by setting parameters on credit risk management. The creditworthiness of each customer is evaluated by management, taking cognizance of past experience and related factors. The borrower's credit risk limit is based on internal or external evaluation as set by the board. The board has also put in place an elaborate liquidity risk framework for the management of short to long-term liquidity requirements. This is achieved through close monitoring of actual versus projected cash flows.

Market risk includes volatility in equity prices, foreign exchange and interest rate which affects the corporation's income or the value of equity stake. At KDC, the audit and risk management committee is tasked with the responsibility of managing market risk. Since the corporation began its operations, there has been no change in the management of market risk exposure. The corporation deposits its finances with existing commercial banks whose interest rates it has no control. This is a source of interest rate risk. To mitigate this risk, the institution banks with retail commercial banks that offer favourable interest rates. It also conducts a sensitivity analysis in order to establish the impact that the volatility of interest rates would have on its profit or loss. A major drawback is that sensitivity analysis assumes that all other macroeconomic variables, such as foreign exchange rates, remain constant. This assumption is however unrealistic since the local currency has lost 27% of its value against the US dollar since February 2020.

During COVID-19, the corporation used fast-tracking procedures to speed up the authorization of transactions, provided working capital in the form of loans and guarantees, adopted standstill approach which involved maintaining existing loans, extended the grace period, offered additional support for the health sector and county governments particularly at the municipal level, enhanced collaboration with other regional development banks and offered additional support to existing customers through interest rate moratorium. The risk management system has been beneficial to the corporation since it has enhanced the level of internal controls, risk-based decision making and risk culture. A major challenge in implementing the risk management system is lack of automated system and fit to use off-shelf systems.

7.9 Business Model

The policy mandate of KDC is to promote sustainable development by providing long-term funding to medium- and large-scale enterprises. The establishing legislative instruments do not provide a framework for the selection of the target sectors. The sectors selected have high social impact and are the key priority areas for the government as well as for the vision 2030 economic blueprint. The activities of the corporation are influenced by the development agenda of political regimes since the corporation's core activities are aligned with the government agenda. The board and the management have the mandate to review the sectors of operations. KDC does not mobilize deposits from the public. It is exclusively financed by the government and development partners and partly from internally generated funds in the form of dividends, interest on loans and advisory fees.

The institution has a mix-up of clients but largely drawn from the large private firms. The main lending model is retail. KDC does not have branches. Additional branches may provide convenience of many possible points of contact with the corporation's customers which they may be willing to pay for and which in turn could raise corporation's revenue. Due to past failures emanating from retail lending during the pre-merger period, KDC could leverage on the existing vast commercial banks' branch networks and offer loans through wholesale lending similar to what Kenya Mortgage Refinance Company does. Banks are better suited in credit risk management relative to NBFIs. Wholesale lending could also mitigate moral hazard associated with loans from publicly financed DFIs and agency costs stemming from informational asymmetries.

KDC offers a variety of financial instruments which include long-term loans, bridge or short-term loans, working capital, business start-up loans, trade and infrastructure loans, syndicated loans and loans for launching new products. The pricing of loans is pegged to the central bank rate plus a risk premium.

7.10 Major Achievements and Current Challenges

By 31 March 2023, KDC had disbursed approximately \$17,087,932 to different sectors of the economy and mobilized about \$50,551,798 from development partners. During the period under review, KDC has continued to implement the post-COVID-19 economic stimulus program. The government has so far availed a financial package amounting to \$15,663,937 to the former TFC for disbursement to eligible establishments in the hospitality industry to help them cope with the adverse effects of the COVID-19 pandemic. KDC has so far disbursed a total of \$6,087,576 to over 40 establishments. The corporation has also implemented a line of credit from Exim Bank of India. In this regard, a total of \$242,079 has been disbursed to various projects in the manufacturing and agro-processing industries. Various projects have also been supported with internally generated funds to the tune of \$4,072,624.

Some of the flagship projects financed by KDC include concrete investment, accommodation and food services, wood and paper processing, health equipment, quarry and mining.

Sustainability entails balancing the quest for profitability with the diverse priories within the economic, social and environmental contexts (Riegler, 2023). The funding requirements for Sustainable Development Goals (SDGs) are enormous. Investment in infrastructure, which is a prerequisite to economic development and sustainable growth, requires substantial funding. The corporation has subscribed to green, sustainable and gender-oriented framework for measuring impact. Climate finance has been integrated into the business model. The corporation's impact objectives are closely aligned with the SDGs. The institution's core business is integrated with environmental, social and governance (ESG) initiatives. Thus, a strong ESG mechanism that creates value has been embedded into the core business processes and procedures. The ESG framework has established a screening/assessment process that helps in identifying stakeholders who have integrated ethical governance practices, social responsibility and environmental protection into their business operations. Figure 7.1 shows the SDG sectoral linkages.

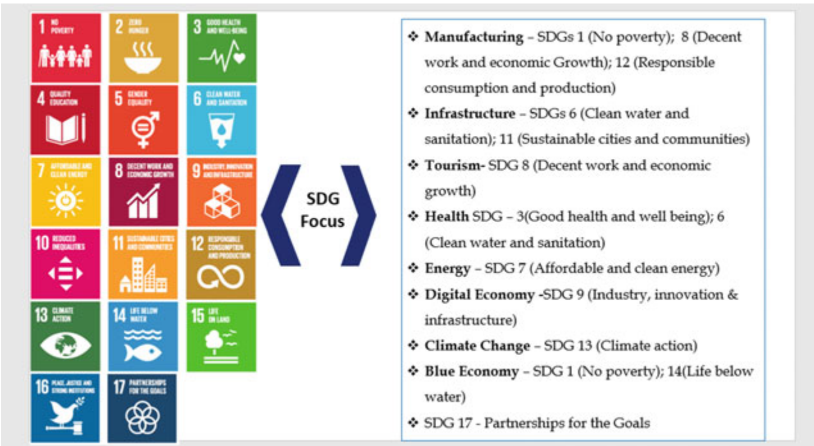

Fig. 7.1 Sectors linkage with sustainable development goals (*Source* KDC annual report and financial statements for the financial year that ended June 30, 2022)

The main challenge facing KDC is the lack of sufficient and affordable funding for retail lending. One of the most spectacular project failures is the leather and textile project due to government policy on imports. Such failures have been addressed through cabinet policy papers. Among the lessons learnt from both successes and failures is the need for data-driven investments and policy support from the government. There is a mechanism in place to institute reforms as a result of the lessons learnt from both the successful and failed projects. The corporation has responded to major socio-economic crisis such as COVID-19 through extension of moratoriums, subsidized financing and restructuring.

7.11 Conclusion and Policy Options

Although KDC is in its nascent stages after the merger of the three former DFIs, the role it has played in the national development path cannot be overemphasized. One of the challenges highlighted in this study is lack of independence in decision making. KDC could retain government ownership, but political interference needs to be curtailed. The statute that established the corporation should be evaluated to give the board more autonomy in holding the management accountable. The other option is divestiture where the government allows private sector ownership. Although this may curtail political interference, it may be at the expense of compromising the core activities. Unless KDC identifies alternative sources of long-term capital, diverting from the core activities may hamper the industrialization process that KDC is expected to spearhead. Rather than offload the entire government shareholding, it could sell part of its shares and still retain the corporation as public entity.

Maintaining sufficient flow of funds is important for sustainability and contributes significantly to the development process. The corporation could explore alternative sources of long-term capital. One of the options available is the vibrant bonds market at the Nairobi Securities Exchange (NSE). KDC could also access contractual savings from National Hospital Insurance Fund (NHIF), provident funds and National Social Security Fund (NSSF). Since these are long-term funds, they can be invested in long-term projects rather than the short-term government securities currently offered at the money market.

From a prudential regulation perspective, a coordinated effort between CBK and Ministry of Finance is critical in order to identify risks and to evaluate regulatory and supervisory deficiencies. The corporation should also ensure adequate monitoring and evaluating of projects in order to reduce the information asymmetry and enhance efficiency. The challenge, however, would be the delicate balancing act on social versus private returns in the appraisal of investment projects. A framework for assessing alignment between the corporation's investment portfolios and national development priorities is critical to unearthing additional opportunities. The corporation should also embark on vigorous sensitization to private investors and policymakers so as to create awareness on the corporation's growing role in the development path and to showcase potential areas of collaboration.

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CHAPTER 8

The Experience of the Development Bank of Mauritius

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8.1 Introduction

Development Finance Institutions (DFIs) serve as critical drivers of economic growth and sustainable development worldwide, specializing in providing long-term financing and support across various sectors including agriculture, infrastructure, and small and medium enterprises. In the context of developing countries, DFIs play an instrumental role by offering a diverse range of financial services such as loans and guarantees to investors and entrepreneurs, equity investments in firms, and funding for public infrastructure projects. They often take the lead in initiating projects in industries or regions where traditional commercial banks may be hesitant to invest without official collateral (Abor

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et al., 2020; Dickinson, 2008). Moreover, DFIs actively support the financing of Small and Medium-sized Enterprises (SMEs), bridging the gap for those perceived as too risky by private financiers. As Dickinson (2008) highlighted, this approach often grants DFIs a unique advantage in burgeoning markets with promising growth potential, enabling them to be pioneers in their investments. An example of this phenomenon is seen in the successful case of Celtel, an African telecommunications company, where DFIs' initial investments proved highly lucrative in the long run. For instance, Mo Ibrahim in 1998 pioneered Celtel telecoms which received major DFI assistance and fundamentally revolutionized telecommunications availability on the continent.

Historically, DFIs have faced the challenge of mitigating risk and contributing to the financial performance while fulfilling their developmental goals and mandates (Ducastel et al., 2023). However, Adian et al. (2020) propose that DFIs can be instrumental in helping small and medium enterprises navigate through crises and foster recovery through financial support, mobilization of resources, and advisory services—ultimately contributing to the promotion of entrepreneurship and regulatory reforms.

The objective of the Development Bank of Mauritius (DBM), as stated in its founding law, has always been to assist the holistic development of Mauritius, including industrial, agricultural, and economic sectors. DBM has effectively matched creativity with careful planning, adapting to correspond with government policies and national objectives, with a persistent commitment to cautious and forward-thinking banking. Also, DBM has achieved a successful balance between dynamism and prudence, adapting to match with governmental policies and national goals. This is because of its unwavering dedication to cautious and cutting-edge banking.

However, DBM faces multifaceted challenges in this endeavour. Recognizing that sustainable development is crucial, the bank must strike the delicate balance between promoting economic growth and protecting the environment in its business endeavours. Additionally, the bank is in charge of tackling socioeconomic imbalances among the various population of the country while also supporting technical advancement to stay up with the quickly changing global environment. These difficulties highlight DBM's persistent commitment to its goal as it works to steer Mauritius' future in a sustainable and inclusive direction.

This chapter provides a comprehensive overview of the Development Bank of Mauritius (DBM). By thoroughly examining various aspects of the DBM, such as its profile, history, corporate governance arrangements, risk management practices, regulation and supervision, monitoring and evaluation, impact evaluation practices, business models, achievements, challenges, operations, and performance, the chapter aims to gain valuable insights into the dynamics of development finance and its profound impact on Mauritius' developmental journey. Through a meticulous analysis of the DBM's experiences, the chapter seeks to identify best practices and lessons which can serve as a foundation for informed recommendations to enhance the institution's effectiveness and guide future developmental endeavours in Mauritius.

The rest of the chapter is structured as follows: an overview of development finance institutions in Mauritius; profile and history of DBM; political economy and institutional context of DBM; DBM's corporate governance arrangements; risk management practices of DBM; regulation and supervision of DBM; monitoring and evaluation; impact evaluation practices; business models of DBM; main achievements and challenges; and operations and performance.

8.2 Overview of Development Finance Institutions in Mauritius

DFIs are critical for bridging Africa's financial development gap and supporting the continent's infrastructural demands. These organizations, which are mostly government-funded, channel investments into underserved regions, industries, and nations that have difficulty attracting major funding. They blend conventional multilateral assistance organizations' developmental goals with the commercial strategy of private-sector banks and investors. While DFIs are funded by the government, they often sustain their operations and expansion through investment profits. DFIs play an important role in launching ventures as "first movers," minimizing the perceived dangers that sometimes prevent private investors. This encourages private finance to flow into projects that might otherwise be regarded as too risky.

In Mauritius, DFIs have emerged as key entities supporting the government's developmental agenda by providing financial and technical assistance to various sectors of the economy. Mauritius has the DBM being the prominent DFI and the only National Development Bank in the country. The DBM operates under the Companies Act, with the government and government-owned entities serving as its shareholders. DFIs in

Mauritius do not only provide financial support but also play a crucial role in capacity building and advisory services. They often collaborate with stakeholders, including government agencies, international organizations, and private-sector entities to foster knowledge sharing, best practices, and technical expertise. These collaborations help to strengthen the overall ecosystem for development finance, ensuring effective utilization of resources, and maximizing the impact of development projects. Regulation and supervision of DFIs in Mauritius is primarily governed by the Companies Act and other relevant legislations. While the DFIs are not directly regulated by the Central Bank, they operate within a regulatory framework that ensures compliance with applicable laws and promotes transparency and accountability. DFIs in Mauritius, led by the DBM, play a critical role in driving economic development and addressing developmental challenges. Through the provision of financial resources, technical, and advisory services, these institutions support entrepreneurship, job creation, and the growth of strategic sectors. The DFIs, in collaboration with various stakeholders, contribute to the sustainable development of Mauritius thereby promoting inclusive and resilient economic growth for the benefit of its citizens.

8.3 Profile and History of the Development Bank of Mauritius (DBM)

The DBM, previously known as Agricultural Bank, was established in 1963 with the primary objective of providing financial support to Micro, Small, and Medium Enterprises (MSMEs) through tailor-made products. The DBM also offers industrial support to entrepreneurs at concessionary rates for the establishment of their enterprises. The bank was particularly established by the government to finance industrial, agricultural, and tourism development. As a DFI, the DBM plays a pivotal role in providing financial support to stimulate economic activities and address developmental challenges in Mauritius. The DBM offers a range of financial instruments including loans (both concessional and ordinary) and grants financing, guarantees, equity investments, and insurance-type products. These instruments cater to the diverse needs of businesses, entrepreneurs, and projects across various sectors, including agriculture, manufacturing, infrastructure, and renewable energy. By providing access to finance, the DBM helps promote entrepreneurship, job creation, and overall economic development. In addition to the DBM, other financial institutions in Mauritius, such as commercial banks and non-banking financial institutions, also contribute to development finance. These institutions may offer specialized products and services targeting specific sectors or segments of the economy. Their involvement in development finance further enhances the availability of financial resources for businesses and projects seeking to contribute to Mauritius' economic growth.

The bank currently has 232 staff. The government of Mauritius is the majority shareholder with about 96.3% shares, and State Investment Corporation Ltd. holds about 3.7% shares. This ownership structure reflects the government's commitment to promoting economic development through the DBM. At its inception, the bank was mandated to focus on supporting small and medium entrepreneurs, financing agriculture, industrial, and tourism development. This emphasis on fostering entrepreneurship remains a key sector for the bank's operations. However, over the years, there have been changes in the focus sectors as the bank adapts to the evolving needs of the economy. One notable change in the history of DBM has been its pioneering role in the construction of Industrial Estates throughout the island. By facilitating the establishment of industrial hubs, the bank has contributed to the growth of various industries and provided opportunities for job creation. In recent times, DBM has also ventured into the production of green energy through Solar PV Panels. This expansion into renewable energy showcases the bank's commitment to sustainability and alignment with global trends towards a greener future. The key drivers for changes in DBM's mandate and other major transformations are primarily rooted in the bank's status as a government institution. DBM is tasked with implementing measures announced in the National Budgets to financially support entrepreneurs and other economic operators. These changes are driven by the government's policies and strategies aimed at sustaining economic development and addressing emerging challenges. Despite these changes and challenges, DBM has effectively delivered on its mandate over the years. The bank has consistently met the objectives set by the government by demonstrating its commitment to supporting economic growth and development in Mauritius. During its formative period, the structure of the bank was designed to support this core mandate. This structural framework facilitated the bank's operations and enabled it to effectively carry out its functions in promoting economic activities and providing financial services to entrepreneurs. The mandate of DBM has been influenced by political, economic, and structural reforms. As the government implemented various reforms, the bank's focus sectors and strategies were adjusted accordingly to align with the changing economic landscape. These reforms reflect the dynamic nature of the financial sector and the need for DBM to adapt and evolve to meet new challenges and opportunities.

8.4 Political Economy and Institutional Context

The DBM operates within the national development strategies and framework/agenda, acting as an implementing agency of the government's strategies. As a key player in driving economic growth and development, the bank aligns its activities with the national development goals, supporting initiatives that contribute to the country's socioeconomic advancement. The bank acts as a financial agency for local government and government-owned entities, it also helps facilitate effective financial management and supports the smooth implementation of public projects. In the past five years, DBM has relied on government loans with a total amount of about MUR 20 million that were given at preferential conditions. There are two steps in the process of appraising industrial loans. Clients initially provide information using a brief, two-page form. An initial choice is chosen based on predefined standards for promoter equity, fixed assets, working capital, and other finance sources. In the industrial sector, DBM actively engages in promoting industrial growth. This entails not only encouraging individuals to establish new industrial ventures but also conducting feasibility studies and attracting potential investors to these projects.

Several institutions directly impact the operation and governance of the DBM. Institutions like the State Investment Corporation (SIC), the Mauritius Chamber of Commerce and Industry (MCCI), Mauritius Revenue Authority (MRA), the Ministry of Finance and Economic Development, along with the Bank of Mauritius (BoM) all impact the operations and governance of DBM. While DBM currently operates within its own set framework, it is worth noting that if in the future it operates under the Bank of Mauritius, it will have an impact on its operations and governance. Formal engagement platforms or mechanisms with key actors are currently not in place, which could facilitate structured dialogue and collaboration between the DBM and other stakeholders.

Establishing such platforms can promote transparency, strengthen relationships, and ensure effective coordination in driving the country's development agenda. The DBM faces several specific challenges in the context of its institutional and political environment. Among them are balancing economic growth and environmental conservations, addressing socioeconomic disparities, and fostering technological innovation.

Balancing Economic Growth with Environmental Conservation

Balancing economic growth and environmental protection frequently necessitates manoeuvring through intricate regulatory systems. To fight this problem, the DBM must remain up to speed on developing environmental standards and ensure that its financing and assistance are in line with these needs. Furthermore, political movements and agenda may have an influence on the DBM's ability to support long-term growth. Changes in government or policy direction might affect the bank's commitment to environmentally sensitive initiatives.

Addressing Socioeconomic Disparities

The DBM's capacity to address disparities in socioeconomic status in the Mauritius region presents another problem. In order to alleviate socioeconomic inequities, the DBM must match its methods with national development policies. To guarantee that its activities are in line with the more general socioeconomic aims, this calls for strong involvement with governmental institutions and officials. Additionally, due to a lack of funding, prioritizing initiatives that serve underprivileged populations and areas might be difficult. To properly address these inequities, the DBM may need to develop new financing sources or creative solutions.

Fostering Technological Innovation

DBM has the same difficulty of promoting technical innovation as DFI institutions across the African continent. Often, substantial financial backing is needed to promote technical innovation. The DBM may struggle to assist new ideas and companies if it has limited access to funds. It may be difficult to acquire the knowledge necessary to assess and support efforts driven by technology. To encourage technological innovation successfully, the DBM may need to make investments in training and development.

In the context of the DBM, these challenges are not only about addressing broad issues but also about tailoring their strategies and operations to the specific needs and priorities of Mauritius. This involves a continuous effort to adapt to regulatory changes, engage with political stakeholders, and align with the country's development agenda while addressing the challenges of balancing growth, addressing disparities, and fostering innovation.

8.5 DBM's Corporate Governance Arrangements

Corporate governance of National Development Banks (NDBs) entails putting in place the structure, process, and mechanisms that ensure that the bank is directed and managed in a manner that improves the bank's long-term value through accountability, transparency of managers, and the performance of the bank (Abor, 2023). The DBM places significant emphasis on corporate governance to ensure effective management, internal controls, and minimal external interferences. By adhering to strong governance practices, the bank aims to deliver its mandate efficiently and safeguard against management abuse. DBM is principally owned by the Government of Mauritius, which owns 96.3% of the bank. Moreover, the State Investment Corporation Ltd (SIC) owns 3.7% of DBM. This ownership structure emphasizes the government's critical role in steering DBM's strategic direction and aligning its activities with national development goals, while SIC also adds to the institution's overall ownership landscape.

DBM has implemented a unitary board structure consisting of 11 Directors (one (1) executive director, four (4) non-executive directors, and six (6) independent non-executive directors). This board composition reflects a diverse range of expertise and perspectives. The board operates through six committees to assist in its functions, which include corporate governance committee, audit and risk committee, credit committee, recovery committee, nomination and remuneration committee, and the procurement committee. These committees operate with defined terms of reference and provide recommendations to the board after a comprehensive evaluation of specific issues. The board also ensures that all directors are informed about the key discussions and decisions of these committees. The bank's secretary plays a crucial role in assisting the board and ensuring compliance with legal and regulatory requirements.

Additionally, the separation of roles between the Chairman (a Non-Executive director) and the Chief Executive Officer ensures a balance of power and accountability within the operations of the bank. The Chairman is responsible for leading the board and aligning corporate strategy while the CEO reports to the Chairman of the board, thus, promoting independence in decision-making. Notably, the roles of the board chair and CEO are decoupled; this promotes a system of checks and balances. Furthermore, the board comprises one woman, indicating a need for greater gender diversity in its leadership. To ensure proper oversight, the DBM has established an Audit and Risk Committee comprising five (5) directors, responsible for monitoring financial reporting and risk management. DBM has internal audit and control department that plays a crucial role in ensuring sound corporate governance. This department operates independently and reports to the Audit and Risk Committee, which in turn reports to the board. The internal audit and control department helps identify risks, evaluate internal controls, and ensure compliance with established policies and procedures. Its role enhances accountability and provides assurance to stakeholders.

The DBM faces ongoing challenges in evolving its corporate governance arrangements. It must comply with the eight principles of the National Code of Corporate Governance (NCCG) which serve as benchmarks for governance practices. These principles include the necessity for effective governance structures, diverse board compositions, transparent director appointment procedures, ethical conduct, robust risk management, integrity in reporting, appropriate audit arrangements, and constructive relationships with shareholders and stakeholders. These principles, when combined, constitute a comprehensive framework that fosters openness, accountability, and ethical behaviour within businesses, thereby assisting DBM and others in their governance activities. Adapting to these evolving standards requires continuous assessment and adjustment of the bank's governance structure to enhance transparency, accountability, and integrity. The appointing authority for the board and CEO lies with the shareholders. The selection process for board and management members involves a resolution passed by the Company Secretary. Operational practices within the DBM align with international governance standards, emphasizing the need for effective internal controls, risk management, and compliance. These practices contribute to a robust governance framework and foster the trust and confidence of stakeholders. The DBM is a mechanism for information disclosure and transparency. It follows the principles of the NCCG, ensuring timely and accurate dissemination of relevant information to shareholders and the public. By adhering to these standards, the bank promotes accountability and allows stakeholders to make informed decisions.

While political actors may set the strategic direction for the bank to align with national development agendas, they do not influence its day-to-day operations. Effective regulation and supervision are vital to the DBM's operations. The bank operates within the regulatory framework established by the Ministry of Finance, Economic Planning, and Development. The effectiveness of these regulations and supervision ensures that the DBM adheres to legal requirements, prudential standards, and ethical practices. This oversight contributes to maintaining the stability and integrity of the bank's operations. Within the regulatory and political economy environment, the DBM operates under the guidance of the government through the Ministry of Finance, Economic Planning, and Development. This guidance ensures that the bank remains aligned with the national development agenda.

In summary, the DBM has implemented a robust corporate governance framework to facilitate effective management, minimize external interference, and deliver its development mandate. By adhering to the principles of the NCCG, maintaining transparency, and aligning operational practices with governance standards, the bank strives to uphold high standards of corporate governance.

8.6 Risk Management Practices

The DBM recognizes the importance of effective risk management in safeguarding its operations and ensuring the stability of its financial position. NDBs are exposed to different categories of risks, and it is important to identify these categories of risks in order to appreciate the most appropriate financial instruments to manage (Abor, 2023; Griffith-Jones et al., 2020). As a financial institution, the DBM is confronted with various risks that can significantly impact its operations and reputation. These risks include credit risk, market risk (such as interest rate risk, currency risk, and liquidity risk), strategic risk, operational risk, compliance risk, and reputational risk. The DBM understands the need to proactively identify, assess, and mitigate these risks to protect its stakeholders and maintain its financial integrity. To address these risks, the DBM has implemented a robust risk management system. The bank has appointed a consultant to implement a comprehensive risk management framework, indicating its commitment to strengthening risk management practices. This framework encompasses several key areas, including operational risk, human resource risk, compliance risk, physical risk, technology risk, business continuity risk, reputational risk, liquidity risk, counterparty risk, and financial risk. By addressing these areas, the DBM aims to enhance its risk mitigation capabilities and minimize potential losses. In normal times, the DBM utilizes a range of instruments to support its operations and fulfil its development mandate. These instruments include loans (both concessional and ordinary) and grants financing, guarantees, grants, equity investments (including venture capital and private equity), as well as insurance-type products, securitization, and other diversified financial products. The diverse range of instruments allows the DBM to tailor its support to meet the specific needs of its clients and projects.

When the COVID-19 pandemic struck, the DBM swiftly adapted its risk management practices to mitigate the emerging challenges. It utilized fast-track procedures to expedite the authorization of transactions, enabling quick financial assistance to be provided to affected businesses. This included providing working capital in the form of loans, grants, and guarantees to support companies facing financial constraints. The DBM also adopted a standstill approach, granting grace periods, and rescheduling existing loans to ease the financial burden on borrowers during the crisis. Furthermore, the DBM extended its support to the health sector and governments, particularly at the municipal level, recognizing the critical need for additional funding in these areas. The DBM collaborated with other regional development banks and municipal funding banks and agencies to provide financial support to the various sectors that needed financial assistance.

The risk management system of the DBM has proven to be beneficial to the bank in several ways. The formulation of a risk register has allowed the bank to classify risks as low, medium, or high, enabling a targeted approach to risk mitigation. This classification helps the DBM to allocate appropriate resources and implement effective risk mitigation strategies based on the severity and likelihood of each identified risk occurring. By proactively managing risks, the DBM is better positioned to protect its assets, maintain the confidence of its stakeholders, and ensure the sustainable growth of its operations. However, like any risk management system, the DBM faces challenges and potential lapses in its implementation. These challenges may include evolving regulatory requirements, emerging risks that require immediate attention, and the need for continuous monitoring and reassessment of existing risk mitigation measures. The DBM must remain vigilant in staying abreast of changing market conditions, economic trends, and regulatory frameworks to effectively manage risks and adapt risk management practices accordingly.

8.7 Regulation and Supervision

The DBM operates under a regulatory framework that ensures its compliance with applicable laws and regulations. The DBM operates under the aegis of the Ministry of Finance, Economic Planning and Development. While the DBM is not directly regulated by the Central Bank, it is subject to oversight and regulation through other legislative measures. The DBM has been incorporated under the Companies Act, with the government and government-owned entities serving as its shareholders. As a result, the DBM reports to the government and is accountable to its shareholders for its operations. The Companies Act provides a legal framework for the governance and operations of the DBM as a corporate entity.

Additionally, the DBM is subject to the provisions of the Financial Reporting Act, which ensures transparency and accountability in the bank's financial reporting practices. This act sets out the requirements for financial reporting, including the preparation, presentation, and audit of financial statements. Compliance with the Financial Reporting Act ensures that the DBM maintains accurate and reliable financial information, promoting trust and confidence among its stakeholders.

Unlike some other financial institutions, the DBM does not apply the Basel framework in its risk management practices. The Basel framework, developed by the Basel Committee on Banking Supervision, provides guidelines and standards for risk management, capital adequacy, and liquidity requirements for banks. However, the application of the Basel framework is not compulsory for DBM in Mauritius. As a result, the DBM operates under a different risk management framework tailored to its specific needs and regulatory environment. The absence of the Basel framework in the DBM risk management practices may present both advantages and challenges. On one hand, it allows the DBM flexibility in designing risk management strategies that align with its unique mandate and objectives. On the other hand, the lack of a standardized framework may pose challenges in benchmarking against international best practices and harmonizing risk management approaches with other financial institutions.

The bank is regulated and supervised through a combination of legislative measures, including the Companies Act and the Financial Reporting Act. While not directly regulated by the Central Bank, the DBM operates under a governance structure that ensures accountability to the government and its shareholders. Although the DBM does not apply the Basel framework in its risk management practices, it adheres to other regulatory requirements and implements a risk management framework tailored to its specific needs. These regulatory measures aim to promote transparency, accountability, and sound financial practices within the DBM—contributing to the bank's stability and the trust of its stakeholders.

8.8 Monitoring and Evaluation, and Impact Evaluation Practices

Monitoring and Evaluation (M&E), and Impact Evaluation are important concepts in development banking as they enable development banks to assess the financing interventions they make in specific areas. NDBs are expected to systematically report on the impact of their operations, particularly their development mandates (Abor, 2023). Like many developmental banks around the globe, the DBM gauges its performance and its development impact through the number of beneficiaries who have benefited from their operations. In spite of this monitoring and evaluation process, the DBM does not have a specific monitoring and evaluation department. This may not be very appropriate because the very nature of development banks calls for proper scrutiny to ensure safe credit facilities. The performance of monitoring and evaluation for every project financed by the DBM is non-existent. More so, projects financed by the DBM do not undergo impact evaluation and no specific legislative framework or regulation exists in the bank's constitution for purposes of measuring the development impact of its financed projects. Lastly, the DBM, aside not having specific regulations pertaining to the monitoring and evaluation and measurement of development impact of projects it finances, it does not subscribe to any global model or framework for purposes of its development in impact measurement. Given the narrative above, the clear indication is that DBM lacks an important function like M & E with its attendant relevant issues such as a guideline or a framework for measuring development impact. This absence could be detrimental to the overall growth and long-term sustainability of the development bank as its progress and the outcome/impact of its financing of businesses in an economy cannot be tracked for purposes of taking corrective steps to make things right in the future.

8.9 Business Models of DBM

This section discusses the policy mandate, funding sources, lending model, and products and services of DBM.

Policy Mandate and Sectors Served

The business models of development banks differ somehow from the operations of commercial banks. Their activities tend to focus on providing long-term credit facilities to various areas of an economy especially, sectors that are deemed too risky by the commercial banks (Abor, 2023). In the case of DBM, its activities are intended to ensure socioeconomic development via the provision of finance to MSMEs through tailor-made financial products and also, to provide industrial space to entrepreneurs at concessionary rates to fund the establishment of enterprises. In this regard, the indication is that the policy mandate of DBM is narrow and specifically focuses on MSMEs and other entrepreneurs in the economy of Mauritius.

In spite of the specific focus on MSMEs and entrepreneurs, the DBM does not have a specific key sector it focuses on. More so, the legislative instrument that guides the activities of the DBM does not have a specific clause or provision that mandates the bank to concentrate on a specific sector at the expense of other sectors. However, the sector or area of the economy that is focused on at any point in time by the DBM flows from government policy and priority as they arise. For instance, during the COVID-19 pandemic, the government directed the DBM to roll out a COVID-19 financial support to various MSMEs and entrepreneurs.

Funding Sources of the Bank

It is however worthy of note that although the activities of the DBM are largely driven by government policies and priorities, the board and management of the bank have the authority to review and make decisions regarding the sector to focus on in the provision of credit facilities. The financing of operations of the DBM is achieved through direct budget allocations from the government, raising funds from the international capital markets, obtaining credit facilities from other financial institutions, issuing of debt instruments in domestic financial market, retained earnings of the bank, and the acquisition of official development assistance.

It is the case that the DBM does not engage in the mobilization of funds from the public for purposes of lending to its clients, but its key financiers include governments, impact investors, and other development financing institutions.

Lending Models, Loan Pricing, and Product and Services of the Bank

The DBM's business model is supported through its retained earnings whose main source is interest differentials. There are different lending models as far as the operations of development banks are concerned. That is, a development bank can either engage in retail banking or wholesale banking or even have a mix of retail and wholesale. In the case of the DBM, the lending model that is applied is the retail model.

Though development is guided by regulations in terms of processes it follows in giving out credit facilities, in times of emergency, processes in credit extension are eased. During the COVID-19 crisis, the DBM eased the credit appraisal criteria for purposes of ensuring that credit was injected into the economy to stimulate economic activities, ensure increased production, and increase job openings. It is also the case that the activities of the DBM are not restricted to the provision of credit facilities to deficit spending units but can also be engaged in investment activities. However, whether the DBM will engage in the provision of credit facilities and investment activities is all informed by the decisions of the government and the governing board of the bank.

More so, DBM does not provide grants, equity financing, or guarantees but focuses on loan provision which comes in the form of long-term loans, loans for working capital, short term or bridge loans, and business start-up loans. However, these loan products come at both commercial and subsidized rates where the government bears the cost of the subsidy on the loan. Additionally, aside the financial offerings of the DBM, it also carries out mentoring for its clients. Such mentoring sessions may be relevant as they equip clients with the requisite knowledge and technical know-how in putting financial resources to use.

8.10 Main Achievements and Challenges

On the basis that development banks around the globe are supposed to pursue one form of developmental project or another, their activities are expected to yield certain results. In the case of DBM, several successes have been chalked. The key achievements of DBM are evidenced in it being the pioneer in the provision of credit facilities to entrepreneurs, pioneer in the construction of industrial buildings which are leased to import substitution industries and export-oriented industries which were key in promoting the expansion of the EPZ sectors in the 1980s and early 1990s. This generated important surpluses for the diversification of the economy especially, for the expansion of the tourism industry. The bank also provides financial assistance to enterprises that are negatively impacted by natural occurrences and catastrophes such as cyclones, drought, and pandemics (e.g., COVID-19). Although it is the case that the DBM has been engaged in the financing of different projects in the past, one of the key things representing its key flagship projects in recent times (during COVID-19) is the financing of more than 16,000 beneficiary enterprises including MSMEs with loans amounting to MUR 5.06 billion.

In addition to providing finance for real sector growth leading to socioeconomic growth, the DBM also engaged in green investment activities that ensure the overall long-term sustainability of the society. This the bank is pursuing by investing in PV panels for industrial buildings and J Nehru Hospital for purposes of producing electricity for usage. The DBM envisages that with the assistance of UNDP, its project of installing PV panels will be extended to government education institutions (secondary schools). The DBM has also put measures in place to ensure that households and domestic users get access to a loan of MUR 250,000 at an interest rate of 2% per annum for purposes of affording PV panels to be installed on their rooftops. It is worthy of note that such investments in cleaner source of energy go a long way in promoting the sustainability of the environment and the society as climate change challenges and issues are addressed. These activities regarding the investment in cleaner sources of energy are in consonance with goal 13 of the sustainable development goals which focuses on taking urgent action to combat climate change and its impacts.

In addition to the DBM's efforts towards sustainable environment and society as well as green investment, the bank is making efforts in addressing gender-based gaps by easing the processes and requirements that lead to credit access by women entrepreneurs for purposes of women empowerment. This the bank achieves by providing loan amounts up to MUR 500 K to women entrepreneurs at a low interest rate of 0.5% per annum. In addition to the low interest rate, the woman entrepreneur is not required to provide a collateral security before accessing the loan facility. The bank is ensuring investment in cleaner sources of energy where it has made substantial investment in PV panels for the production of electricity which is in consonance with SDG goal 13 which is on climate action. The bank has made efforts at women's empowerment through the easing of its loan application processes and requirements for women.

In spite of these key achievements of the DBM, in overall terms, the bank is confronted with the key challenges which include: (i) limited financial resources, (ii) inadequate human resource, (iii) increase default of loans, (iv) poor monitoring and evaluation systems, and (v) lack of ability to assess impact of DBM operations. First, DBM operations are mainly financed through government allocations. Other financing sources include raising funds from the international capital markets, obtaining credit facilities from other financial institutions, issuing of debt instruments in domestic financial market, retained earnings of the bank, and the acquisition of official development assistance. Interestingly, these other sources are not stable and keep dwindling over the years while government expenditure constantly increases to translate into declined allocation of finance for the operations of DBM. This situation limits the scale and scope of financing activities that DBM can undertake and hence impede growth of businesses and the economy of Mauritius. Second, the Bank has human resource and capacity challenges, particularly, in the monitoring of the operations of the Bank and selecting quality proposals.

For instance, the Bank is yet to design and develop monitoring and evaluation processes, procedures, and systems that can support the investigation of impact assessment of the activities and operation of DBM for review and corrective measures adoption. Again, well trained and reliable staff that can evaluate business proposals, monitor the progress of funded businesses/proposals are limited and hence leading to less rigorous proposals being accepted. Also, the lack of qualified human resources translates into default of loans in two ways which include (i) lack of client visitation and monitoring and (ii) weak application criteria for selecting projects to be funded by the Bank. Furthermore, the Bank is faced with the huge challenge of not being able to assess its impact for two reasons which include lack of financing and human resources. This is a major challenge because the lack of impact assessment does not help the Bank to improve on its performance which has reflected the Bank's financial performance. Another key challenge is the economic and business environment in Mauritius. The economic condition of Mauritius remains very volatile and increases the risk exposure of the Bank through loan defaults.

8.11 Operations and Performance

Generally, for businesses to remain in operations, they are supposed to attain positive outcomes and ensure that their balance sheet is always strong. In overall terms, the operations of firms are said to be successful if financial performance is positive (Table 8.1). Fundamentally, within the context of businesses including financial institutions, performance is considered from certain key dimensions, key among them being profitability, liquidity, asset and operational efficiency, and solvency. In relation to the DBM, the computed performance indicators reveal that in overall terms, DBM's role in providing credit facilities to MSMEs is less threatened given that over the last five years (2018–2022), the bank recorded profit in the current year although there is a decline compared to the previous years (see Table 8.1).

Figure 8.1 shows a decline in both ROA and ROE over the five-year period, with a significant drop in 2021, indicating challenges in maintaining profitability. The interest margin to gross income ratio also fluctuated but showed an increase in 2022, which could indicate changes in the bank's income composition or its interest rate environment. These indicators suggest that DBM faced profitability challenges in the years leading up to 2022 but may have taken steps to improve its financial performance.

In terms of liquidity assets, Table 8.1 and Fig. 8.2 show variations in liquidity indicators over the five-year period, with fluctuations in the

Table 8.1 Financial performance indicators

	Indicators	*2018*	*2019*	*2020*	*2021*	*2022*	*Average*
Earnings	Return on assets (%)	10.92	6.72	1.75	0.27	2.01	4.33
	Return on equity (%)	19.89	11.93	3.37	0.74	6.57	8.5
	Interest margin to gross income (%)	48.58	40.47	41.03	51.72	66.54	49.67
Liquidity assets	Broad liquidity assets to total assets (%)	14.5	17.3	12.7	14.5	13.4	14.48
	Broad liquidity assets to short-term liabilities (%)	64.4	74.2	55.1	84.2	101.2	75.82
	Core liquidity asset to total assets (%)	5.6	8.3	6.9	9.7	9.1	7.92
	Core liquidity asset to short-term liabilities (%)	24.7	35.5	29.7	56.4	9.1	31.08
Management efficiency	Noninterest expenses to gross income (%)	117.46	100.13	83.28	78.48	50.94	86.06
	Personnel expenses to gross income (%)	68.21	64.86	83.28	78.48	50.94	69.15
Operational performance	Portfolio Yield (%)	3.23	3.29	3.51	3.89	10.51	4.89

Source Authors' computation based DBMs annual report

proportions of broad liquidity assets and core liquidity assets. A noteworthy observation is the substantial increase in broad liquidity assets to short-term liabilities in 2022, indicating a strong liquidity position relative to short-term obligations. The allocation of core liquidity assets also increased over the years, which could signify a strategic effort to enhance liquidity and manage short-term liquidity risk. The data suggests that DBM experienced fluctuations in its liquidity position during this period, with notable improvements in certain years. These fluctuations may be

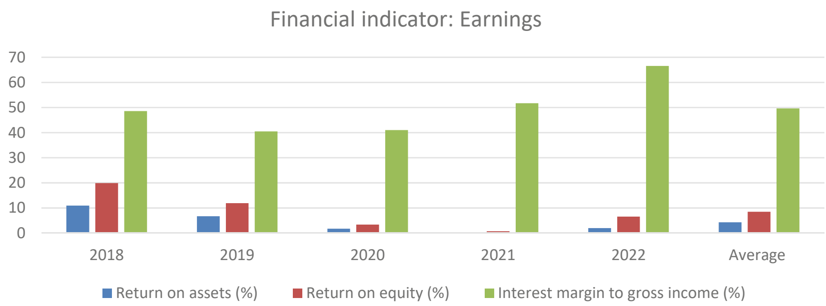

Fig. 8.1 Earnings of DBM

attributed to changes in the bank's asset composition, market conditions, and liquidity management strategies.

More so, Fig. 8.3 and Table 8.1 reveal a notable improvement in management efficiency of the DBM over the five-year period, as evidenced by the decreasing percentages for both non-interest expenses to gross income and personnel expenses to gross income. A decrease in these ratios indicates that the bank was able to reduce operating and personnel expenses relative to its income, which can contribute to higher profitability. The reduction in these ratios may result from various factors, such as cost control measures, operational streamlining, or changes in the bank's business model. This trend suggests that DBM made significant efforts to improve its management efficiency by controlling non-interest

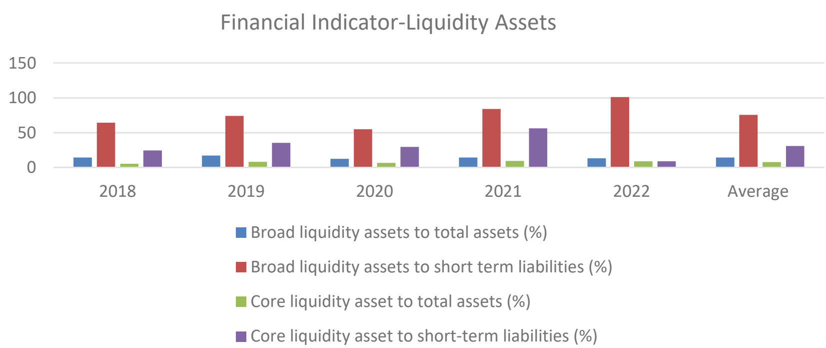

Fig. 8.2 Liquidity assets

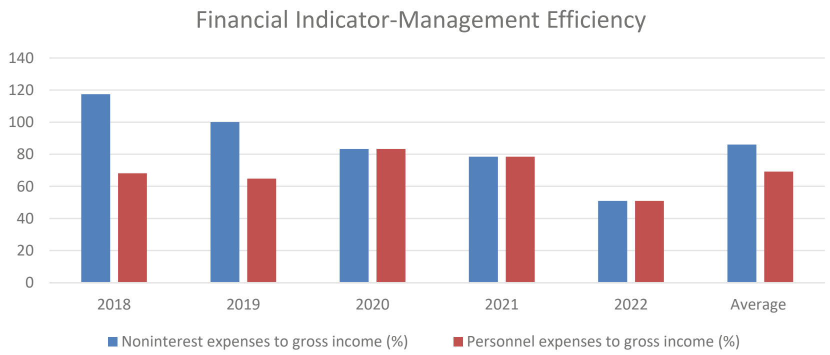

Fig. 8.3 Management efficiency

expenses, including personnel-related costs, which contributed to a more favourable expense-to-income ratio by 2022. This improved efficiency can have a positive impact on the bank's profitability and overall financial health.

Lastly, the data in Table 8.1 and Fig. 8.4 depict a notable improvement in the portfolio yield over the five-year period, with a significant increase from 2018 to 2022. The increasing trend in the portfolio yield suggests that DBM may have been successful in increasing the return on its portfolio assets. This can be achieved through various means, including lending to higher-yielding borrowers, managing investments more effectively, or optimizing the bank's asset mix.

In sum, the indication from the performance indicators in Tables 8.1, and figs. 8.1, 8.2, 8.3, and 8.4 are that DBM has over the five-year period (2018–2022) been well positioned in terms of delivering on its mandate of supporting the economy through its activities with MSMEs and other areas of the Mauritian economy. In spite of the indicators showing that the bank is stable to continue pursuing its mandate, it is imperative that the bank pursues more robust and cutting-edge strategies to minimize costs to improve profitability, enhance liquidity and solvency, and improve their viability for purposes of consolidating the gains the bank chucked in the past.

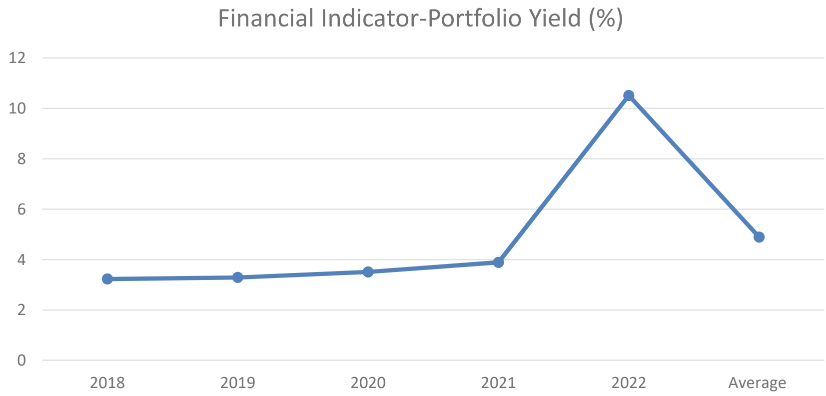

Fig. 8.4 Portfolio yield

8.12 Conclusion

The chapter focused on a comprehensive overview of the DBM. The overview brought to bear a number of issues and provided a certain level of insight into the operation of the bank. Specifically, the comprehensive overview of the DBM focused on its history; the political economy and institutional context within which the bank operates; corporate governance and risk management mechanisms and policies of the bank; regulation and supervision issues of the bank; monitoring and evaluation issues of the bank; the bank's business model; its key achievements and the challenges as well as performance outcome of its operations. From the review, it is clear that the DBM has a role and mandate to support the developmental agenda of government through the provision of financial services and products to different sectors of the economy including the private sector for purposes of stimulating economic activities. With this role of the bank, its collaboration with various players in the economy must be cordial to foster the needed partnership in its efforts to achieve its mandate. More so, given the key role it plays in the developmental agenda of country, it is imperative that it complies with appropriate regulations as well as global standard benchmarks in order to ensure that it remains financially and operationally efficient in the pursuit of its intended objectives and goals to ensure long-term growth and sustainability.

Furthermore, the DBM should ensure that its corporate governance, risk management, and regulation and supervision issues are given the needed attention they require. Consequently, by having a board and its committees such as the Audit and Risk Committee in place, the signal is that the bank takes its risk prevention and management seriously by putting in place the appropriate systems. Also, the bank has shown commitment to long-term sustainability by appointing a consult to implement a comprehensive risk management framework.

However, it is revealed from the review that the DBM has no specific department that is responsible for monitoring, evaluation, and impact evaluation of the projects it finances. This may be problematic given the importance of development interventions the bank engages in. The implication is that the bank may end up investing in non-viable or wrong projects. Thus, although the bank appears to be complying and operating within acceptable standards, based on what its objectives are, it is important that the board and management consider a function that will be responsible for monitoring, evaluation, and impact evaluation of financed projects for purposes of informing quality decision-making and result based interventions by the DBM.

Additionally, the DBM does not focus on any specific sectors but that its activities are dependent on government policies and priorities. However, given that certain sectors of an economy are more vulnerable than others, it will be required of the board and the government to place a certain weight on each of the sectors. This is important because it has the potential to ensure appropriate planning as far as the provision of financial resources is concerned.

Lastly, the DBM has demonstrated that its operations are intended to ensure growth and sustainability. The suggestion from these activities pursued by the bank is that the bank is not just concerned about lending money to stimulate economic activities, but it is making efforts to ensure a sustainable environment.

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CHAPTER 9

National Development Bank and Financing of SMEs in Tunisia: The Case of Banque de Financement des Petites et Moyennes Entreprises (BFPME)

Mondher Khanfir and Charles Odoom

9.1 Introduction

The financial and economic system in Tunisia has undergone significant transformation over the past decades. The development trend of the financial sector in Tunisia has long stood out on the African continent due to the country's resilience to economic growth, openness to foreign trade, investment in its domestic and offshore sectors, and its strengthening macroeconomic policies. Tunisia's model for development has produced

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reasonably good macroeconomic results in the past, leading to a reduction in major economic crises. For instance, strategic sectors of the economy, particularly, the small and medium enterprises (SMEs), play a key role in the Tunisian economy by contributing significantly to building a sustainable economic growth. According to the International Financial Corporation's (IFC) report (2023), approximately 98% of businesses in Tunisia are micro, small and medium-sized enterprises (MSMEs), which account for about 40% of gross domestic product (GDP). However, about 30% of MSMEs lack all forms of access to financing. Thus, SMEs' ability to access finance for their business operations and investments is, therefore, crucial to Tunisia's future economic development. In addition, the government of Tunisia's plan to develop a national development bank or a new state-backed regional bank, focused on improving access to SME financing, will help the development of the sector.

Drawing from Tunisia's efforts to achieve the global sustainable development goals, development financial institutions have played a critical role in mobilizing resources to facilitate economic transformation, provide a number of initiatives to boost the levels of financing of development plans and intervene directly through lending models. Over the past two decades, Tunisia has consolidated its arsenal of financial players dedicated to entrepreneurs. In addition to the two national development banks, namely the Banque de Financement des PMEs (BFPME) and the Banque Tunisienne de Solidarité (BTS), the government has allowed microcredit organizations to operate, with the support of a range of local and foreign partners. We can cite Enda Tamweel and Microcredit, which are dedicated exclusively to micro-enterprises. Today, the development banks in Tunisia have played a pivotal role in supporting economic development and stimulating appropriate structured lending to MSMEs.

Development finance is well anchored in the national agenda of the Tunisian government, and it is implemented within the framework of public policy, encouraging investment and regional development. More specifically, BFPME has played a leading role in boosting the entrepreneurial ecosystem and industrial diversification. However, its performance has been diminished over time by various constraints because of its positioning on the market and its governance.

This chapter explores the contributions and limitations of BFPME in financing SMEs in Tunisia. It is structured as follows. Section 9.2 provides an overview of the development finance landscape in Tunisia while Sect. 9.3 presents the case of BFPME. Section 9.4 discusses the political economy and institutional context. Section 9.5 examines the business model of BFPME while Sect. 9.6 discusses BFPME's corporate governance arrangements. Sections 9.7 and 9.8 discuss the risk management practices and regulation of BFPME. Section 9.9 examines the monitoring and evaluation, and impact evaluation of BFPME. Section 9.10 discusses the main achievements and challenges confronting BFPME while Sect. 9.11 concludes the chapter.

9.2 Evolution and Overview of Development Finance Landscape in Tunisia

The Tunisian financial sector was born after independence, in 1956, with the nationalization of colonial banks, the creation of the Central Bank of Tunisia (1958), the Tunisian Dinar and a launch of the monetary market. The evolution of the financial sector was then characterized by monetary policy focused on the banking sector. From the end of the 60s, every decade has been marked by a specific development strategy. The period from 1967 to 1980 was marked by the separation of deposit banks from investment banks, and the creation of offshore banks to support the industrialization strategy supported by Foreign Direct Investments (the famous Law 72). The period between 1981 and 1990 was marked by a deep economic crisis and a heavy public deficit. This led to the increase in the number of private banks, as well as joint venture banks with funds from the Gulf region. This made it possible to diversify the investments and targeted sectors.

The policy of economic liberalization in the 1990s led to the activation of the capital market exchange, established in 1969. Meanwhile, its governance remained dominated by the public sector until 1995, when it was renamed Bourse des Valeurs Mobilières de Tunisie (BVMT) and entrusted with private sector management. The end of the 90s witnessed the merger of state deposit banks and investment banks.

In the early 2000s, the economy of Tunisia opened the country for the entry of foreign banks as well as the privatization of state-owned banks. During the same period, the universal banking system was instituted with the widespread diversification of money market instruments. Consequently, the economy of Tunisia established consumer credit schemes, home mortgages, and Islamic banking. At the same time, the government enacted public policies focusing on enabling access to capital to SMEs through different instruments, i.e., a bank dedicated to financing

SMEs, namely the BFPME, a guarantee fund managed by Société Tunisienne de Garantie (SOTUGAR), or again an early stage investment fund managed by SAGES Capital.

The 2001 banking reform abolished the distinction between deposit banks and development banks in favour of the principle of universal banking. The law permits the banking system to perform all banking operations including credit administration, with the exception of development banks that operate under a specific agreement. However, it does not apply to offshore Banks that are governed by law 85–108 of 6 December 1985.

The instability brought by the revolution revealed the structural weaknesses of the Tunisian financial system, in particular state-owned banks. The banking sector, in recent times (i.e., in post-revolutionary Tunisia), is characterized by serious liquidity problems, market failures, less developing bond markets, high non-performing loans level, gaps in risk management and failures in governance systems—leading to an alarming impact on economic competitiveness and growth.

Since gaining its independence, Tunisia has benefited from international development aid, which has been used at various levels to promote economic development and welfare in recipient countries, build a high-quality public sector, and support the industrial and tourism sectors, as well as education and health sectors. It is observed that Tunisia's development financing remains limited to conventional instruments that are under state control (Abor, 2023). A few donors have included some private equity or mixed finance techniques in supporting infrastructure projects, but this is still relatively rare and only applies to a small number of public–private partnership (PPP) initiatives, such as specific technological clusters. According to the World Bank, the country could do much better in terms of investments and public service enhancements that are able to guarantee economic recovery, provide more employment opportunities for young people, and thereby contribute to a better establishment of social peace and democracy.[1]

Since the 1970s, industrializing the economy with the aim of promoting self-sufficiency and employment creation has been at the top of the political agenda. Several achievements can be attributed to this policy, which may be credited with a number of successes that had their foundation in the 1990s with the signing of the free trade agreement

[1] https://www.worldbank.org/en/country/tunisia/overview.

with the European Union in 1995 and the escalation of Foreign Direct Investment (FDI) flows in Tunisia. However, after independence, the idea of development has continued to play a significant role in the policies of succeeding governments. In the 1960s, development banks were founded as a result of the need to finance investments. The earliest national development banks were the Economic Development Bank of Tunisia (BDET) and the National Tourism Development Bank (BNDT). BDET is a generalist multi-sectoral bank while BNDT is primarily focused on the tourism industry. These banks provided development financing that contributed to the investment boom until the entry of bilateral development banks and the influx of foreign banks. These bilateral development banks undoubtedly helped the industrial and tourism industries grow, and they also significantly aided in the diversification of the Tunisian economy.

In the early 2000s, Tunisia began to feel its economic model running out of steam and chose to link its development policy with entrepreneurship. The objectives of financial inclusion and regional development, thus, motivated the creation of the bank for funding SMEs such as *Banque de Financement de la Petite et Moyenne Entreprise (*BFPME). BFPME was, thus, created on March 1, 2005. It carries out its activity within the framework of the law n°2016–48 of July 11, 2016, relating to credit institutions.

9.3 BFPME's Corporate Governance Arrangements

Tunisia has a governance guide for public enterprises and a specific law[2] on the governance mechanism for banks and financial institutions. The latter has just been supplemented by a new BCT circular N° 2021–05, dated August 19, 2021, which sets even stricter conditions for the functioning of the Boards of Directors of banks. BFPME has a Board of Directors (BoD) of 12 directors, including two independent members. The appointment of the BoD is done by the government. However, the appointment of the executive directors does not follow a formal recruitment process. In addition, the separation of the roles of Chairman of the Board and Chief Executive Officer complies with Article 46 of the Banking Law 2016–48.

[2] Law n° 2016-48 of July 11, 2016.

The bank has well-established audit, risk, appointment and remuneration committees. In terms of integrity and non-corruption, BFPME has set up a good governance unit[3] which is responsible for the coordination of best practices between the Board, the various internal and external departments, and stakeholders. Although the bank has well-established committees, it is faced with several constraints, including the lack of necessary resources to fully carry out their work and inefficient information system for proper monitoring and reporting of its activities. The unenforceable regulatory texts and the "differentiated" treatment of the banking supervision do not give BFPME the means to establish an effective governance. Thus, the governance of the BFPME suffers from several shortcomings that need to be corrected as part of an overall restructuring plan. Despite the number of shortfalls, the bank pays attention to appointing well-experienced Board of Directors that provides a sound governance system, transparency, accountability and strict compliance with the requirements of international standards.

9.4 Risk Management Practices

BFPME is, by virtue of its mandate, highly exposed to solvency risk. The bank continues to advance with a very high exposure to risks. These include credit risks linked to sparse and unstructured financial information on both sectors of activity and projects whose average profitability is often low or even uncertain. The guarantee mechanism applied does not in fact cover more than 30% of the breakage according to the Bank's management. There are also operational risks linked to institutional weaknesses in terms of written procedures and descriptions of the bank's business processes, resulting in ineffective internal controls and an inadequate information system. Similarly, liquidity risks associated with a solvency risk put the bank in a delicate situation towards the Central Bank of Tunisia.

These risk exposures require a sophisticated information system, capable of reinforcing the capacity of BFPME in its relationship with its customers as well as its partners. However, the current information system (IS) of the BFPME does not automate the risk management process. It has evolved by internal development without being able to rise to a global banking level. Several important and critical activities such as database

[3] In accordance with the president of the Government's Circular of 2012 No. 16 concerning public enterprises.

management and reporting are still managed manually or with the help of Excel spreadsheets. This situation compromises good governance and the reliability of financial information.

Given the aforementioned challenges, the board gives the Audit and Finance, Risk Management and ICT Committees responsibility to control possible risk exposures, and to oversee internal financial management and operational control systems. The basis for those procedures is provided by the bank's corporate governance standards for ethical conduct, legal requirements and sound accounting practices. The internal control structure is based on the corporate risk management methodology and risk strategy defined by the board.

Internal control and bank risk management policies are approved by the board, and the risk management committee is responsible for carrying out the implementation of those policies. Through the numerous pertinent board committees that are in place, the board is kept up to date on risk management problems. The Central Bank of Tunisia provides supervisory oversight to ensure that the bank's operations and activities are not detrimental to its sustainability and mandate. The central bank closely monitors and reviews the bank's financial transactions and activities on a regular basis to guarantee compliance and caution. This is done to lessen the risks associated with market exposure, liquidity restrictions and credibility with its important partners and stakeholders. The bank has adopted strict governance processes and implemented risk-mitigation strategies to deal with various forms of risks and prevent future occurrences.

9.5 Regulation and Supervision

The banking sector is under the direct supervision of the Central Bank of Tunisia concerning the exercise of the profession. On the other hand, the administrative supervision, which appoints the CEO and board members, in particular, is the Ministry of Finance. Surprisingly, there is no specific regulation for development banking in Tunisia, even when it experienced the bilateral development banks, which ended in 2001 after nearly 3 decades of operations. Policymakers did not consider it useful to create an adequate legal framework when BFPME was created in 2005. Thus, BFPME operates under a universal bank licence without complying to any formal prudential rules laid down by the Central Bank of Tunisia for commercial banks.

Finally, BFPME shareholding is evolving to ensure better compliance with state-owned enterprises' governance principles. The entanglements of holdings in the capital of public enterprises are replaced by a common public investment fund that represents the State in its capacity as an investor for BFPME. This avoids complex arrangements and interference of interests between public entities and the bank's development mandate.

9.6 Business Model of BFPME

BFPME's business model is to provide medium- and long-term investment loans to SMEs with subsidized rates, and sharing the risk with commercial banks. Its mission is to bring to the market a dual value proposition combining economic development with financial inclusion through entrepreneurship. Its offering consists of financial and non-financial services to entrepreneurs. Its catalog of services has been enriched over time through local and international partnerships. BFPME provides financial services to SMEs based on three phases including creation, growth and restructuring.

Table 9.1 shows the instruments made available to BFPME to accomplish its objectives in line with the stages of SMEs financing.

Over the years, BFPME has acquired alternative financing instruments, including granting of interest-free or low-interest equity loans to strengthen the capital base of SMEs created by young promoters, and co-financing of investments in the creation or expansion of SMEs through medium- and long-term loans.

In addition to the direct financing of projects, BFPME ensures that promoters benefit from programmes and facilities allowing the development of projects such as investment premiums, special government measures for the promotion of key sectors, implementing programmes, export assistance, innovation support and various public initiatives in favour of SMEs. As such, BFPME plays the role of advisor to the promoter in order to facilitate the necessary administrative procedures in project development.

As part of strengthening its assistance to SMEs, especially those experiencing financial difficulties, the BFPME has been mandated to manage a specific fund, namely the Support Fund for Small and Medium Enterprises (FSPME). It was launched in accordance with the complementary

Table 9.1 BFPME—Financial services provided to SMEs during their life cycle

Project stage	*Intervention of the BFPME*	*Dedicated instruments*
Creation of the SME	Strengthening of the equity capital	Interest-free equity loans (Intilak, Bader, QFF…)
	Financing/co-financing of investments	Medium- and long-term loans at a reduced rate
		Insurance on the capital invested by SOTUGAR
		Access to the Tunisian Investment Fund (currently being set up)
Growth of the SME	Financing of the extension (operation and/or investment)	Growth support programmes financed by donors such as the World Bank or the EBRD
	Rescheduling granted under the exceptional government measures (2020–2021)	Facility with special measures (fiscal, social and financial) to deal with the impact of the crisis COVID-19
Restructuring of the SME in difficulty	Mobilization of capital for the strategic, organizational and financial restructuring of the ailing SME	Financial restructuring lines for SMEs FSPME (2014) and FAR (2018) with a technical assistance facility and a guarantee fund for the financing granted

finance law relating to the year 2014 and decree No. 2015–31 of 13/01/2015, setting the terms of organization and operation of the conditions and methods of intervention of the fund.

The non-financial services provided to SMEs (see Table 9.2) are based on two phases, ante-creation and post-creation. BFPME, thus, covers all the needs of the promoters it targets to become its clients. The services of the bank include providing assistance to identify project ideas and to inform promoters and project holders of economic and prospective projects carried out by ministerial departments. It puts promoters in touch with various public structures such as the Regional Development Offices and the Sectoral Technical Centres. In addition, it provides access to the sectoral databases held by Agence de Promotion de l'Investissement et de l'Innovation (APII), Agence de Promotion de l'investissement Agricole (APIA) and Foreign Investment Promotion Agency (FIPA) and to facilitate the connection of promoters with the various support and assistance structures for the creation of SMEs (business centres, business incubators, spin-off cells, Regional Development Offices, "entrepreneurial spaces" under ANETI, etc.). The bank also directs promoters to support and assist programmes in the field of entrepreneurship set up by international organizations operating in Tunisia.[4]

9.7 Main Achievements and Challenges

BFPME has demonstrated a remarkable dedication to supporting SMEs and achieving economic development in Tunisia. Over the years, the bank has reached a number of noteworthy milestones and helped Tunisia significantly enhance its SMEs. Despite the number of risks, BFPME has a few success stories that serve as examples for future promoters. These successes are not only due to the fact that they have access to financing, but also to the general conditions of the business environment, the market potential, the technological mastery and the managerial qualities of the leaders.

It is generally admitted that SMEs play a crucial role in boosting economic growth and creating jobs. The latest trend in the loans to the economy by sector (see Table 9.3) shows that total bank credits rose from TND 65 billion (US$ 5.8 billion) in 2015 to TND 98 billion (US$ 31.7 billion) in 2020. The share of industry represents about 25%; agriculture and fisheries represent about 3% in 2020. It is observed that the private sector accounts for more than 90% of total bank credits. However, it is noted that despite the exceptional measures to support the economy, credit to industry remained almost stable between 2018 and 2020. This could be explained by a reallocation of credits rather than the issuance of new credits. The emergency measures that were adopted served only to relieve some of the SMEs that took bank loans before the COVID-19 pandemic.

Thus, SMEs that do not have access to bank financing are doubly harmed; they have no access to loans nor to government assistance. Indeed, the Central Bank of Tunisia's statistics show that it is the medium- and long-term credits that have increased in the context of the rescheduling of SME debts, while the short-term credits remained almost stationary between 2019 and 2020 (see Table 9.4).

[4] "National mapping of promoter support programs". AfDB-Ministry of Vocational Training and Employment Study—2018.

Table 9.2 BFPME non-financial services provided to SMEs before and after creation

Project stage	*Intervention of BFPME*	*Programmes & Initiatives*	*Donors/ Programme Sponsor*	*Programme Management Agency*
Ante creation stage	Sourcing of SME projects and participation in the steering committee and/or other monitoring bodies of these programmes	Souk- Attanmia ANDI FEKRA AGRIPRENEUR 2.0	African Development Bank Tunisie Télécom GIZ	African Development Bank Radio Express FM APIA
		PROAGRO	Italian Agency for Development Cooperation	APIA, in partnership with several other concerned organizations
	Organization of entrepreneurship competition and event sponsorship	APII innovation competition Global Entrepreneurship Week—Tunisia	APII Global Entrepreneurship Network	APII, in partnership with several actors of the entrepreneurial ecosystem IACE in collaboration with ecosystem partners
		Hult Prize Challenge 2021	UN	University of Tunis El Manar
	Capacity building (BootCamps and coaching sessions), participation in jury work	Univenture	Carthage Business Angels	Wiki Start Up
		The National Student Entrepreneur Program	European Union (ERASMUS + project)	Agence Universitaire de la Francophonie

(continued)

Table 9.2 (continued)

Project stage	*Intervention of BFPME*	*Programmes & Initiatives*	*Donors/ Programme Sponsor*	*Programme Management Agency*
Post creation stage	Mentoring: Assistance and guidance of promoters by experienced investors	Accompaniment and loan of honour Mentoring, accompanying and coaching	AFD French Embassy, Campus France and ATB	Tunisia Entrepreneurial Network MOOVJEE
	Collaboration in order to make SME clients of the BFPME benefit from various technical assistance programmes, oriented to SMEs in Tunisia	ISECO TUNISIA JOBS Technical Assistance to SMEs/FAPA Fund Technical assistance to SMEs experiencing difficulties as a result of COVID-19	GIZ USAID JICA and the Austrian Agency for International Cooperation UK Embassy in Tunis/OECD	GIZ USAID BFPME FMEP

Table 9.3 Evolution of Credits to the Economy of the Financial System (in Million US$)

Indicators	*2015*	*2016*	*2017*	*2018*	*2019*	*2020*
Agriculture & fishing	757	835	946	980	1038	1103
Industries	6031	6569	7676	8751	8935	9211
Services & loans to individuals	16,646	18,324	20,559	22,050	22,990	24,897
Total	**23,434**	**25,727**	**29,181**	**31,781**	**32,962**	**35,211**

Source Central Bank of Tunisia

Table 9.4 Credits to the economy by term and by beneficiary (in Million US$)

Indicators	*2015*	*2016*	*2017*	*2018*	*2019*	*2020*
Short-term loans	9,994	10,957	12,738	14,476	15,229	15,439
Medium- and long-term loans	13,440	14,770	16,444	17,305	17,733	19,772
Loans to professionals	16,807	18,385	21,069	2,3224	24,372	26,121
Loans to individuals	6,627	7,343	8,112	8,557	8,590	9,090

Source Central Bank of Tunisia

This confirms that for Tunisian SMEs, access to capital continues to be very difficult due to an insufficient supply and an unstructured capital market. Banks, on the other hand, complain about the lack of information on SMEs as well as the difficulty of obtaining a credit risk rating or reliable financial statements. Banks also lack innovative products and financial technologies that would reduce the cost of lending to SMEs. As a result, they rely mainly on the ability of their customers to provide tangible assets as collateral. This strategy excludes many potentially credit-worthy SMEs and startups with a good business plan and sustainable cash flow, as they cannot provide real external collateral or a sufficient financial track record.

In Table 9.5, it can be observed that BFPME approved a total amount of TND 21.9 million for 42 projects in 2019, a decrease compared to 2018 of 15% in commitment and 48% in number of projects. In 2019, the bank committed about 54% to the extension of projects against 44% for the new creation of projects and 3% for restructuring of projects. This shows a clear preference for extension projects, where the risk is lower. It can be observed that the most financed sectors are the agri-food industries, followed by the chemical and paper and cardboard industries.

Table 9.5 BFPME. Loan Approvals by Nature (Source BFPME)

	Number of deals			*Project's cost (TND)*			*BFPME Loan*			*Job Creation*		
Category of credit	*2019*	*2018*	*Var*	*2019*	*2018*	*Var*	*2019*	*2018*	*Var*	*2019*	*2018*	*Var*
Greenfield Investment(holding Companies)	8	25	-17	8,781.00	45,661,000	36,880,000	1,677,000	9,446,000	7,769,000	144	337	−193
	19%	31%		12%	36%		8%	36%		10%	31%	
Project expansion loan	17	16	1	24,162,000	12,086,000	12,076,000	11,724,000	5,103,000	6,621,000	996	216	780
	40%	20%		33%	10%		54%	20%		71%	20%	
Complementary loan	7	9	−2	576,000	1,969,000	−1,393,000	403,000	753,000	−350,000			0
	17%	11%		0	0%		0%	0%				
SME creation	9	31	−22	39,300,000	65,406,000	−26,106,000	7,957,000	10,721,000	−2,764,000	269	529	−260
	21%	38%		1	1		0%	0%		19	49	
Restructuration	1		1	550,000		550,000	138,000		138,000			0
	2%	0%		0		0	0%		-3			
Total	42	81	-39	73,369,000	125,122,000	−51,753,000	21,899,000	26,023,000	−4,124,000	1,409	1,082	327
	100%	100%		100%	100%		100%	100%		100%	100%	

The regional distribution shows that financing expansion projects dominate in three leading regions (i.e., Kairouan, Sfax and Sousse). Furthermore, it can be seen that, in some cases, financing has progressively shifted towards micro projects and non-industrial activities (such as craftsmanship and professional services). This shift in market positioning is explained by the scarcity of industrial projects, or rather the diversion of BFPME as an investment bank.

BFPME has managed to allocate about a hundred participatory loans at zero interest rate, thus boosting projects that were on hold due to the non-completion of their financing scheme. This experience, which is outside BFPME's mandate, has opened up new prospects for collaboration with other donors, such as Qatar Friendship Fund (QFF). Initially, BFPME's loan policy was to grant medium- and long-term loans to SMEs at a reduced rate and without guarantee. The creation of enterprises in the interior regions was the bank's target, thus helping to achieve the Sustainable Development Goals (SDGs). BFPME's market share represents about 7% of the enterprises created, and this has contributed to about 7350 jobs creation by SMEs.

It can be seen that, after 15 years of operation, BFPME has processed 10,094 credit applications, approved 1,723 projects corresponding to a commitment of TND 404 million (UD$ 131 million) and has been able to raise nearly TND 1 billion (UD$ 323.7 million) as investment for SMEs development. These amounts remain modest compared to the financing needs of the economy estimated at TND 3.4 billion (US$ 1.1 billion) per year. With a commitment of TND 432 million (US$ 170 million) at the end of 2020, and out of a total of 15,000, more than 1,100 SMEs were supported with finance.

In addition, BFPME plays a key role in the entrepreneurial ecosystem, by directing financing flows to priority sectors and regions. It can be seen in Fig. 9.1 that BFPME receives several hundred applications for funding per year. A peak was observed in 2011 when it received 1,449 applications. The number of approvals peaked at 366 in the same year, decreasing to 42 in 2019.

Given the important contributions of BFPME to SMEs and economic development, it faces a variety of difficulties, such as limited financial resources, political and economic unpredictability, difficulty determining project viability and bankability, inadequate infrastructure maintenance and operations, changes in regulatory and policy framework, skill and capacity limitations and difficulty ensuring environmental and social

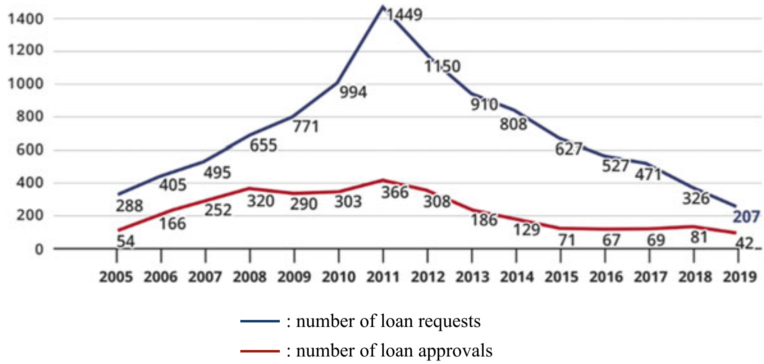

Fig. 9.1 Evolution of funding requests and approvals (*Source* BFPME)

considerations. Even though the bank has launched new financing products and services, such as the participatory loans, it recorded a bad debt peak of 83% in 2020. This is largely due to the poor loan quality, lack of experience of the promoters targeted by measures focusing more on "social solidarity" than profitability.

In addition, the lack of control over market risks, the cumbersome administrative procedures of all stakeholders and, above all, the unsuitability of the proposed financing scheme for "greenfield" projects, combined with the long time taken to assess applications and the multiplicity of panelists, have ultimately resulted in the low margin that development projects could generate. It is estimated that a good number of projects could have succeeded if there was more flexibility in the financing schemes and if the working capital requirements were properly taken care of by BFPME. The low bank capitalization and the lack of a refinancing capacity led BFPME to rethink and explore other avenues to ensure its survival.

9.8 Conclusion and Recommendations

It is generally admitted that SMEs play a crucial role in boosting economic growth in the country. However, SMEs are limited by the lack of access to finance. In view of that, BFPME operates a wholesale lending business model under strict corporate governance and risk management regimes to promote the development of SMEs and improve SMEs' access to financing. The macroeconomic conditions in which BFPME operates can be explained as a major limitation that affects its contribution to building a sustainable SME and economic development. BFPME, in partnership with development finance institutions, could be a guarantee of greater transparency and independence from direct political influence. The bank should be resourced to facilitate the SME's access to financing, which is essential for economic development and sustainability. Moreover, to strengthen sustainable economic development, an appropriate institutional framework that supports the SME financing framework is essential. Thus, policy reforms and implementation of more effective legal and fiscal provisions are required. In addition, the political economy within which BFPME operates should be strengthened to contribute effectively to the achievement of sustainable development goals in Tunisia.

Finally, the bank continually faces three interdependent challenges, namely the challenge of continuity, the challenge of performance and the challenge of consolidation of the ecosystem. The challenge of continuity requires financial restructuring and recapitalization to absorb accumulated losses. The cleaning up of doubtful debts could be done, if necessary, via a ring-fencing approach. This necessarily requires the enactment of a specific development bank status with ambitious strategic objectives supported by appropriate governance rules.

The challenge of performance requires a revision of the economic model as well as a restructuring of the financial sector or markets. Indeed, the mandate of financing SMEs, whether directly or through the bank, should integrate several forms of financing vehicles, including blended or hybrid financing, to reach higher performance thresholds.

The challenge of consolidating the ecosystem points to better cooperation between the different stakeholders, to accelerate the creation of sustainable businesses in all sectors. The development of the bank cannot be achieved without the development of the financial system, which in turn depends on the private sector development agenda.

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CHAPTER 10

The Role of Botswana Development Corporation in National Development

Mbako Mbo

10.1 Introduction

Botswana gained its independence from Britain in September of 1966, then one of the poorest countries in the world, with very limited avenues for economic prosperity. The country largely depended on Agriculture, notably livestock and related products which accounted for 85% of total exports by 1967 (Cervenka, 1970). For perspective, when the colonial rulers left the country, there were a mere 12 kilometres of tarred roads, 22 university graduates and some 100 people with secondary school education (obtained mostly from South African schools) See (Samatar, 1999; in Barclay, 2009). Botswana's economic fortunes would later take a dramatic turn on the 1 of March, 1967, just 6 months into independence. This is the day diamonds were first discovered in the central part of the country. The rest is history: GDP per capita has grown from $90 in

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1966 to $7,347 by the end of 2021.[1] As of 2022, there exists a vast network of roads of which 10,400 kilometres is tarred,[2] a sound co-existence of private and parastatal sectors, world class public health and education infrastructure dotted throughout the sparse country. The story evolves mainly around the diamond, but of course, beyond diamonds, other sectors have gradually come up over the years, a milestone very critical for the thinly diversified economy. The country's sovereign credit rating remains the highest in Africa, i.e. rated A-2 by S&P Global Ratings as of 2022.[3]

The country's success is a story widely publicised, and a number of factors have been attributed to the rather exemplary journey, at least in the context of Africa. There is a generalised consensus among many commentators, scholars and writers that good governance and strong institutional framework supported by a conducive political climate have been the major drivers of Botswana's progress. Riding on the back of good governance and sound economic and development policies, quite a number of State-Owned Enterprises were formed in the late 1960s to early 1970s. These had special mandates to pursue in the broader scheme of driving development from sectoral perspectives; telecommunications, power, water, rail and air transport, housing, postal and financial services and development finance.

In this chapter, we look at the role played by development finance institutions in Botswana's impressive socio-economic progression path, with a special focus on Botswana Development Corporation (BDC). We draw important lessons from the success stories, point out pitfalls to avoid and share views from a future perspective. In the rest of this chapter, we look at an overview of the DFI landscape in Botswana before delving deeper into the BDC story wherein we cover the Corporation's history, its institutional and governance set up. We then look into its business and funding model through the years and performance outcomes during its formative years through the growth and transformation phases. These subtopics end with a conclusion, with a highlight of key learnings from the BDC's story.

[1] World Bank national accounts data, and OECD National Accounts data files.

[2] Statistics Botswana, 2022.

[3] S&P Ratings report on Botswana, September 2022.

10.2 Overview of Development Finance Institutions in Botswana

The role of Development Finance Institutions (DFIs) in any set up is invariably enshrined in their very definition. Borrowing from Xu et al. (2019);

> Development finance institutions (DFIs) are legally independent and government-supported financial institutions with explicit official missions to promote public policy objectives. DFIs are potentially potent policy instruments for fixing market failures, incubating markets, and promoting structural transformation.

The formation of DFIs in Botswana pre-dates independence, but continues well into modern day. Each exists to pursue a specific policy mandate. Although entirely government owned, these institutions were typically enacted by a legal instrument passed through Parliament. Below, we outline Botswana's DFIs landscape.

National Development Bank

National Development Bank (NDB) was formed in 1963,[4] the same year a Post Office Savings Bank was formed by the Government (Then Bechuanaland Protectorate). Operations began in May of 1964, focusing on providing loans for the development of agriculture (livestock and non-livestock) and housing. This twinned mandate is not surprising, as agriculture (livestock in particular) was then the mainstay of the economy, while housing would have been a central issue at a time when a new independent nation was being contemplated.

Also to note, NDB became the implementation vehicle for two key post-independence flagship programmes of the new Government. The World Bank (1974) notes a farmer's loan programme under an IDA-SIDA Livestock development project (1973) as the first of such programmes to be implemented under NDB. Quite importantly, this was directly linked to Government's rural development policy which had a component of increasing financial flows to rural economies, and Agriculture was

[4] www.ndb.bw/introduction.

the natural vehicle to precipitate this. Second was the Botswana Enterprises Development Programme, which was coordinated by the Botswana Enterprises Development Unit (BEDU) under the then Ministry of Commerce and Industry, according to the World Bank (1974). Formed in 1972, the objectives of BEDU were primarily focused on the development of local citizen owned and managed enterprises in the commercial and industrial sectors, and this entailed channelling of financial assistance which was arranged through NDB.

Riding on concessionary capital received from Government and development partners, NDB was able to extend pro-development loans (patient capital) to businesses, but still making decent returns to run as a commercial entity. Thus, from a policy lens, Government was very clear on its role on providing public goods while creating an enabling environment for the private sector to thrive. What also stands out from Government's approach is what is seemingly a clear acceptance of the fact that some endeavours were not so attractive for the private sector (e.g. rural agriculture), while some could not be effectively rolled out under public systems (e.g. administration of concessionary loans). It can be argued, therefore, that the Government set up NDB as a more efficient tool to roll out relevant national priorities that the private sector would not find interesting.

Over the years, a variety of issues colluded and rendered NDB a loss-making entity, heavily reliant on government subventions for over the 10 years to 2022, when Government decided to re-organise it into a commercial Agri Bank. Efforts to realise this were underway at the time of writing this chapter.

Botswana Savings Bank (BSB)

Botswana Savings Bank (BSB) was set up in 1963[5] (pre-independence) alongside NDB. Originally, BSB was a Post Office Savings Bank under the then South African Government, but later transferred to Botswana (then Bechuanaland) where it got housed under the Ministry of Works and Communication, still in 1963. It operated as a government department providing savings accounts to communities, including the lower income segments which typically would have been unbanked. In 1982,

5 www.bsb.co.bw/about-us/.

the Post Office Savings Bank was moved to the then Ministry of Finance and Development Planning and re-named "Botswana Savings Bank", a specialist department although pursuing broadly the same mandate. BSB was corporatised in 1992 when Parliament passed the Botswana Savings Bank Act, which specifically provided for:

> … for the establishment of the Botswana Savings Bank as an independent, but wholly Government owned corporate body to provide banking and financial services for all the peoples of Botswana.

Two specific objectives were stated in the act:

a. promoting the saving habit among the peoples of Botswana and mobilising local savings;
b. and granting loans on commercial terms and providing efficient banking and financial services to meet the requirements of the rural and urban population of Botswana.

The corporatisation of BSB was timely as socio-economic standards had positively shifted since independence; per capita income was at US $3,041 compared to US $90 at independence, with the population more than doubling to 1.4 million during the same period.[6] By early 1990s Botswana was already grappling with rapid rural–urban migration rates, with the population of its Capital, Gaborone, reaching 8 times higher than what was assumed in original city plans.

From a policy perspective, thus, it can be reasoned that BSB played a key role in stimulating a saving and wealth creation culture at a time when the country's socio-economic landscaping was promising a bright future, while at the same time extending financial services to the rural communities to support the overall rural development strategy. As of 2022, BSB remains a profitable, independently run entity with huge popularity among low-income segments, informal traders, and rural area dwellers. It has branches in most areas of the country.

[6] Statistics obtained from World Bank Database; GDP per capita (current US$)—Botswana | Data (worldbank.org).

Botswana Development Corporation (BDC)

BDC was set up in 1970 through a model that was rather unique for an enterprise owned by government at that time; it was incorporated under company law as a limited liability company whose shares were exclusively held by government. The company was set up to "promote and facilitate the development of industrial, commercial, and agricultural enterprises within the framework of the Government's plan for economic development", and right from the onset, there has always been a scope for an overlap between mandates of BDC and NDB, something to be expressly addressed by the SOE rationalisation exercise that was kicked off in April 2022.

BDC is the focus of this chapter, more on it later.

Citizen Entrepreneurial Development Agency (CEDA)

CEDA was formed in 2001, mainly as a response to the need for a consolidated and a more focused approach to supporting entrepreneurship endeavours by citizens. It must be noted though, that Government had already began as early as the 1970s to assist small-scale entrepreneurs (including start-ups) and rural area-based ventures through policy instruments (OECD/AfDB, 2005). Earlier we mentioned the Botswana Enterprises Development Program of 1972 which channelled its financial assistance through NDB; this was later followed by the likes of Rural Industrialisation Program and the Business Advisory Service (notes OECD/AfDB, 2005). Perhaps a watershed moment was the establishment of the Financial Assistance Programme (FAP) in 1982 with an objective of stimulating investments, creating exports, precipitating import substitution, and boosting employment creation. The programme went through several reviews during its existence, the last of which was carried out in 2000. Central to this last review was that:

> …the FAP was no longer effective in achieving its objective of promoting sustainable employment creation. Although some jobs were created as a result of the FAP, the cost of creating them was unsustainable and unacceptably high…

> … the FAP was inappropriate to 21st-century Botswana and that it was not addressing the main constraints to investment and the development of sustainable productive enterprises. The review therefore recommended that the FAP should be replaced with alternative forms of support for effective promotion of SMEs. (OECD/AfDB, 2005)

Major reasons for FAP's ineffectiveness, characterised by high business failure rates, were granting funds to citizens and citizen entrepreneurship based on very shallow due diligence, and later employing very weak to no meaningful performance monitoring mechanisms. This was the case with programmes before FAP.

Thus, CEDA was formed as a company limited by guarantee, wholly owned and guaranteed by Government to provide financial and technical support for business development with a view to promote viable and sustainable citizen owned business enterprises.[7]

By many measures, CEDA has been a successful enterprise since its formation. In launching a revised set of the entity's financing guidelines in 2020, Botswana's President, HE Dr. Mokgweetsi Masisi disclosed that in 5 years to 2020, CEDA had created 15,000 jobs through funding of 5,410 businesses, while supporting investments amounting to US $200 million in the same period[8]: These are not small figures in Botswana's context.

While carrying out the same policy objectives of developing and supporting entrepreneurship among citizens, CEDA has combined commercial principles with public sector policy to deliver its mandate on more efficient and sustainable basis.

Other Supporting State-Owned Enterprises

Overtime, the Government of Botswana continued to set up certain institutions, often loosely classified as DFIs for the central role they play in either facilitating core DFIs to achieve their mandates, or pursuing policy objectives that would typically sit with a DFI (Table 10.1).

[7] See www.ceda.co.bw.

[8] www.ceda.co.bw/president-masisi-launches-revised-ceda-guidelines-0.

Table 10.1 An outline of DFI supportive institutions in Botswana

Institution	*Description*
Botswana Housing Corporation (BHC)	• Formed in 1971 through an act of Parliament, Botswana Housing Corporation, CAP 74:03 • Stated objectives; a. To provide for the housing, office and other building needs of the government and local authorities; b. To provide for and to assist and to make arrangements for other persons to meet the requirements of paragraph (a) c. To undertake and carry-out and to make arrangements for other persons to undertake and carry-out building schemes in Botswana DFI Policy angle: BHC has for years executed housing schemes across the country, running tenant purchase schemes that permitted increased home ownership, including in peri-urban areas where mortgage finance from commercial Banks could not be available

Institution	*Description*
Local Enterprise Authority (LEA)	• Established in 2004 by an Act of Parliament, Small Business Act of, 2004 • Key objectives (among others); a. To assist SMMEs with business planning, business kills; unlock growth opportunities, b. To promote and facilitate SMME-big industry linkages, access to supply chains and technology, c. To promote products and service standards among SMMEs d. To monitor and evaluate effectiveness of Policy interventions by LEA DFI Policy angle: Since its formation, LEA has been complementary to CEDA in preparing small businesses for financing by the latter (including any other institution). The Agency has been pivotal in addressing common factors leading to high business failure rates
Botswana Trade and Investment Center (BITC)	• Formed in 2012 through an Act of Parliament; the Botswana Trade and Investment Centre, 2012 • Consolidation of former Botswana Export Development Authority (1997) and the International Financial Services Centre (1999) • The objectives of BITC include the promotion and attraction of inward investments, export promotion and development and management of the Nation's brand DFI angle: The facilitation of access to external markets by local enterprises, among others, is complimentary to DFI objectives

Source Author's compilation from the relevant founding law instruments (i.e. Botswana Housing Corporation Act, Small business Act, Botswana Investment and Trade Centre Act)

The SOE Rationalisation Programme

After years of intimating, in April 2022, the Government finally announced firm action plans to rationalise State-Owned Enterprises through a programme aimed at eliminating mandate overlaps, inefficiencies and crowding-out of the private sector. DFIs were impacted, the highlight of which was that CEDA and LEA are to merge. Observers have pointed to this as a potential mis-step, arguing that LEA was not incorporated to serve CEDA clients, it was set up to promising entrepreneurial dreams irrespective of who will provide capital. It was set up to support even those with intentions to seek private capital from commercial banks, but it is yet to be seen how the new model will work.

Similarly, NDB is to be designated a 100% Agri Bank, and the intention is to have CEDA and BDC transferring all their Agri-assets to NDB for consolidation, with NDB doing the reverse with their non-Agriculture portfolios.

Traditional Agri-assets have predominantly been a non-performing class across Botswana; thus, implications of concentrating them under one entity remain to be well understood. Further, the micro and wide dispersion nature of Agri business start-ups raises questions on NDB's suitability as a financier of choice, compared to CEDA which was designed for micro start-ups. CEDA has a wide footprint across the country, whereas NDB does not. These factors by themselves do not point to a bad policy stance, rather, they have important bearing on implementation.

10.3 Botswana Development Corporation (BDC)

BDC's Context

Right from inception, BDC was the main investment arm of government, focusing on setting up mid-large-scale commercial undertakings in Hotel and Tourism, commercial and residential real estate, agro-processing and manufacturing, among others. These industries were absolutely critical in supporting a booming economy, which was driven in the main by diamond mining. The population numbers were also rising, with notable inflow of expatriates; hence, BDC was that entity that accelerated the availability of supportive amenities (city standards accommodation, leisure and convenience) and setting up of industries outside mining. Of interest to note is BDC's investment model at that time; partnering directly with foreign enterprises to set up shop in Botswana through equity holdings.

However, the model was not fixed, but rather set to evolve with realities in the landscape of the national economy and government's development priorities at a given period.

Below are snap shots of BDC investment structure over its more recent history (Figs. 10.1 and 10.2).

With such a structure, BDC had a more than just financing role which a 1974 world Bank mission[9] phrased as "…[BDC] performs a basic entrepreneurial role in conceiving and developing projects. It is the principal instrument of the Government for accelerating the development of commercial business enterprises in a variety of sectors". This twinned mandate, combining entrepreneurial roles with financing, has the advantages, principally through equity investments of driving impact and influencing market development through three leverage points of equity: entry, governance and exit (Lahaye, 2016; in Morretto et al., 2017).

Another important piece in the history of BDC is its pivotal role in the development of Selibe-Phikwe, a mining town in the far eastern part of the country. Mining operations (production of copper nickel) commenced in 1973 and a year earlier, at the request of the government, BDC had taken charge of commercial developments in the town, mainly using its unique investment model to develop commercial and industrial buildings, including a hotel. The Corporation pursued the developments in the mining town through two of its wholly owned subsidiaries (private companies incorporated under company law), Botswana Hotel Development Company and Commercial Holdings. These subsidiaries were however not dedicated to the town and had interests elsewhere, notably in Gaborone, the capital city.

[9] In June 1974 the World Bank fielded an Appraisal mission to Botswana, the purpose of which was to conduct an Appraisal on Botswana Development Corporation for possible financing. The mission recommended a loan facility of US $ 4 million to BDC (US $1 was ZAR1.49 at June 6, 1974: Botswana was using the South African Rand, ZAR as it currency then).

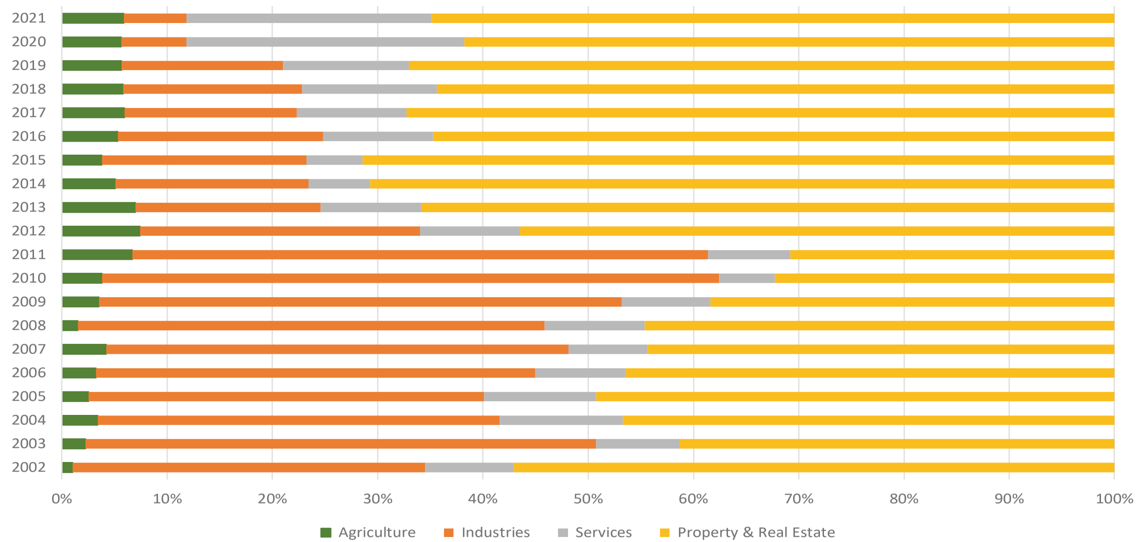

Fig. 10.1 BDC's investments by sector (2002–2021) (*Source* Author's compilation from BDC's annual report overtime)

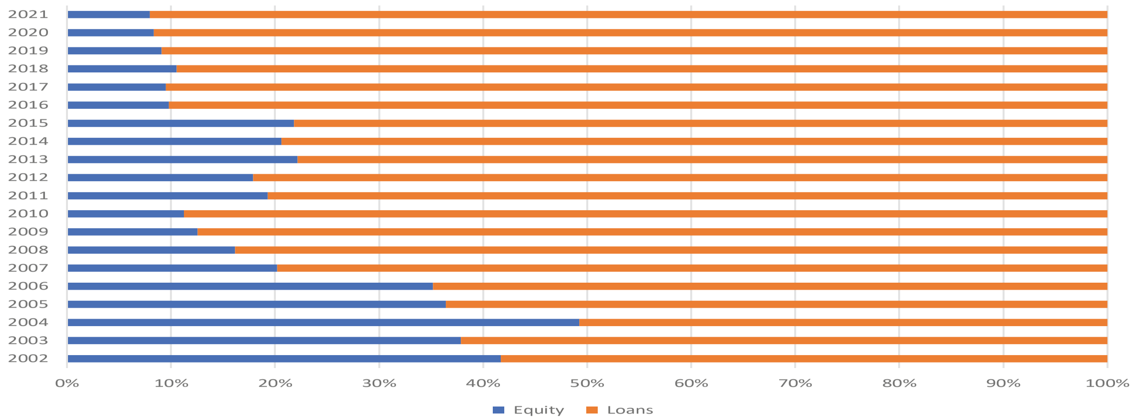

Fig. 10.2 BDC's investments by instrument (2002–2021) (*Source* Author's compilation from BDC's annual report overtime)

Institutional and Governance Set up

Legal Structure

BDC is a company duly incorporated under the Company law of Botswana, as a "private limited" company with its shares (common stock) wholly held by the Government (Represented by the Ministry of Trade and Industry). This is a departure from the norm with other State-Owned Enterprises, which are commonly set up through a statutory instrument passed by parliament. The merits of such an arrangement are real; the entity assumes obligations and discipline expected of a private company, deals with stakeholders (notable credit markets) as a private company subjected to all levels of scrutiny as the law may require. Under this arrangement, however, the Government still maintains control and a significant level of influence, but on the basis of a sole shareholder exercising her rights.

It is worth noting that BDC is a self-regulating institution, with performance reporting obligations to both the Public Enterprises Evaluation and Privatization Agency (PEEPA) and the Ministry of Investments and Trade. As a private limited company, the Corporation remains compliant to the regulations of the Company and Intellectual Property Authority (CIPA) which call for, among other things; filing of annual returns and notices as well as the maintenance of an up to date register of directors and company secretary.

The Board

As mandated by law, BDC's constitution requires the company to have a Board of Directors, whose composition shall predominantly be of independent non executives. Board appointments are through a process coordinated by PEEPA, a specialist state body set up to monitor the performance and privatisation of State-Owned Enterprises in Botswana. The agency kickstarts the process by inviting suitably qualified members of the public to express interest in writing, and the invitations expressly state qualifications and experience. Once the window for expressing interest closes, PEEPA screens the applications, and nominate potential candidates based on a balanced mix of core competencies and skills as well as relevant experience. Typically, a BDC Board has a mix of the following skills; Accounting/Finance, Law, Human resources, public policy and real estate.

Table 10.2 BDC's key governance instruments

Instrument	*Purpose*
Shareholder Compact	This is the Performance Contract of the Board with the Government (Shareholder), among others it; • Sets out performance expectations of the Ministry with respect to agreed objectives and targets of a BDC and how they will be met • Describes expected governance standards of the BDC • Outlines relationship between shareholder and Board to support effective oversight • Complements the Companies Act/enabling statutes
Board Charter	The Board Charter exists to govern the operations of the Board, and specifically; • Provides clarity to Board's role and functions • Outlines financial governance issues (compliance and reporting, risk management, etc.) • Establishes reporting lines and accountability • Prescribes procedural matters • Complements Memorandum and Articles of Association

Source www.peepa.co.bw

The nominated candidates are then recommended to the Minister of Trade and Industry, who may further consult as she deems fit before making formal appointments. The Minister also appoints the Chairperson while the Permanent Secretary (Ministry of Trade and Industry) is by default the shareholder's representative on the Board.

Two key instruments exist to provide the basis of Board operations, as well as evaluation of their performance, these are outlined in Table 10.2.

Committees of the Board

As permitted by its charter, the BDC Board has four (4) standing committees as presented in Table 10.3.

Evaluation of the Board

An annual Board evaluation is conducted, as required by the charter. The evaluation is carried out on each individual member as well as the Board as a collective, and the same applies to Board Committees. The exercise is coordinated by a third party independent from the Board, typically an external professional services firm.

Table 10.3 An outline of BDC's committees of the board

Committee	*Composition*	*Purpose*
Board Tender Committee	• 3 Non-Executive Directors • 1 Executive Director • 1 Independent Director • Company secretary	• Acting on behalf of the Board, the committee maintains oversight of procurement policy compliance, ensuring fairness and transparency in the process of procurement for works and services. Depending on internally set limits, the committee from time to time adjudicates procurement tenders and makes decisions
Board Finance and Audit Committee	• 3 Non-Executive Directors • 1 Independent Director • Company secretary	• The committee exists to assist the Board in matters of financial policies, controls and reporting. Acting on powers delegated by the Board, the committee considers internal and external audit reports and provide oversight in implementation of audit recommendations. Internal Audit reports directly to this committee, while the committee is the interface between the Board and external auditors

(continued)

Table 10.3 (continued)

Committee	*Composition*	*Purpose*
Board Risk and Investment Committee	• 4 non-Executive Directors • Company Secretary	• Acting on behalf of the Board, the Committee provides an oversight of the investment and credit policies and strategies. Depending on internally set limits, the committee considers investment proposals recommended by management, approves some and recommends those above its authority limits to Board for consideration
Board Human Capital Committee	• 4 Non-Executive Directors • Company Secretary	• The committee, acting on behalf of the Board provides oversight on overall people strategy, including talent sourcing and retention, welfare, development and remuneration

Source BDC Annual Reports

> The annual [Board] evaluation is aimed at finding a balance between the increased demands for Boards to be accountable, effective leadership, and performance of the Board. Fiduciary duties, risk management, strategic leadership, and direction are the focus areas for the assessment.
> The Board evaluation focused on the role of the Committees, remuneration of the Board members, competency of the Board in line with BDC's mandate and statutory requirements,

the size of the Board as well as the ability of the Board to meet as mandated. The outcomes of the evaluation across the scope highlighted above reflected that the Board scored and/or ranged from 70 to 80%.
Following the evaluation, recommendations were made that would continue to have the BDC Board exercise its mandate in line with corporate governance best practices, and improve where necessary. Management continues to explore and/or implement the recommendations.
Source BDC Annual Report: 2021

There is a plan in place to offer Directors continuous training and development opportunities, and a pipeline of possible successors (particularly for the Board Chairperson) is maintained at all times, with candidates' readiness and availability linked to the overall director rotation plan.

The Business and Investment Model

BDC's business and investment model has evolved overtime, most importantly aligning to the phase of development of the national economy, and the specific role BDC would be expected to play in rolling out national development priorities, but specifically linked to its mandate. Below is an extraction from the Corporations website[10]:

BDC's Mandate
BDC's primary mandate is to drive the Industrialisation of the country by providing financial assistance to investors with commercially viable projects. BDC provides both debt and equity financing to commercially viable projects that perform one or more of the following functions:

[10] https://www.bdc.bw/bdc-mandate-and-structure.

- *Pioneer new industries*
- *Unlock value in existing industries*
- *Stimulate private sector growth and foster linkages with the local and foreign investors*
- *Drive diversification and exports*
- *Create significant employment.*

Sectors

The Corporation Invests in commercially viable projects in all sectors of the economy except large-scale mining. These sectors include:

Industry / Manufacturing
Agriculture
Services
Property & Infrastructure
Energy

BDC finances companies only, typically well-established entities seeking expansion capital, or foreign established enterprises seeking to set up in the country through partnerships with local enterprises. Traditionally, the Corporation has offered its financing through term loans, equity, debentures and preference shares. Over the years, BDC has been offering variants of mezzanine finance and borrowing from principles of private equity and venture capital in extending capital to less proven investments with high potential for returns or high development impact.

From inception to date, BDC can be seen as having gone through three phases characterised by evolving business and investment models;

a. **Formative years: 1970 to 1990s**

BDC was formed at a time when the then "young" government of Botswana was resolute in constructing a pragmatic industrial policy through which development and employment creation were to be achieved. In this regard, considerable progress had been made by 1970 to create the necessary infrastructure and institutional framework aimed at inducing both domestic and foreign investments (World Bank, 1974). Given the critical lack of domestic capacity for meaningful investments, BDC then became an important catalytic agent of government in stimulating and supporting domestic investments, while at the same time scouting for foreign investors who would then come into the country on models that varied, including equity participation (co-investing) in targeted industries critical to the overall development objective of Government.

In the first 4 years to 1974, there was huge focus on non-public real estate developments, with BDC's portfolio growing to ZAR2.5 million spread in residential, commercial and industrial investments, among other sectors. The major investment instrument was equity in subsidiaries and non-controlled associates, with the subsidiary and associate companies also obtaining loans from BDC on favourable terms. By 1974, the portfolio of companies comprised 7 subsidiaries and 5 non-controlled entities (Fig. 10.3).

Thus, BDC started off as a critical precipitant of an accelerated development agenda, bringing in much desired foreign partners into the country's emerging industries where no local partners existed. In doing so, the corporation was effectively underwriting risk by injecting equity. It was through this model that BDC brought into Botswana some of the very first larger scales hotels, manufacturers and key heavy industries.

Funding and Capitalisation During the Formative Phase

A well thought out plan was in place right from inception to support BDC on its mandate as an agent of development for the Government. In 1970, the Government had funded the Corporation through an equity injection of ZAR1.9 m (against authorised ordinary share capital of ZAR2.1million, and a further ZAR0.3 million in authorised preference share capital). Government's subscription through direct cash transfer was

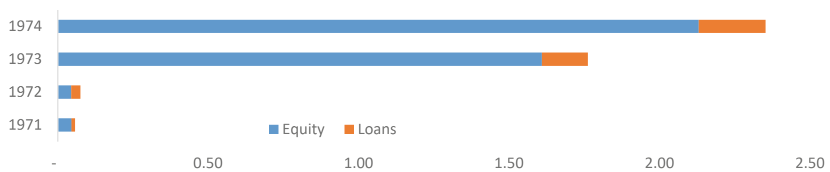

Fig. 10.3 Early Investments by Instrument Type (ZAR' million) (*Source* World Bank [1974])

only ZAR0.3 million, supplemented by reserves from a sugar importation operation the Government had transferred to BDC. The balance was made up of assets transferred to the Corporation from Government, majority of which were tourism assets.

Building up on the initial capital base, BDC was expected to make returns from its operations. Typically, the Corporation was charging a blended rate of 9% on loans it extended to companies, and also charged fees aligned to market practice. On the equity side, BDC was getting fair representation on its investee company Boards, and ensured a balance on returns and sustainability when influencing dividend payout profiles. Government deliberately stayed out of such decisions.

In 1973, the International Bank for Reconstruction and Development (The World Bank) assessed the early operations of BDC, as well as its 5 year investment pipeline. The World Bank subsequently approved a loan of $4 million, with a $0.8 million ringfenced for funding foreign currency components of BDC's pipeline (mostly associated with developments taking place in the town of Selibe Phikwe).

From inception to the early 1990s, BDC continued on a growth path, remaining commercially focused while supporting the development agenda. The Corporation was a key source of "patient" capital, i.e. loans issued at concessionary, pro-development terms to sustainable businesses with longer pay back profiles. The investment philosophy gradually transformed, as has been the capital structure in line with the nature of the role BDC would play in the national development agenda.

As we it can be discerned from paragraphs that follow, BDC's sources of capital were gradually diversified post the Corporation's formative phase to include foreign multi-lateral DFIs, local commercial banks and bond issuances from local capital markets.

b. **A phase of growth and pro-active participation in the economy, and important lessons: 1990s to mid-2013**

The BDC growth story continued into the 1990s, with noticeable expansion into other sectors of the economy. Through its various real estate subsidiaries, the company significantly grew its property portfolio. The Hotel Development Company acquired land and developed Hotels, and in turn BDC would own a minority stake in the operating company, typically in partnership with strong regional brands. The Western Industrial Estates Company, an industrial property focused subsidiary, also significantly expanded its footprint of warehouses in various towns of the country, in most cases developing for demand occasioned by industries either setting up in Botswana or the expansion of existing ones. Similarly, another subsidiary, the Residential Holdings Company also expanded its stock of residential houses and apartments, in most cases catering for the upper middle class where there was a shortage, mostly for expatriates but also for locals whose income levels were gradually rising.

Outside real estate, BDC set up wholly owned subsidiaries focusing on floor tile manufacturing, fruit juice production, road construction, clay brick manufacturing, can manufacturing, export credit insurance, amusement (a theme park) and a few others. These subsidiaries would run independently from BDC, with their own management although their Boards would be constituted mainly by staff from BDC.

Unfortunately, apart from the property companies, most of BDC's wholly owned subsidiaries did not really perform well, mostly failing in a very short period of time. A well-publicised failed investment by BDC is the Fengyue Glass Manufacturing company, which collapsed before commencing the production of its primary product, float glass. At the point of failure, BDC had expended about USD65 million (estimated to have been 70% of total budgeted project capital), yet less than 50% of the project works had been delivered.[11] This company was supposed to be a partnership between BDC and a Chinese glass manufacturer, Shanghai Fengyue Glass Co. Limited.

Bad investments eventually caught up with BDC, impairment provisions and write offs rose to concerning levels overtime. Notably, Lobatse Tile Company, a floor tile manufacturing subsidiary was liquidated and written off BDC books in 2009, throwing BDC into its first loss in a decade.

In 2013, BDC had to restate its 2011 and 2012 financial results to recognise the investment into the Fengyue Glass Manufacturing Company as fully impaired, resulting in huge losses reported for the three years to 2013. A forensic audit into the investment, as well as a

[11] This was revealed by a Special Select Committee set up by the National Parliament to conduct an inquiry over alleged corrupt practices concerning the Fengyue Glass Manufacturing Project.

subsequent inquiry by a select committee of Parliament did not rule out corrupt practices by those involved in the project.

BDC's success gradually turned into a failure, and the reasons could be many. Most notably though, the company was expanding fast into unknown territories, with a business model that was almost akin that of a venture capitalist. While there is nothing wrong with infusing different approaches to investment, the company did not invest in commensurate skills, and almost missed the opportunity to realise the uniqueness of the model they underpinned their expansion on. BDC approach to investment denied them an opportunity to see things independently and objectively in that staff would source business deals, conceptualise them with promoters, perform due diligence, structure the funding, supervise implementation and later sit in boards.

The failed investments suggest flawed due diligence processes employed by BDC; Lobatse Tile Company failed as a result of lack of sufficient market for its products (although the country continues to import floor tiles); Fengyue Glass Manufacturing Company could not complete its production facility and a number of reasons were given: cost overruns, a partner with no experience on projects of similar type and magnitude to the one they were roped in to implement, and corrupt practices. Subsequently, attempts to revive the project to completion were aborted as a more informed due diligence process pointed out there is no business case (some raw materials targeted to be sourced locally were not suitable for the intended product, logistics to ferry product to final markets were not well thought out, etc.).

c. **A phase of transformation and internationalising: 2013 to date**

In April 2014, the Government appointed a new Managing Director, giving him a specific mandate to transform BDC. This was an individual who spent a major part of his career as a consultant, mainly involved in strategy and organisational transformation. The new MD took some bold steps early on; he suspended business, i.e. stopped origination and limited disbursements to only where BDC had legal commitments to honour. He restructured the management team, bringing in new executives with local and international experience, and most importantly bringing in investment and risk management skills that would be handy in building a sound investment portfolio. BDCs investment mandate remained, but the business model was altered to one where equity investments would be limited, and replaced by new alternative investments (mostly mezzanine finance and pure debt). There was a major policy overhaul and BDC team's role in the investment cycle was redefined, with an arrangement to use external independent consultants to conduct full scope due diligence on new projects, and the same applied for supervision of implementation of BDC funded projects. Total head count reduced by 33%, and by 2016 majority of the staff complement had been with the organisation for 2 years or less.

There was a significant clean up of the investment portfolio, selling off quite a number of idle assets and ailing entities of no strategic fit. The proceeds were used mainly to pay-off unsustainable debt which in part had been taken to finance the failed investments.

With a cleaned-up portfolio, revamped control environment, a refined investment strategy and a more curated approach to credit risk, a pipeline of investment was gradually built. BDC approached Moody's for an independent assessment and credit rating, and the outcome was a favourable investment grade rating. With this, BDC was able to approach market for more sustainable funding, setting up and drawing down on a USD100 million medium term bond programme in 2016, with the issuances listed on the Botswana Stock Exchange. A further credit line of USD76 million was approved for BDC by the African Development Bank in 2016 (this was signed in 2019). The funding facilities were supplemented by a credit guarantee from the African Guarantee Facility (AGF) which would cover any subsequent borrowings from local commercial banks.

The transformation brought the desired results; BDC bounced back to profitability in 2015, and has not reported a loss since then (as of 2021), and has continued to pay dividends to Government. The company now has investments outside Botswana, and with more industry-diversification.

10.4 Major Achievements and Challenges

By many measures, BDC has been very instrumental in the development path of Botswana, pioneering the local hotel industry by building into the country strong brands through partnerships. The first was the Phikwe Hotel, which was set up in a then fledgling mining town of Selibe-Phikwe following the commencement of Copper Nickle mining in 1973. The corporation replicated its success, setting up more hotels around strategic areas of the country into the 2000s. To date, the only hotel listed in the local stock exchange, Cresta Marakanelo, is a BDC investment, and it continues to expand sustainably to this day.

BDC has been instrumental in shaping commercial farming as it is known in Botswana to this day, setting up large-scale farms in a suitable area in the deep eastern parts of the country, bordering South Africa. Over the years, the operating model in the farms changed, and so was the crop produced and partners.

The beverages industry was set up by BDC through a partnership with a South African Outfit, Sab Miller. BDC had invested in a locally incorporated giant, Sechaba Breweries Holdings, that then con-invested with SAB Miller in entities producing and owning clear and opaque liquor and non-alcohol drinks. To date, Sechaba Breweries Holdings is among the top 6 companies by market capitalisation in Botswana.

A vast majority of industrial buildings in Botswana, and a significant stock of commercial and residential developments were originally built by BDC. Quite notably, in 2010, BDC selected a number of premium properties across its Hotel Development, Commercial Development and Residential Development subsidiaries and transferred them to a newly set up entity, Letlole La Rona, which then got listed in the Botswana Stock Exchange. The company has significantly grown since then.

In addition to the significant contribution BDC has made to the local stock exchange through equity listings, BDC to date continues to be a notable issuer of listed bonds.

The above are only but a few examples of what great outcomes BDC has delivered for Botswana over the years, but they are other successful stories, including numerous former BDC companies that are now flourishing under private ownership including the largest private hospital in the country, game farms, construction enterprises, asphalt enterprise, hotels and lodges and many others. All these, and those cited before them have been and are still crucial in employment and job creation while contributing to GDP growth.

BDC has not been without challenges though. Some well-intentioned investments went bad, costing the country huge sums of money, but most importantly, lessons were learnt. The Corporation ventured into investment models they were not accustomed to along the way, compromising greatly on basic tenets of good governance. They failed to take into account the need to transition their traditional skills mix in tandem with their evolving business model, both at management and board level. Along came allegations of serious corruption, and possible unwarranted political interference. The result was a rapt deceleration in financial and operational performance which saw a complete stoppage of business due to lack of capital.

Getting out of the dark place called for a spirited transformation, which although was a resounding success, faced its own challenges, chief among others being an impaired ability to attract the right skills into the business, reducing the crippling levels of debts and re-gaining credibility among providers of capital.

10.5 Conclusions

Development Finance Institutions (DFIs) have played a pivotal role in the development of Botswana, emerging overtime to pursue specific mandates which the Government was not best placed to fulfil, but at the same time, which private sector interest could not be attracted. Care was greatly exercised to avoid, or at worst minimise scope overlap on DFI mandates. Among a number of DFIs in Botswana, this chapter focused on BDC.

BDC was formed by Government with a specific mandate to lead industrialisation of the country, specially modelled around the state of development the country was in. Most importantly, BDC has always had a latitude to evolve over time and adapt operating and investment models to emerging needs. BDC has been a success story, but with important lessons to learn; the investment footprint grew from zero to substantial amounts, touching all key sectors of the economy over four decades. BDC has been responsible for massive amounts of foreign direct investment through equity partnerships with international brands, while leading the emergence and later the critical expansion of key sectors of the economy, notably agriculture, real estate, tourism and manufacturing.

By early 2010s, however, BDC started experiencing signs of distress on its financial and operational health, characterised by heightened impairments and allegation of corrupt practices within the company. By 2013, the losses were too huge to ignore, and the Government had to intervene. Among other things, BDC had gradually shifted its investment model towards one linked to venture capital, but failed to equally migrate its skill base, investment philosophy, credit practices and investment governance towards the new paradigm, leading to costly investment decisions. The decisive actions by Government to quickly transform the Company in 2014 saved the day, and this entailed bringing in a new leader who implemented key changes including bringing in new executives with requisite and diverse skills, re-writing the strategy and government tools, bringing in a new independent Board and revamping key policies. The operating model was significantly altered to adapt to new norms. The changes bore fruit, for by 2021, the company had remained soundly profitable, with a diversified investment portfolio which straddled to foreign jurisdictions.

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CHAPTER 11

The Infrastructure Development Bank of Zimbabwe and Infrastructure Financing

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11.1 Introduction

Infrastructure development is critical in driving economic growth and development. However, poor infrastructure development and expansion, which are heavily driven by funding shortfalls, continue to be key barriers to global economic growth and development especially in developing countries. In Africa, limited access to sustainable infrastructure has been

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identified as one of the critical developmental challenges facing the continent and this tends to constrain productivity and limits the continent's gross domestic product (GDP) potential (Abor, 2023; Kuttu et al., 2020). Development finance institutions (DFIs) have recently been thrust back into the limelight of global discourse, notably in the context of infrastructure development. As a result of the global financial crisis in recent times, DFIs are gradually filling the gap in infrastructure funding that had previously been handled by national governments.

Over the years, DFIs, including National Development Banks (NDBs), have been instrumental in providing long-term finance for development projects. For instance, they are proven to play a significant role in providing funding for infrastructural development in general and complementing governmental and private investment in infrastructure. NDBs are designed to provide long-term financing to support infrastructure development given the huge volume of initial investment required (Abor, 2023). They are well-suited to finance infrastructure projects, which often have longer payback periods. Hence, they have become the backbone in providing sustainable financing for developmental projects which include renewable energy, sustainable agriculture, and water and sanitation (Pere, 2021). Furthermore, NDBs are often able to provide financing for projects that may be considered too risky for commercial banks. This is particularly important for projects that have significant social and environmental benefits but may not generate immediate financial returns. NDBs are also able to work with governments and other stakeholders to design innovative financing instruments that can address infrastructure development challenges in emerging markets (Pere, 2021). They operate in different forms and structures in various countries, depending on their legal frameworks, ownership structures, and areas of focus. However, they all share a common goal of promoting development within their respective countries.

This chapter provides a case for the Infrastructure Development Bank of Zimbabwe (IDBZ). The chapter provides an overview of DFIs in Zimbabwe, the profile and history of IDBZ, and the political economy and institutional context of the bank. The chapter then examines the corporate governance arrangement, risk management practices, regulation and supervision, monitoring and evaluation, and impact evaluation practices of the bank. The chapter also discusses the main achievements and challenges confronting the bank and evaluates its financial performance.

11.2 Overview of Development Finance Institutions in Zimbabwe

DFIs are essential for providing strategic funding to businesses, and areas of social and economic activity that are normally undesirable to private and commercial banks (Abor, 2023). In Zimbabwe, DFIs are specialized financial institutions established by the government to provide long-term financing for developmental projects in the country. These institutions play a critical role in promoting sustainable economic growth, reducing poverty, and achieving social inclusion, among other developmental metrics. The development of DFIs in Zimbabwe in the early years of independence provided long-term financing for the development of specialized projects in the country. The first DFI in Zimbabwe was established in 1980, shortly after independence, with the establishment of the Agricultural Finance Corporation (AFC). Since then, several other DFIs have been established in the country, each with a specific mandate and focus on different sectors of the economy.

There are about six DFIs in Zimbabwe, including the Agricultural Finance Corporation (AFC), Infrastructure Development Bank of Zimbabwe (IDBZ), Small and Medium Enterprises Development Corporation (SMEDCO), the Zimbabwe Women's Microfinance Bank (ZWMB), the Zimbabwe Asset Management Corporation (ZAMCO), and Empower Bank. These DFIs are structured differently and each of them has a specific mandate and focuses on different sectors of the economy. They receive subsidies from public funds to execute their mandate. The government provides financial incentives to DFIs in many different forms, including low-cost borrowing, low-cost guarantees, exemptions from reserve requirements and taxes, and partial or complete government financing of its operational costs and capital transfers.

Although these DFIs in Zimbabwe may have a common goal of contributing to sustainable development in Zimbabwe, they have specialized mandates. For instance, the AFC provides financing for agriculture projects, with a focus on supporting smallholder farmers. The AFC offers a range of financial services, including loans, grants, and technical assistance to help farmers increase productivity and improve their livelihoods. The IDBZ provides financing for infrastructure projects, including energy, transport, water, and sanitation. The IDBZ works with both the public and private sectors to finance infrastructure projects that promote sustainable economic growth and development. The SMEDCO provides financing for small and medium-sized enterprises (SMEs) in Zimbabwe. The institution offers a range of financial services, including loans, equity financing, and technical assistance to help SMEs grow and become more competitive. The ZWMB provides financing and other financial services to women entrepreneurs and small business owners. The ZWMB aims to promote financial inclusion and economic empowerment for women in Zimbabwe. ZAMCO was established in 2014 as a resolution vehicle for non-performing loans in Zimbabwe. The institution works with banks and other financial institutions to acquire and resolve non-performing loans, with the aim of improving the stability of the financial sector in the country. Empower Bank is the latest DFI established in 2018, with a focus on providing financing and other financial services to the youth and women entrepreneurs. The bank aims to promote financial inclusion and entrepreneurship among young people in Zimbabwe.

11.3 Profile and History of Infrastructure Development Bank of Zimbabwe

The IDBZ was established on August 31, 2005, taking over the assets and liabilities of the erstwhile Zimbabwe Development Bank (ZDB). The IDBZ was primarily created as a tool for promoting economic development and social growth as well as raising Zimbabweans' standards of living through the provision of infrastructure, including but not limited to energy, transportation, water and sanitation, information and communication technology (ICT) and housing. The bank was established by an Act of Parliament, Act Chapter 24:14. The IDBZ Act (Chapter 24:14) requires the bank to build institutional capacity for firms to engage in infrastructure development in Zimbabwe. The bank's corporate mandate as prescribed by the IDBZ Act (Chapter 24:14) includes:

- promoting economic development and growth, and improving the living standards of Zimbabweans, through the development of infrastructure.
- developing institutional capacity in undertakings and enterprises of all kinds in Zimbabwe.
- supporting development projects and programmes in infrastructure sectors of the Zimbabwean economy.

The bank is owned by the government of Zimbabwe (87.24%), the Reserve Bank of Zimbabwe (12.43%), local institutional investors and foreign DFIs (0.33%). The Public Finance Management Act [Chapter 22:19] No. 11 of 2009 and the Corporate Governance Framework for State Enterprises and Parastatals of November 2010 also serve as guidelines for the institution in its daily activities. Through an amendment by parliament to the Banking Act [Chapter 24:20], IDBZ was placed under the supervision of the Reserve Bank of Zimbabwe (RBZ), which took effect on 2 January 2015. Hence, the IDBZ operates within the regulatory framework and statutory requirements issued by the RBZ. However, the commercial and mandatory operations of the IDBZ slightly differ from the rest of the banks regulated by the RBZ due to its social enterprise motive in the infrastructure provision of the country.

The bank aims among other things to "champion sustainable infrastructure development through: mobilization of resources; capacity building; and knowledge generation and sharing in support of national efforts for inclusive socio-economic development" based on the corporate principles of professionalism, innovation, integrity, sustainability, service orientation, among others. IDBZ is a major player in the infrastructure and utilities sector. In general, this cluster is anticipated to act as a catalyst since a strong, complex, and resilient infrastructure lays a solid foundation for national economic growth. The bank operates under the ZimAsset agenda, which lists the recovery of utility services in Zimbabwe and the rehabilitation of infrastructural assets as the cluster's primary areas of concentration. The primary role and mandate of the bank is to serve as a vehicle for the promotion of economic development and growth, and improvement of the living standards of Zimbabweans through the development of infrastructure.

According to the World Bank (2012), Zimbabwe needs to raise around US$33 billion over the next 20 years, which equals US$1.65 billion annually. Estimates of the infrastructure investment requirements might be 20% higher than the baseline scenario of US$40 billion over the next two decades if Zimbabwe were to pursue a growth path more in line with that of a middle-income nation (Lim & Pommerenke, 2012). Zimbabwe needs to attract investment to modernize and expand its electricity infrastructure, transport, ICT, and other critical social infrastructure to fill the gaps occasioned over the years.

11.4 Political Economy and Institutional Context

In order to accomplish a complete transformation of the economy, DFIs in Zimbabwe have been categorized and given the mandate to carry out certain developmental programmes and interventions for different segments of the country's economy. As a result, participation and access to infrastructure have become critical in the nation and have been listed as a development strategy in the government's national recovery programme. The recovery agenda of the Zimbabwean national development policy strategy from the effects of the country's economic recession and hyper-inflation in the 1990s and recent global economic shocks, which impeded inclusive growth and economic development, depends on both the private and public sectors' access to financing in order to invest in the structural growth of the economy (Bradlow & Humphrey, 2015).

To ensure a sustainable structural transformation, the IDBZ has been given the responsibility to launch an infrastructure expansion programme in four areas, including transportation, energy, information and communications technology (ICT), and social infrastructure in health, water and sanitation, and education. This would guarantee inclusive growth and the expansion of improved institutional and human capability to encourage full involvement and contribution to the country's development. In accordance with the priorities of the national development plans and strategies, the bank's initiatives are designed to address gaps in access to diverse services in the areas of health, education, water and sanitation, as well as ICT. This is accomplished by using the bank's infrastructure-driven approach, which involves organizing, financing, planning, carrying out, and sustaining development projects.

IDBZ's 2020 annual report states that the bank is legally mandated to assist sustainable development through its operations and that this is incorporated in the Bank's strategy. IDBZ also works with other state institutions in carrying out its mandate by developing operational strategies that are in line with the national development strategy. Additionally, the Sustainable Development Goals (SDGs) of the United Nations, the African Union's Agenda 2063, and the Vision 2030 of Zimbabwe, all guide the developmental and operational activities of the bank.

The IDBZ, through its policy partnership with regional bodies, has collaborative strategies to ensure collective development, especially in the sub-region. The Southern Africa Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), the African Development Bank, the UN Economic Commission for Africa (UNECA), and the French Development Agency are all part of the IDBZ's regional development and integration strategy, which aims to leverage infrastructure investments across the continent in order to improve connectivity and trade within Africa and to foster the growth of local industries and markets within the region.

The bank's operating activities are impacted by the dynamics of the world's economies and governments. Its planned programmes have suffered as a result of multiple global shocks, including the Global Financial Crisis, the COVID-19 pandemic, and the Russia–Ukraine war. The bank receives funding from its bilateral partners as well as from the issuance of bonds on the international and domestic capital markets. Therefore, any external shocks that increase borrowing costs, restrict capital flows and trigger liquidity crisis, constraint the bank's efforts in raising the required funds for its operations and planned programmes. Further, an increase in uncertainty on the global financial ecosystem has a direct and indirect impact on the IDBZ's capacity to raise the required funding to execute its agenda.

The main party involved in the bank's operations is the Zimbabwean government. Important IDBZ stakeholders include the Reserve Bank of Zimbabwe, the Parliament of Zimbabwe bilateral partners, institutional investors, DFIs and commercial banks. The bank is overseen by the Reserve Bank of Zimbabwe and is partially governed by its main shareholder, the government. The main shareholder is represented by the minister of finance and economic development. Through ongoing engagements, rating agencies play a significant role in the regulatory framework for the bank.

11.5 IDBZ's Corporate Governance Arrangements

In carrying out its statutory duties, the IDBZ adheres to the fundamentals of good corporate governance and ensures these are ingrained in all of its business operations. Although the IDBZ Act serves as the matrix's anchor for institutional governance, an improved governance system has since been developed for the bank, as a public organization. Any other corporate governance law is superseded by the Public Entities Corporate Governance Act (Chapter 10:33) ("the PECG Act"), which came into effect in June 2018. The PECG Act takes precedence over the Establishing Act to the extent that it supersedes the provisions of the Establishment Act if there are any contradictions between the two Acts. The Office of the President and Cabinet (OPC) is responsible for administering the PECG Act, underscoring the significance the government places on corporate governance in the public sector.

The bank also adheres to the best corporate governance practices embodied in other governance standards, both locally and internationally. The IDBZ Act, as amended, stipulates in Section 4 (2) that there must be a minimum of 7 and a maximum of 9 directors on the board. The bank has eight (8) non-executive directors and the Chief Executive Officer (as ex-officio member), who constitute the current board of directors. The Chairman is a Non-Executive Independent Director.

On the recommendation of the Board, the Minister for Finance and Economic Development and institutional shareholders' designate members of the Board nominate between 12 and 15 people for consideration and appointment. The Minister appoints directors in accordance with their professional qualifications, knowledge of socioeconomic development, development finance, business, banking, administration, or both. Prior to making any such appointment, the Minister consults with the President and follows any instructions the President may provide. Except for the Chief Executive Officer, appointments to the Board are made for terms outlined in the Act or by the Minister of Finance. The majority of the board members must be non-executive directors, and the minister must choose a non-executive director to serve as board chairman. The board has a charter that directs its main operations in accordance with the IDBZ Act and specifies the fiduciary obligations of the directors, their relationship to executive management, and the policy stances that the board and the shareholders should take to ensure the bank's sustainability and efficiency.

The Board has 4 Committees with clearly defined areas of responsibility and terms of reference in order to effectively carry out its duties and to improve supervision of the various areas of the bank's operations. The Committees are the Corporate Governance, Ethics, and Sustainability Committee, Finance, Risk Management, and ICT Committee, Human Resources Committee and Audit Committee.

11.6 Risk Management Practices

The bank is cognisant of the risks to its operations and reputation. As a result, the board of IDBZ is responsible for the risk management of the bank, and this is carried out through the Audit and Finance Committee, Risk Management Committee, and ICT Committee. The bank's corporate governance norms on ethical behaviour, legal requirements, and good accounting practice serve as the framework for those procedures, while the corporate risk management approach and risk strategy established by the Board serve as the foundation for internal control.

Executive management is in charge of assessing the efficiency, scope, and performance of control systems. In order to identify, assess, control, and monitor risks, the bank adheres to an enterprise-wide risk management approach. Internal control and bank risk management policies are approved by the board, while management is responsible for carrying out the risk management practices. Through the numerous pertinent board committees that are in place, the board is kept up to date on risk management issues. The Reserve Bank of Zimbabwe remains one cardinal anchor through its supervisory oversight of the IDBZ to ensure that the bank's operations and activities are not injurious to its sustainability and mandate. Regular reviews of the bank's financial engagements and transactions in the financial market are keenly monitored by the Reserve Bank to ensure compliance and prudence. This is done to mitigate risks of liquidity, market exposures, and credibility with its key partners and stakeholders.

The IDBZ remains exposed to several risks associated with its operations. These exposures are occasioned by both internal and external factors within the domestic and global economic environment, respectively. These factors have implications for the delivery of the bank's mandate. Among the risks that affect the operations of the bank include credit risk, reputational risk, liquidity risk, operational risk, market risk, concentration risk, project risk, business risk, and compliance risk, among other enterprise risks faced by businesses. Therefore, mitigation strategies must be created to guarantee that, even if they do occur, their effects on the bank's operations are mitigated. The bank implemented risk-mitigation strategies through portfolio diversification, monitoring prudential limits, and adoption of strict governance processes in the approval of dealings in transactions between the bank and other parties.

11.7 Regulation and Supervision

The bank is governed by the Infrastructure Development Bank of Zimbabwe Act (Chapter 24:14), which was enacted by the Parliament of Zimbabwe in 2005. The bank's operations are specifically under the Minister of Finance's supervision (IDBZ Annual Report, 2021). The Reserve Bank of Zimbabwe and the Minister for Finance and Economic Development jointly share the regulatory duties of IDBZ under the Finance Act Number 3 of 2014, which amended the Banking Act (Chapter 24:20) to bring IDBZ under the regulatory purview of the Reserve Bank. The macroprudential requirements of the Reserve Bank apply to the IDBZ, thereby serving as a check on its operations. The reputational risk faced by other DFIs that are not supervised by central banks does not affect IDBZ.

The Public Entities Corporate Governance Act (PECG) (Chapter 10:33) of 2018 also regulates the activities and operations of the IDBZ. The Act, by its objectives, supersedes any other regulatory provision and corporate governance arrangements, created by any statute of any state entity, including the IDBZ. The provisions of the PECG Act place the administration and implementation of the act in the hands of the Office of the President and Cabinet, underscoring the immense significance the state places on the governance structure and regulation of the state-owned enterprises in the country. This may serve as a form of executive interference in the performance of the bank's mandate and can greatly undermine the independence of the bank in its decision-making.

The bank, as part of its compliance with other international standards and their requirements, prepares its financial reports based on the Basel requirements. The bank adheres to and maintains an adequate level of capital to support its operations and absorb potential losses. This involves adhering to the minimum capital requirements set out in the Basel framework, particularly focusing on common equity tier 1 (CET1) capital as a percentage of risk-weighted assets. The bank also has a robust risk management practice in place, including stress testing and scenario analysis, to assess its ability to withstand adverse economic conditions and report the same to regulatory authorities. Compliance with Basel requirements involves transparency in disclosing information about capital ratios, risk exposures, and other relevant financial data, which the bank does annually. This transparency helps regulators and the public assess the bank's financial health.

Parliament has the power to examine and approve the bank's borrowing policies and agreements. Other state organizations, such as the Stock Exchange Commission, also have monitoring and regulatory authority over the bank. The laws and recommendations of the commission govern the issuance and flotation of bonds in both the domestic and international capital markets.

11.8 Monitoring and Evaluation Practices

To ensure prudent and efficient investment of financial and human resources in the provision of infrastructure and the expansion of institutional and human capacity, the IDBZ adopts monitoring and evaluation tools to assess the level and impact of various interventions. Monitoring and evaluation enable the IDBZ to evaluate the effectiveness of its interventions in achieving the intended goals and objectives. It involves tracking and measuring progress against predetermined targets, identifying any gaps or bottlenecks, and determining whether the interventions are delivering the desired outcomes. By assessing effectiveness, the IDBZ is able to make informed decisions about the success of its initiatives and to adjust strategies if needed.

The tools of monitoring and evaluation enable the IDBZ to assess the efficiency of its interventions by examining the inputs (financial, human, and technical resources) required in relation to the outputs and outcomes achieved. It helps identify areas of inefficiency, such as cost overruns, delays, or resource misallocation. By analysing efficiency, the IDBZ can optimize resource utilization, improve project management, and ensure that interventions are cost-effective. This helps to measure the impact of its interventions on the target beneficiaries and broader socio-economic development on the long-term effects of interventions, such as improved access to infrastructure, increased economic productivity, poverty reduction, and enhanced quality of life. Accountability is thus assured by providing evidence-based information on the outcomes and impacts of its interventions. This enhances transparency and enables stakeholders, including beneficiaries, government agencies, and development partners, to hold the IDBZ accountable for its actions.

The above monitoring function by the bank is carried out by the strategy and performance monitoring unit with the support of the sustainability and standards certification unit. The bank, however, currently does not conduct an impact evaluation and assessment on its intervention as there is no established department responsible and equipped with the mandate and capacity to do so.

11.9 Business Model of IDBZ

This section discusses the bank's policy mandate, funding sources, lending model, loan pricing, and products and services.

Policy Mandate and Sectors Served

The Zimbabwean government established the IDBZ as a DFI to promote economic development and growth and raise the quality of life of Zimbabweans through the provision of infrastructure. The IDBZ focuses on five primary sectors, which are Water and Sanitation, Housing, Irrigation Infrastructure, Transport, and Energy—with the acronym "WHITE". The bank also focuses on the secondary sectors, including Health, Education, Tourism, and Information Communication Technology (ICT), under the guidance of its Long-Term Strategy (LTS), for the period, 2021–2030.

The goals of the LTS policy framework are to: (i) promote inclusive and equitable development; (ii) develop resilient and sustainable infrastructure; and (iii) build and promote institutional capacity, and knowledge generation and sharing. To achieve these goals of the framework, key strategies have been identified by the IDBZ and its partners as the fulcrums within which the implementation of the interventions must evolve. These include the following: (a) growing a pipeline of bankable and shovel-ready projects to catalyse infrastructure investments; (b) broadening funding sources through strengthening the bank's balance sheet and deepening partnerships; (c) scaling up funding support to the private sector, focusing on the infrastructure value chain, agri-businesses, and mining; (d) deepening capacity in the areas of climate finance; project preparation & development, and project management; and (e) enhancing the bank's ICT platforms to build greater agility, efficiency, and security. The bank, since its establishment in 2005, has invested heavily in these strategic priority areas to improve the infrastructure base of the country.

Funding Sources of the Bank

It is important to note that the specific funding mix for the IDBZ may vary over time depending on the availability of different sources and the nature of infrastructure projects being undertaken. The bank employs a diversified approach to funding to ensure sustainable financing for infrastructure development in Zimbabwe. The various funding sources for the bank include the following.

Government Capitalization: The IDBZ receives capital injections from the government of Zimbabwe through annual budgetary allocations made from the consolidated fund. These funds are provided by the government to enhance the bank's financial capacity and to enable it to support infrastructure development initiatives in the country.

International Financial Institutions (IFIs): The IDBZ collaborates with various international financial institutions such as the World Bank, African Development Bank (AfDB), and the European Investment Bank (EIB). These institutions provide financial assistance, loans, and technical expertise to the IDBZ to support its infrastructure projects.

Development Partners: The IDBZ works closely with development partners, including bilateral and multilateral agencies, to secure funding for infrastructure development. Development partners such as the United Nations Development Programme (UNDP), the United States Agency for International Development (USAID), and the European Union (EU) provide grants, concessional loans, and technical assistance to the bank.

Capital Markets: The IDBZ raises long-term finance through the issuance of bonds and other debt instruments in the capital markets. These bonds are typically purchased by institutional investors such as pension funds, and other financial entities. The funds raised from the capital market enable the IDBZ to finance its infrastructure projects and expand its lending portfolio.

Deposits and Savings: The IDBZ accepts deposits from individuals, corporations, and institutions. These deposits contribute to the bank's overall funding base and provide a stable source of capital for its operations. The IDBZ also offers savings products at competitive interest rates to attract deposits.

Loan Repayments: As a development bank, the IDBZ provides loans to various entities for infrastructure projects. The loan repayments received from borrowers form a significant source of funding for the bank. These repayments are reinvested into new projects, enabling the IDBZ to continue with its lending activities.

Returns on Equity Investments: The IDBZ makes equity investments in infrastructure projects, either directly or through partnerships with private investors. These equity investments generate returns for the bank, which can be used to finance additional projects.

Lending Model and Pricing of Loans

The IDBZ often uses a combination of retail and wholesale lending approaches in its loan portfolios. In terms of wholesale lending strategy, IDBZ distributes its loans through financial intermediaries which then on-lend to deficit units. Retail lending involves the bank providing the finance directly to retail customers or borrowers. The bank also provides group-based lending, where participants develop methods for sharing resources, enjoy economies of scale, bargain for lower pricing, and identify solutions to common financing issues confronting them.

The pricing of the bank's loans uses the short-term interest rates determined by the Reserve bank of Zimbabwe as the baseline. In addition, global economic and financial market conditions also play a pivotal role in pricing the credit provided by the bank to its clients. These conditions include cost of borrowing from the capital markets, inflation, debt sustainability levels, exchange rate stability, and loan recovery rate among others.

Products and Services Offered by the Bank

The IDBZ offers a range of financial products and services tailored to meet the specific requirements of infrastructure projects. These include loans, project finance, guarantees, equity investments, advisory services, capacity building and technical assistance.

Project Financing: The IDBZ provides project financing solutions to support infrastructure development initiatives. Financing is provided at various stages of the project lifecycle, ranging from project development to construction and operations. The financing instruments include loans and credit facilities tailored to meet the financial requirements of projects at various stages, such as project development, construction, and operation. The bank offers competitive interest rates and flexible repayment terms to promote sustainable project implementation.

Guarantees: The bank provides guarantees to support infrastructure projects and enhance borrowers' creditworthiness. These guarantees can help mitigate risks for borrowers, making it easier for them to secure financing from other financial institutions. The bank encourages private sector participation in infrastructure development and facilitates access to funding.

Equity Investments: The IDBZ makes equity investments in infrastructure projects, either directly or through partnerships with private investors. The bank participates in the ownership and future returns of the project by taking an equity stake. Equity investments allow the IDBZ to support projects that align with its objectives while sharing in the project's financial success.

Advisory Services: The bank offers advisory services to assist project sponsors and clients in the planning, development, and implementation of infrastructure projects. These services may include project feasibility studies, financial analysis, project structuring, and risk assessment. The provision of expert guidance by the bank helps clients navigate the complexities of infrastructure development and optimize project outcomes.

Capacity Building and Technical Assistance: The IDBZ provides capacity-building initiatives and technical assistance to enhance the skills and knowledge of stakeholders involved in infrastructure development as required by the Act that established it. This includes training programmes, workshops, and knowledge-sharing platforms aimed at improving project management, financial planning, and governance practices.

Public–Private Partnerships (PPPs): The banks also play an active role in promoting and facilitating public–private partnerships (PPP) for infrastructure development. It assists in structuring PPP projects, conducting feasibility studies, and attracting private sector investors. The bank collaborates with various stakeholders, including government entities, development partners, private investors, and other financial institutions. These partnerships facilitate project development, co-financing arrangements, and knowledge sharing. The IDBZ can leverage such partnerships to access additional funding, technical expertise, and resources to support infrastructure development. Through its expertise in PPPs, the IDBZ helps create opportunities for collaboration between the public and private sectors in providing critical infrastructure development that is needed in the country.

11.10 Main Achievements of the IDBZ

The IDBZ has achieved several notable milestones and contributed significantly to infrastructure development in Zimbabwe over the years. Through its financial support, partnerships, and technical expertise, the bank has made significant contributions to improving energy access, housing, water supply, sanitation, and renewable energy development in the country. The specific sectoral contributions of the IDBZ are discussed below.

Energy Sector Expansion

The IDBZ played a crucial role in financing the expansion of the energy capacity of Kariba South Hydro Power Plant as part of its key primary focus areas. The bank supported the addition of two new generation units, thereby increasing the plant's capacity by 300 megawatts. This project has helped to address Zimbabwe's electricity supply deficit and to improve energy access for the population. This addition to power supply has helped the manufacturing industry in Zimbabwe to expand and produce to full capacity, thereby creating employment opportunities and propelling economic growth over the years. The IDBZ has also been actively promoting renewable energy development in Zimbabwe. One notable achievement is the financing of the Gwanda Solar Power Plant. This project involved the construction of a 25-megawatt solar power plant, contributing to the diversification of Zimbabwe's energy mix and reducing dependence on fossil fuels. This initiative of renewable energy expansion ensures that clean energy consumption is promoted, thereby contributing to global efforts of reducing the impact of fossil fuels' exploration and use on the natural ecosystem. Climate change and its effects are, thus, minimized in the country's quest to address its energy needs. The cost of production and consumption is also reduced significantly, thus, making energy affordable to end users.

Housing Development Initiatives

The IDBZ has been actively involved in financing and facilitating housing development projects across Zimbabwe. One notable achievement is the Budiriro Housing Project in Harare, where the bank provided funding and technical support for the construction of affordable houses. This initiative has contributed to addressing the housing shortage in urban areas and to improving living conditions for many Zimbabweans.

Water and Sanitation Projects

The IDBZ has supported various water and sanitation projects aimed at improving access to clean water and sanitation facilities. For instance, the bank provided finance for the rehabilitation and expansion of the Harare Water and Sanitation Infrastructure. This project has helped to enhance the water supply system, reduce water loss, and improve sanitation services in the capital city.

Infrastructure Financing Partnerships

The IDBZ has established partnerships with various international financial institutions and development partners to expand its financing capacity and leverage additional resources for infrastructure development. These partnerships have enabled the bank to access funding from institutions such as the African Development Bank, World Bank, and European Investment Bank, thereby strengthening its ability to support infrastructure projects in Zimbabwe.

Technical Assistance and Capacity Building

The IDBZ has provided technical assistance and capacity building initiatives to enhance project planning, management, and implementation capabilities. This includes conducting feasibility studies, offering training programs, and providing advisory support to project sponsors and stakeholders. By building local capacity, the IDBZ contributes to sustainable infrastructure development that is cost-effective, timely, and sensitive to the needs of the people in Zimbabwe.

11.11 Challenges Confronting the IDBZ

The IDBZ is confronted with a number of challenges, including limited financial resources, economic and political uncertainty, difficulty in identifying project viability and bankability, lack of proper infrastructure maintenance and operations, changes in regulatory and policy framework, lack of skilled labour, capacity constraints and difficulties in ensuring environmental and social considerations.

Limited Financial Resources

The IDBZ's ability to finance infrastructure projects is constrained by limited financial resources. The bank relies on government capitalization, international financial institutions, and capital markets to raise funds. However, the availability of funding may be insufficient to meet the high demand for infrastructure financing in Zimbabwe. The bank raises credit on the global capital market as its main source of finance and the cost at which the bank receives funds is determined by global economic and financial conditions. The high cost of raising finance tends to affect the cost of on-lending to borrowers. The bank's efforts to stimulate sustainable infrastructure financing, which is one of its key mandates, are significantly hampered by the high cost of loans that the bank may offer. This poses a challenge to adequately address the country's infrastructure needs which requires nearly 60% of the country's GDP annually to finance (IDBZ Annual Report, 2019).

Economic and Political Uncertainty

Stable economic and political environments are necessary for ensuring the successful implementation of infrastructure projects. However, Zimbabwe has had its share of economic and political challenges, including inflation, currency volatility, and policy uncertainties. These factors tend to affect investor confidence, project viability, and the overall business environment. Shocks in the global financial system have also impacted the bank's financial standing, capacity to generate capital, and ability to execute its mandate. External shocks such as the COVID-19 pandemic and the 2007–2008 Global Financial Crisis have had a significant impact on all financial institutions, globally, including the IDBZ. During such times, the bank's capacity to deploy resources is limited. The IDBZ has had to navigate these uncertainties, mitigate risks, and attract investments to ensure the successful implementation of infrastructure projects.

Difficulty in Identifying Project Viability and Bankability

Infrastructure projects often require substantial investments and have long gestation periods. Identifying financially viable and bankable projects that meet the IDBZ's criteria can be challenging. Some projects may face technical, financial, or environmental constraints that make them less attractive to investors or lenders. The bank must carefully assess and select projects that have the potential for long-term sustainability and economic viability.

Lack of Proper Infrastructure Maintenance and Operations

While the IDBZ focuses on financing new infrastructure projects, ensuring the maintenance and sustainable operation of existing infrastructure assets is equally important. Inadequate maintenance, lack of proper operation and maintenance strategies, and limited funding for upkeep can lead to the deterioration of infrastructure assets, over time. This has been a major challenge confronting the IDBZ and the bank needs to consider the long-term maintenance requirements and develop strategies to address this challenge.

Changes in Regulatory and Policy Framework

The IDBZ operates within the framework of regulatory and policy environments set by the Reserve Bank of Zimbabwe and the government through the Minister of Finance and Economic Development. The minister is clothed with the authority to issue annual policy directions to the board of the bank for implementation. This serves as a direct interference in the execution of the bank's mandate. This tends to weaken the board's independence in taking critical and long-term initiatives. Changes in regulations, policies, and legal frameworks also impact project planning, implementation, and financing. Inconsistent policies, delays in policy reforms, or lack of clarity tend to create uncertainties and affect the bank's ability to effectively support infrastructure development.

Lack of Skills and Capacity Constraints

Developing and implementing complex infrastructure projects require specialized skills and technical expertise. The availability of skilled professionals, including engineers, project managers, and financial analysts, has been a challenge. Building and retaining a pool of skilled personnel within the bank and the broader infrastructure sector are crucial for effective project appraisal, monitoring, and implementation.

Difficulty in Ensuring Environmental and Social Considerations

Infrastructure projects must adhere to environmental and social safeguards to minimize negative impacts and ensure sustainable development. The IDBZ faces the challenge of ensuring that projects meet the required environmental and social standards. This involves conducting thorough environmental and social assessments, engaging stakeholders, and implementing mitigation measures to address potential risks and impacts.

11.12 Financial Performance

Over the past eight years (2015–2022), the IDBZ has progressively posted commendable financials. During several global shocks, including the COVID-19 pandemic, the bank remained on a steady and consistent financial performance over the period. Operational performance, capital adequacy ratio, asset quality, management effectiveness, earnings, and liquidity assets, as shown in Table 11.1, are some key performance metrics that have seen consistent gains on average over this period.

Capital Adequacy Ratio

Capital adequacy ratio, which measures the total risk-weighted asset ratio (Tier 1 + Tier 2 capital ratio), decreased from 26.81% in 2015 to 13.80% in 2017. It increased steadily to 23.90% in 2020 but dipped slightly to 20.3 in 2021 and increased marginally to 21.20 in 2022. This implies that the Capital adequacy ratio for both Tier 1 and 2 has increased over the period 2017–2022. The decline in capital adequacy for some of the years can be attributed to the increasing risk-taking activities of their total asset for most of the years during the period under review (see Fig. 11.1).

Asset Quality

The asset quality of the bank, which reflects the quality of existing and potential credit risk associated with loans and investment portfolios,

Table 11.1 Financial performance indicators, 2015–2022

		2015	*2016*	*2017*	*2018*	*2019*	*2020*	*2021*	*2022*	*Average*	*SD*
Capital adequacy Ratio	Regulatory CAR (%)	26.81	22.30	13.80	16.93	18.03	23.90	20.30	21.2	20.41	3.85
Asset quality	Non−performing loans	10.40	9.40	7.00	5.53	5.00	6.23	0.40	4.71	6.08	2.88
Liquidity assets	Broad liquidity assets to total assets (%)	88.25	88.24	99.99	98.18	98.34	99.48	99.68	96.02	96.02	4.64
	Core liquidity asset to total assets (%)	66.66	57.11	50.11	55.12	26.29	14.47	20.76	88.79	47.42	23.68
Management efficiency	Noninterest expenses to gross income (%)	7.34	6.48	19.26	13.15	8.36	2.76	20.35	68.95	18.33	19.99
	Personnel expenses to gross income (%)	25.66	22.06	24.99	27.01	23.34	4.64	11.36	8.79	18.48	8.21
Earnings	Return on assets (%)	−3.06	−0.81	0.52	−0.36	36.20	60.05	5.61	6.82	13.12	21.29
	Return on equity (%)	−14.24	−2.67	1.83	−1.05	55.94	75.04	8.22	9.36	16.55	29.45
	Interest margin to gross income (%)	33.44	35.38	17.84	35.60	27.56	26.50	25.35	−14.82	23.36	15.47
Operational performance	Portfolio yield (%)	3.38	4.05	6.47	8.49	47.61	18.20	4.27	38.97	16.43	16.27
	Operating profit (%)	6.16	3.20	11.72	3.57	6.53	6.71	6.89	−17.24	3.44	8.18

Source Authors' construction based on data from IDBZ financial statements, 2015–2022

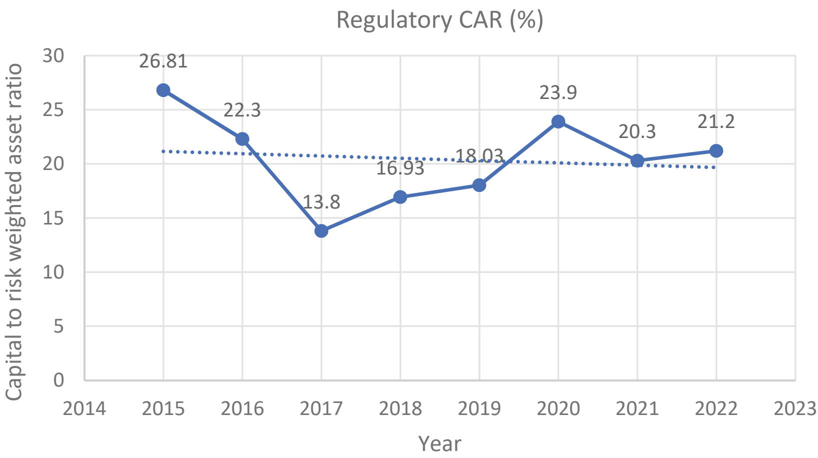

Fig. 11.1 Capital adequacy ratio, 2015–2022 (*Source* Authors' construction based on data from IDBZ financial statements)

saw a consistent improvement over the period. For instance, the non-performing loans, which is a measure of defaulted exposures by portfolio size, saw a consistent decline from 10.40% in 2015 to as low as 0.40% in 2021. It however, increased to 4.71% in 2022, perhaps due to the lingering effect of COVID-19 on the global financial system as shown in Fig. 11.2.

Liquidity

The bank's liquidity base, from both broad liquidity assets to total assets and core liquidity assets to total asset, remained largely stable over the period, 2015–2019, but the latter saw a sharp decline between 2018 and 2021 and a significant increase in 2022 (see Fig. 11.3). This is due to the global tightening of monetary policy by central banks to control inflation as a result of global shocks from COVID-19 and the Russia–Ukraine war. A tighter monetary policy increases the cost of credit and deters businesses and households from borrowing from financial institutions.

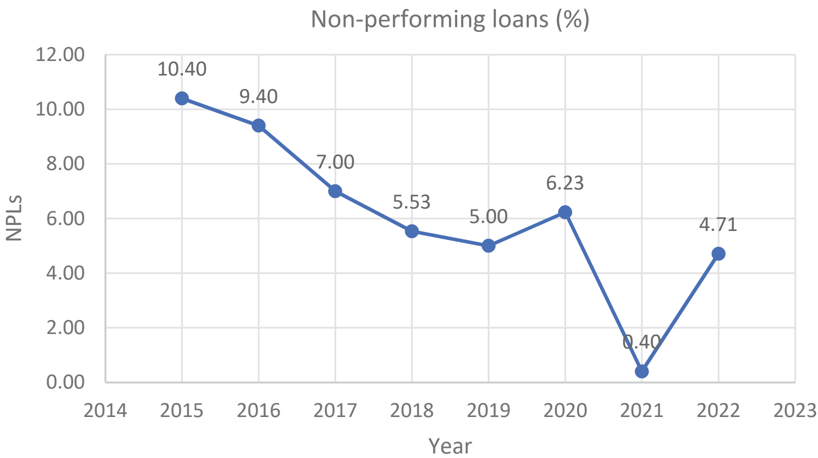

Fig. 11.2 Asset quality (*Source* Authors' construction based on data from IDBZ financial statements)

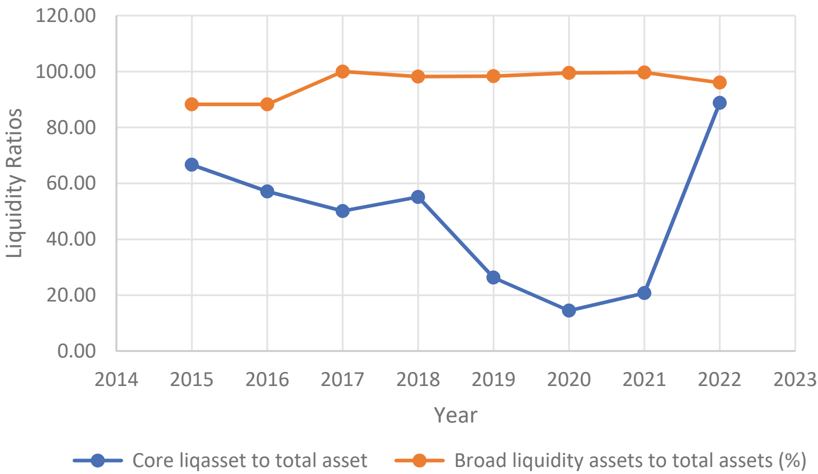

Fig. 11.3 Liquidity ratios (*Source* Authors' construction based on data from IDBZ financial statements)

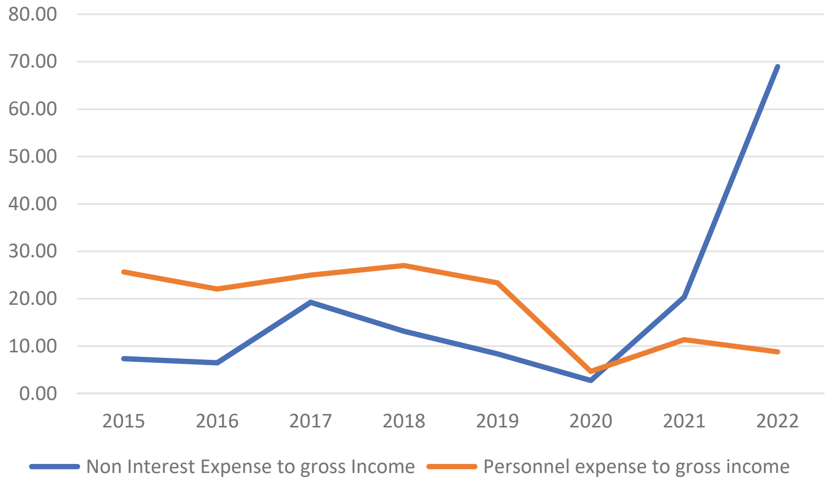

Fig. 11.4 Management efficiency (*Source* Authors' construction based on data from IDBZ financial statements)

Management Efficiency

In Fig. 11.4, the management efficiency ratio, which measures the non-interest expenses to gross income, as well as personnel expense to gross income, witnessed a marginally unstable outcome over the entire period, 2015–2022. Both efficiency ratios saw a steady decline from 2015 to 2016, increased from 2016 to 2017, and then decreased further between 2017 and 2020. Both ratios, however, started inching up in 2020.

Earnings

The profitability measures (interest margin to gross income, return on asset (ROA) and return on equity (ROE)) show interesting trends over the period, 2015–2022. For instance, ROA remained stable from 2016 to 2018 and increased thereafter till 2020, where it experienced a sharp decline to 5.61% in 2021 and marginally increased to 6.82% in 2022. ROE, on the other hand, increased from −14.24% in 2015 to −2.67% in 2016. This, however, was short-lived as it witnessed a sharp increase from 55.94% in 2019 to 75.04% in 2020, decreased to 8.22% in 2021, and recorded a slight increase to 9.36% in 2022 (see Fig. 11.5).

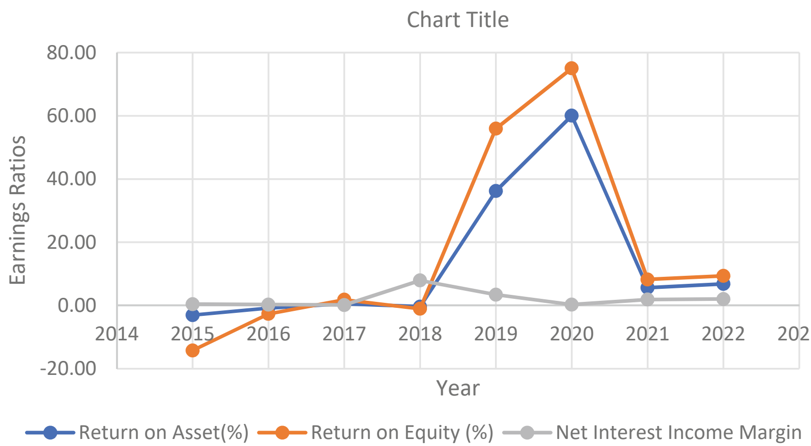

Fig. 11.5 Earnings/profitability ratios (*Source* Authors' construction based on data from IDBZ financial statements)

Operational Performance

The portfolio yield of the IDBZ, which shows the bank's ability to generate cash on the gross loan portfolio, increased steadily from 3.38% in the 2015 financial year to a significant record high of 47.61% in 2019 (see Fig. 11.6). This performance, however, declined steadily to 4.27% in 2021, due to the impact of the COVID-19 pandemic. The portfolio yield inched up to 38.97% in 2022.

In Fig. 11.7, the operating profit margin measuring the effectiveness of operating costs witnessed a stable record on average from 2015 (6.16%) to 2021 (6.89%) except in 2017 where the bank recorded a margin of 11.72%. However, the bank witnessed a sharp loss of 17.24% in 2022. This indicates that the bank embarked on an uncontrolled expenditure pattern in the operations of the bank in the 2022 financial year, which must be checked in order to maintain the stability of the bank.

11.13 Conclusion and Recommendations

The chapter has examined the case of IDBZ in infrastructure financing in Zimbabwe. It has provided an overview of development finance institutions (DFIs) in Zimbabwe and discussed the profile and history of IDBZ,

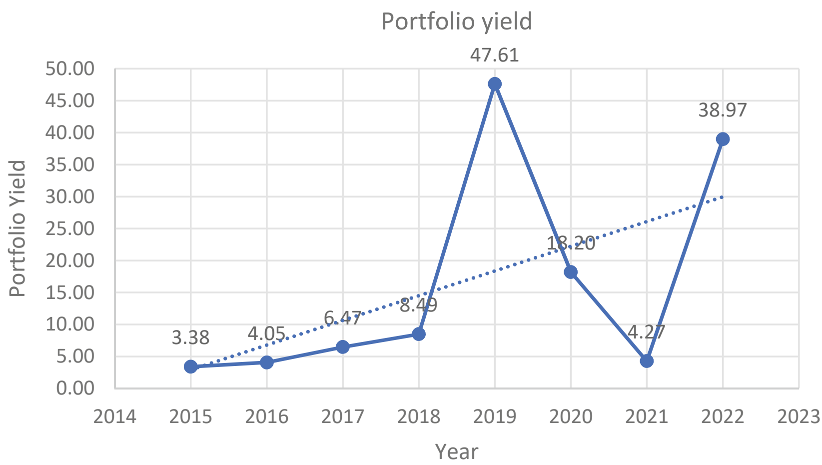

Fig. 11.6 Portfolio yield (*Source* Authors' construction based on data from IDBZ financial statements)

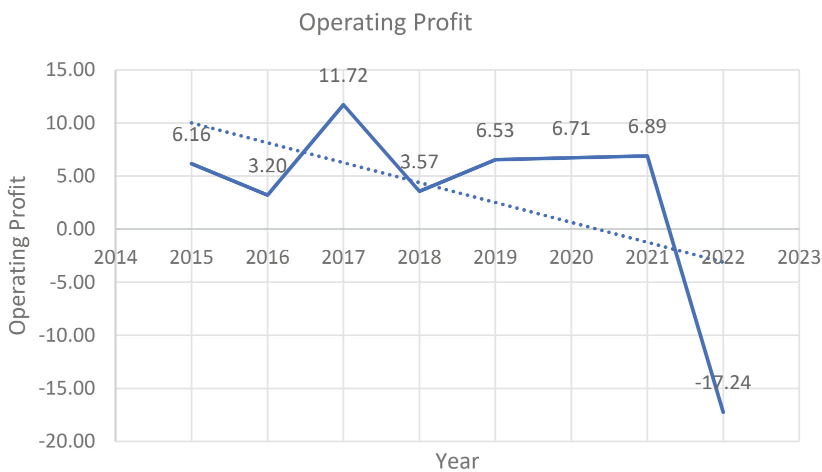

Fig. 11.7 Operating profit (*Source* Authors' construction based on data from IDBZ financial statements)

as well as its policy mandate, political economy and institutional context, corporate governance arrangements, risk management, monitoring and evaluation, and business model. It also discussed the main achievements and challenges the bank faces, as well as its financial performance. The chapter shows that IDBZ collaborates with the Ministry of Finance, the Reserve Bank of Zimbabwe, and other bilateral and multilateral institutions in its operations. The board provides the direction for the bank and ensures that the bank adheres to principles of good corporate governance and high ethical standards, as enshrined in applicable laws and regulations. The bank needs to improve its risk management capabilities and provide technical and advisory services to stakeholders. The IDBZ employs a diversified approach to funding to ensure sustainable financing. It employs both retail and wholesale lending models. Besides, it offers a wide range of financial products and services that go beyond loans. Guarantees, advisory services, capacity training and technical services, project financing, and equity investments are some of the services and products offered by the bank to its clients.

The IDBZ has played a vital role in promoting infrastructure development and in addressing critical needs in Zimbabwe. Through the various products, services, and partnerships, the IDBZ has made significant achievements in financing projects related to energy, housing, water, sanitation, and renewable energy. However, it faces challenges such as limited financial resources, economic and political uncertainty, difficulty in identifying project viability and bankability, lack of proper infrastructure maintenance and operations, changes in regulatory and policy framework, lack of skilled labour, capacity constraints, and difficulties in ensuring environmental and social considerations.

The IDBZ needs to explore opportunities to diversify its funding sources and to attract more capital from domestic and international markets. This could involve engaging with institutional investors, exploring innovative financing mechanisms, and advocating for increased government capitalization. Strengthening its risk assessment and management practices to mitigate project-related risks should be prioritized. This includes conducting thorough feasibility studies, implementing effective monitoring and evaluation systems, and adopting best practices in project appraisal and risk analysis.

The bank can actively engage with the government to promote policy stability and create an enabling environment for infrastructure development. This involves advocating for consistent regulatory frameworks, timely policy reforms, and clear guidelines for project implementation. Close collaboration with relevant ministries and agencies is crucial to align infrastructure priorities and policies. Prioritizing sustainable infrastructure development by integrating environmental and social considerations into project planning and implementation is an important measure to adopt to achieve sustainable development. This involves conducting robust environmental and social impact assessments, promoting climate resilience, and engaging with local communities to ensure their participation and well-being.

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PART III

Multilateral, Regional and Sub-Regional Development Banks

CHAPTER 12

Multilateral Development Banks: Contributions and Challenges

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12.1 Introduction

Multilateral Development Banks (MDBs) are international financial institutions that provide financial and technical assistance to support economic development and to reduce poverty in developing and emerging economies. These banks are multilateral in nature because they are owned and operated by multiple countries, often with their share of capital contributions based on the size of their economies. Examples of MDBs

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include the World Bank, the Inter-American Development Bank (IDB), African Development Bank (AfDB), Asian Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Islamic Development Bank (IsDB), etc. MDBs emerged as one of the greatest success stories of the post-World War II era for the international community. For more than five decades, they combined financial strength and technical experience to assist the investments of their borrowing members in post-conflict reconstruction, growth acceleration, and poverty reduction. The multilateral system's ongoing expansion in terms of scope, purpose, and financing volume stands as a testament to its enduring relevance and general acceptance of MDBs as effective sources of development finance.

Nevertheless, the geo-economic landscape of this century has undergone significant transformations, alongside the evolving aspirations and demands of the emerging global community. For instance, in 2006, urban areas were already home to almost half of the world's population. Looking ahead to the next three decades, the majority of the projected two-billion-plus increase in the global population is expected to occur within cities, with a particular focus on urban areas in the developing world (Cohen, 2006). Today, almost all developing nations manage public investment primarily using local resources, and some of the poorest nations may independently borrow overseas. Likewise, the increasing globalisation and dissemination of professional knowledge in development practice have eroded the once almost exclusive dominance of MDBs in providing advisory services. MDBs have been repeatedly criticised for allegedly lacking openness, accountability, and efficacy. Part of this mistrust may originate from the multilateral system's rising impression of complexity and ambiguity, which is often regarded as a chaotic aggregation of institutions with competing and often overlapping objectives.

The 2030 Agenda re-energised the desire for multilateral ways to support global development goals. The approval of the Addis Ababa Action Agenda (AAAA) gave multilateral players a crucial role and an extended mandate as development stakeholders recognised the necessity

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of utilising the multilateral system's capabilities to support the Sustainable Development Goals (SDGs) (Gulrajani & Hefer, 2016; Rudolph, 2017). The coronavirus diseases-2019 (COVID-19) pandemic has turned the spotlight back on the MDBs' development framework, highlighting the high level of reliance among countries. There is broad agreement that the MDBs must play a critical role in tackling the health, economic, and humanitarian crises in developing countries. MDBs have made enormous contributions to the initial reaction to the disaster. However, the crisis has exposed some limits in the multilateral development system, emphasising the importance of MDBs continued adaptation to the size of new global challenges.

This chapter examines the contributions of MDBs as well as discusses the challenges confronting them. The rest of the chapter is structured as follows. Section 12.2 provides an overview of MDBs and discusses the various types. Section 12.3 highlights the funding and operations of MDBs. Their financing role is discussed in Sect. 12.4, and Sect. 12.5 elaborates on the contribution and challenges. Section 12.6 presents the way forward and Sect. 12.7 provides the concluding remarks.

12.2 Overview of Multilateral Development Banks

MDBs, as international financial institutions, are created by several countries to promote development efforts through long-term financing and professional advice. They are mainly owned by governments with a majority shareholding. But occasionally, you may have other multinationals or private businesses holding shares. MDBs mostly give low- or no-interest loans, as well as grants, to fund projects that encourage development. They provide the following types of financing:

1. Long-term loans: these loans often have a lifespan of up to 20 years and interest rates are determined by market rates. MDBs frequently access funds from the global capital markets, which they subsequently lend to governments of countries in need of financial assistance.

2. Very-long-term loans: these loans often have a maturity of 30 to 40 years with interest rates that are lower than market rates. Such loans are financed through direct donations from donor countries' governments.
3. Grant funding: some MDBs also offer grants for technical support, advisory services, and project development.

MDBs have extensive memberships encompassing both developed and developing countries. Developed countries tend to contribute more financial resources to MDBs compared to developing economies. MDBs include the Word Bank, regional development banks, and sub-regional development banks. The primary regional development banks are Inter-American Development Bank (IDB); African Development Bank (AfDB); Asian Development Bank (ADB); and the European Bank for Reconstruction and Development (EBRD). There are other regional development banks, examples of which include African Export–Import Bank (Afreximbank); Development Bank of Latin America (CAF); Asian Infrastructure Investment Bank (AIIB); and Central American Bank for Economic Integration (CABEI). Examples of sub-regional development banks are ECOWAS Bank for Investment and Development (EBID); West African Development Bank (BOAD); East African Development Bank (EADB); Caribbean Development Bank (CDB); Black Sea Trade and Development Bank (BSTDB); Eurasian Development Bank (EDB); Economic Cooperation Organisation Trade and Development Bank (ETDB); and the New Development Bank (NDB) (formerly BRICS Development Bank). However, for the purpose of the study, we focused mainly on the World Bank and the major regional development banks.

The World Bank Group

The World Bank is a global development finance institution (DFI) that provides loans and grants to countries seeking funding for long-term projects and development initiatives. It was established at the 1944 Bretton Woods Conference, along with the International Monetary Fund (IMF), and became functioning in 1946. It was created with the goal of reducing poverty and providing loans to countries for capital programmes. The World Bank is a collective name that refers to the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA), which is the concessionary arm of the Bank. The IBRD and the IDA are part of five international organisations owned by the World Bank Group. The IDA obtains funds from donors and focuses on providing 'soft' lending, including grants and concessionary loans with long maturities to poor nations. The other three of the five international institutions of the World Bank Group include the International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA), and International Centre for Settlement of Investment Disputes (ICSID).

The IFC, which was established in 1956 represents the private sector arm of the World Bank Group with the mandate of advancing economic development through investment in commercially viable projects and ventures in order to reduce poverty and promote development. While the World Bank focuses on lending to nations, the IFC focuses on the private sector. It aims at creating an enabling environment for reducing poverty by providing resources for private businesses. The IFC is considered the largest global DFI with the focus on providing support for the private sector in developing economies. It provides three main services including investment services, asset management services, and advisory services.

The MIGA provides political risk insurance and guarantees to enable investors to protect their investments against non-commercial risks. The ICSID, however, focuses on the settlement of international investment disputes. Each of these five institutions plays various critical roles in achieving the World Bank Group's mission of ending extreme poverty within a generation and boosting shared prosperity.

Regional Development Banks

Regional development banks (RDBs) focus on financing development activities in specific geographical areas. They are also classified as MDBs though they only operate in certain parts of the world. The regional countries and other large donor countries are the majority shareholders in these entities. In terms of organisation, functions, and operations, RDBs are 'clones' of the World Bank although they tend to have a narrower focus. The Inter-American Development Bank (IDB), African Development Bank (AfDB), Asian Development Bank (ADB), and European Bank for Reconstruction and Development (EBRD) are the primary regional development banks. The Inter-American Development Bank for Latin America was the first major RDB to be founded, in 1959. The second was African Development Bank, which was established in 1964, followed by the Asian Development Bank in 1966, and the European Bank for Reconstruction and Development in 1991.

As previously stated, the RDBs have comparable structures and roles to the World Bank although they differ in some ways. For example, both the RDBs and the World Bank have ‘hard’ and ‘soft’ lending capabilities, with the hard lending terms being quite comparable across the board and the soft loans being paid directly by donors. As previously stated, the IDA provides soft lending from the World Bank. IDB, AfDB, and ADB, for example, run soft loan programmes through the Fund for Special Operations (FSO), African Development Fund (ADF), and Asian Development Fund (AsDF), respectively. Hard lending consists of loans with market-based terms, whereas soft lending consists of grants and concessional loans with longer repayment periods and lower interest rates. The majority of loans have a term of 25–40 years. Both the World Bank and the RDBs are managed by Boards of Governors, which are composed of one governor and one alternate governor from each member country. The Boards of Governors, which are the institutions’ highest authority, appoint and assign the majority of their responsibilities to the Boards of Directors, who oversee the entities’ overall direction. Donor countries prefer to route funding through the World Bank rather than through RDBs, which is a key problem for the latter. This also means that borrowing countries value their relationship with the World Bank more than with their individual RDBs. We now provide an overview of the main RDBs in Table 12.1.

African Development Bank

The African Development Bank (AfDB), also known as the Banque Africaine de Development (BAD), was established in 1964 in Abidjan, Cote d’Ivoire (but in 2003, the headquarters temporarily moved to Tunis, Tunisia because of the Ivorian war and then returned to Cote d’Ivoire in September 2014). Its stockholders include 81 member countries (shareholders), with 54 African countries and 27 non-African countries. The African Development Fund and the Nigeria Trust Fund are two more entities under the African Development Bank Group.

Following the colonial period in Africa, a growing interest for greater unification across the continent resulted in the drafting of two draught charters for the Organisation of African Unity (formed in 1963 and later superseded by the African Union) and a Regional Development Bank (RDB). In 1963, an agreement was drafted to establish the AfDB, which was signed on September 10, 1964. The AfDB was initially created under

Table 12.1 Overview of RDBs

Regional development banks	*Area*	*Year founded*	*Headquarters*	*Main goal*
Inter-American Development Bank (IDB)	Latin American, Caribbean	1959	Washington, DC, (USA)	Promoting poverty reduction, social equity, environmentally sustainable economic growth
African Development Bank (AfDB)	Africa	1964	Abidjan (Cote D'Ivoire)	Spur sustainable economic development and social progress in its regional member countries (RMCs), thus contributing to poverty reduction
Asian Development Bank (ADB)	Asia and Pacific region	1966	Manila (Philippines)	Fostering economic growth and cooperation in the region
European Bank for Reconstruction and Development (EBRD)	Central and Eastern Europe and Central Asia	1991	London, United Kingdom	Promoting transition to market-oriented economies in the Central and Eastern Europe and Central Asia countries

Source Abor et al. (2020)

the aegis of the Economic Commission for Africa (ECA). Despite the fact that the Bank was founded by African countries, non-African countries have been able to join since 1982.

The AfDB Group's overall goal is to promote long-term economic and social growth in its regional member countries (RMCs), thereby helping to alleviate poverty. The AfDB Group is concentrating on mobilising resources and allocating them for RMC investments. It also offers policy guidance and technical assistance to RMCs in their development initiatives. Its main responsibilities include:

- Making loans and equity investments for RMCs' economic and social development.
- Providing technical help for RMCs' development initiatives and programmes.
- Promoting public and private capital investment for development.
- Assisting RMCs in organising their development policies.

The AfDB is also expected to pay particular attention to national and multinational projects that are required to promote and facilitate regional integration. Subscription capital, reserves, borrowed funds, and accumulated net income are the organisation's primary sources of funding. Its shareholding is designed so that RMCs own two-thirds of the entire capital, while non-regional members own one-third. AfDB also has a triple-A credit rating, which allows it to borrow on favourable terms from international capital markets. It provides funding to African governments as well as commercial corporations that invest in RMCs. The AfDB makes non-concessional loans at market rates. It also provides development money on concessional conditions to its low-income member countries that do not qualify for non-concessional loans through the African Development Fund. Funds for concessionary loans which come in the form of grant contributions are typically obtained from the 27 non-regional members.

Asian Development Bank

The Asian Development Bank (ADB) was established in 1966 with its headquarters in Manila, the Philippines' capital. Originally founded with 31 members, the ADB presently has 67 member countries, with 48 from Asia and the Pacific and 19 from other parts of the world. At the start of the 1960s, the notion of forming the ABD was put forward. The plan was to create an Asian-focused financial institution that would focus on boosting regional economic growth and collaboration. A resolution was enacted in 1963 to provide clear instructions for the establishment of the regional bank. This was accomplished at the United Nations Economic Commission for Asia and the Far East's first Ministerial Conference on Asian Economic Cooperation. On December 19, 1966, the Bank was established. It initially provided support mostly in the fields of food production and rural development to a predominantly agricultural region.

Through inclusive growth, environmentally sustainable growth, and regional integration, the Asian Development Bank focuses on supporting social and economic development throughout Asia and the Pacific. Through equity investments, loans, guarantees, grants, technical support, and policy discourse, it aims to assist its member countries, particularly developing countries, in reducing poverty and improving the quality of life for inhabitants. Infrastructure (energy, ICT, transportation, water, and urban development), environment, regional cooperation and integration, financial sector development, education, health, agricultural and natural resource management, and public sector management are among its main areas of focus. Bond offerings, recycled loan repayments, and donations from member countries are among its key sources of funding. A significant percentage of the cumulative lending it gives is from its ordinary capital. The Asian Development Fund is used to provide concessional credit to its underdeveloped member countries. It also maintains a variety of trust funds and helps recipient countries route grants from bilateral donor partners.

European Bank for Reconstruction and Development

The European Bank for Reconstruction and Development (EBRD) is the most recent of the major RDBs, having been founded in 1991 with its headquarters in London. The EBRD was created with the goal of assisting countries in Central and Eastern Europe and Central Asia in their transition to market economies. In total, 71 countries, two intergovernmental agencies, the European Union and the European Investment Bank are its shareholders. The EBRD was established during the disintegration of the Soviet Union and the fall of communism in Central and Eastern Europe, when these nations required assistance in developing a new private sector in a democratic environment. The Bank was established when the shareholders reached an agreement on its charter, size, and power distribution.

The EBRD is also a triple-A credit-rated institution, allowing it to borrow at favourable market rates from international financial markets. EBRB invests mostly in private firms in partnership with commercial entities, despite having public sector shareholders. Through its investments, it is devoted to developing democracies and market economies in various Central European and Central Asian countries. Through its support programmes, the EBRD provides loans and equity financing, trade finance, project finance, leasing facilities, guarantees, and professional development. The EBRD is also committed to fostering environmentally sound and sustainable growth by assisting publicly owned enterprises in their privatisation efforts.

12.3 Funding and Operations

In this section, we discuss the sources of financing and the main operations of MDBs.

Funding

MDBs raise funding from different sources, which enables them to finance their operations. Their main source of finance is raising funds from the international capital market through the issuance of financial instruments such as bonds, swaps and other financial derivatives. For example, ADB used currency and interest rate swaps simultaneously with an issue of bonds to raise funds from the international capital market.[1] As at 31 December, 2021, ADB had borrowed in 42 currencies with an outstanding amount of about US$ 134.1 billion (see Footnote 1). MDBs can, without much of a stretch, get funds from the international capital market since they are supported by the guarantees of their member governments (Nelson, 2010). Guarantees are obtained through ownership shares registered as a result of membership in each bank by the countries. This backing helps MDBs to obtain funds at a lower cost and enables them to lend at lower rates.

Contributions and special donations from member countries are also a major source of funding for MDBs. For example, AfDB's African Development Fund and IDB's Fund for Special Operations are provided by members. The contributions and special donations can be in the form of subscribed capital (shares or paid-in capital) and (or) replenishment. When the resource base of the MDBs gets depleted due to high lending to poor countries, the donor countries meet periodically to replenish such resources. Scheduled meetings mostly occur between 3 and 5 years. AfDB and IDA concluded their replenishment negotiation in 2017, whereas ADB concluded its negotiation in 2016 (Engen & Prizzon, 2018). Both ADB and IDB have merged their concessional arm with their ordinary capital resources as of 2017. However, IDB has not had any replenishment since 2012 (Engen & Prizzon, 2018).

[1] https://www.adb.org/work-with-us/investors/adb-debt-products#:~:text=ADB%20undertakes%20most%20of%20its,through%20its%20private%20placement%20transactions.

Operations

The main areas of MDBs' operation include providing financing and creation of knowledge products. MDBs' financing activities allow them to provide significant financial assistance in the form of loans on market-based terms and soft lending including grants, and concessionary loans, which have very favourable terms (i.e. long tenure with significantly low interest). Concessionary loans may be inaccessible to some developing countries, particularly the least developed, because they lack the depth and capacity to raise capital from the capital market. Such commitments provide recipient countries with the needed sources of funding for essential investments that would otherwise be difficult to obtain in the capital market (Craviolatti, 2018). In 2019, Ethiopia and Pakistan were the top IDA recipients of concessional financial assistance as shown in Box 12.1, while Afghanistan and Tajikistan were the top AsDF recipients in 2018.

Box 12.1: International Development Association

The IDA as part of the World Bank, offers concessional loans and grants to poor countries to support development projects. It provides financing to recipient countries based on their income levels, track record of success in managing their economies, and ongoing IDA projects. The terms of IDA lending are extremely favourable, which means that IDA credits have no or low-interest charges. IDA commitments totalled \$37.7 billion in the fiscal year ending June 30, 2022, with grants amounting to \$13.2 billion. The Africa region received 73% of total commitments. IDA has given \$496 billion to 114 countries since 1960. Annual commitments have steadily increased and have averaged around \$34.7 billion over the last three years (FY20-FY22). In 2019, Ethiopia and Pakistan were the IDA recipients of concessional financial assistance. However, in 2022, Nigeria (\$ 2400 m) is the most recipient of concessional financial assistance followed by Bangladesh (\$ 2161 m) and Ethiopia (\$ 1900 m) being the 4th beneficiaries of the IDA. Primary education, basic health services, clean water and sanitation, environmental safeguards, business climate improvements, infrastructure, and institutional reforms are all addressed by IDA-funded operations. These initiatives pave the way for economic growth, job creation, higher wages, and improved living conditions. In 2022, IDA funds were allocated to infrastructures (33%), social services such as education, health and social protection (30%), public administration (16%), agriculture (11%), industry and trade (6%) and finance

(3%). IDA conducts analytical research in order to create a knowledge base that will allow for the intelligent design of poverty-reduction policies. The International Development Association advises governments on how to broaden the base of economic growth and protect the poor from economic shocks. IDA coordinates donor assistance to poor countries that are unable to manage their debt burdens. With the goal of assisting countries in meeting their debt obligations, the IDA has developed a system for allocating grants based on the risk of countries' debt burdens (debt sustainability).

Source IDA-World Bank (2022)

Box 12.2 shows African Development Fund's significant financial development assistance to various countries in the form of loans, grants, or concessionary financing.

Box 12.2: African Development Fund

The AfDB administers the African Development Fund (ADF), which was established in 1972. It is made up of 29 contributing countries and 38 beneficiary countries, nearly half of which are classified as fragile or conflict-affected states. Since its inception in 1974, the ADF has invested $45 billion. It is also the Bank Group's concessional financing window, providing low-income RMCs with concessional loans and grants, guarantees, and technical assistance for studies and capacity building to support projects and programmes that promote poverty reduction and economic development. Access to ADF's resources is guided by the classification of RMCs under the Bank Group's credit policy, which is driven by two criteria: (i) per capita income; and (ii) creditworthiness to continue receiving non-concessional financing. The 38 countries include Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Liberia, Mali, Niger, Nigeria, São Tomé & Príncipe, Senegal, Sierra Leone, Togo, Burundi, Comoros, Djibouti, Ethiopia, Kenya, Rwanda, Seychelles, Somalia, Sudan, South Sudan, Tanzania, Uganda, Cameroon, Central African Republic, Chad, Congo-Brazzaville, Democratic Republic of Congo, Equatorial Guinea, Gabon, Angola, Botswana, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia, Zimbabwe.

Source African Development Bank (2022)

MDBs are also involved in the creation of knowledge products and have been an important source of data generation and analysis, which leads to policy improvement and ideas generation for effective policy planning and implementation. This can lead to increased global trade and even aid in the resolution of member-state conflicts. For example, the World Bank maintains a number of data bank websites, including World Development Indicators, World Governance Indicators, African Development Indicators, and others, which contain information on a wide range of economic and social issues. Other MDBs, such as AfDB and ADB, have similar data banks and knowledge products where data such as inclusive growth construct and other variables can be obtained. MDBs have been actively engaged in data analysis for policymakers within countries and their own institutions, as well as provided funding for various studies. These knowledge products serve as valuable resources for policymakers and contribute to the broader understanding of development challenges and potential solutions.

12.4 Financing Role of Multilateral Development Banks

MDBs function under the tenets of international laws in order to aid development activities through long-term credits and grants so as to foster social and economic development. Unlike other private institutions, MDBs benefit from a financed capital-based admittance to different subsidies, and they are centred on developmental targets rather than shareholder returns. As a result, they generally provide loans at low to no interest rates, and they occasionally provide concessional assistance and grants to support energy, education, infrastructure, Small and Medium Enterprises (SMEs) growth, and other ventures that support development. Governments in developing countries receive funding at below-market interest rates or concessionary financing. Some private sector entities can sometimes benefit from market-based funding or below-market-rate loans.

MDBs can address both regional and global challenges like disaster assistance, educational reform, energy, and infrastructure because of the scale of the institutions and the scope of their responsibilities. MDBs also play an important role in climate finance, given that they have capital at their disposal and are also able to raise additional finance through the international capital market. They are able to provide the assurance and therefore are better positioned to leverage private finance for climate change projects. MDBs tend to pursue far broader agenda and many nations have mainly benefitted from the help of MDBs in the form of official development assistance (ODA). For example, ODA flow to all African nations expanded from about US$16 billion in 1980 to US$40.3 billion in 2006, and declined to US$30.6 billion in 2007. In 2009, ODA from members of the OECD, and the Development Assistance Committee (DAC) expanded in real terms to US$119.6 billion, which addressed 0.31% of DAC members consolidated gross national income. As shown in Fig. 12.1, foreign aid has been increasing right from 2000 to 2018. From 2000 to 2006, foreign aid to SSA increased whereas it decreased from 2006 to 2008. Thereafter, the aid to SSA increased from US$ 41.2 billion to US$ 50.48 billion.

Following World War II, most European nations were devastated by the war's consequences and found themselves in very vulnerable and fragile situations. It is widely acknowledged that DFIs such as MDBs contributed significantly to the economic growth of the majority of European nations. Continental Europe's rapid industrialization in the nineteenth century was linked to the creation of massive financial organisations (Cameron, 1953). MDBs are also involved in the provision of financial assistance for developmental projects. MDBs give major financial development support as awards or concessionary conditions, some of which have no interest or extended tenure with low service levies or charges. These concessionary terms might be distant to a few emerging countries, especially the most un-created once, since they come up

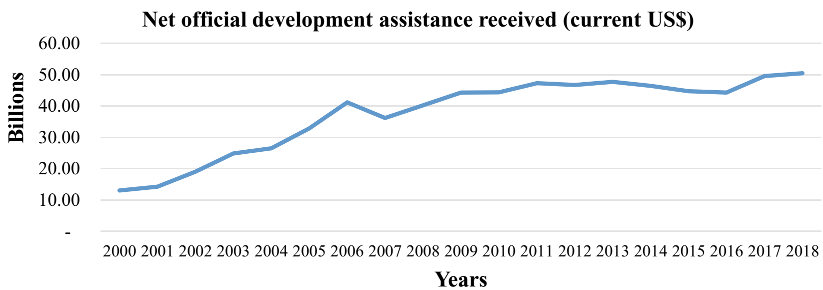

Fig. 12.1 Trend in foreign aid (2000–2018) for SSA (*Source* World Development Indicator, 2022)

short on profundity and ability to raise cash from the capital market. Such arrangement offers beneficiary countries with much-required finance sources for crucial initiatives that would otherwise be difficult to obtain in the capital market. DFIs' ratings are favoured at a certain level, based on loan use.

RDBs also play important roles in infrastructure financing and capital mobilisation. They are primarily involved in funding infrastructure and catalysing finances for both the private sector and public using traditional and new approaches in order to assist public sector growth. Some RDBs, such as the AfDB, have increased the amount of funding that goes into infrastructure projects throughout the years, as well as the proportion that goes to regional project finance. The vast majority of these banks have also shifted to employing blended financing packages and risk management tools to attract private capital, expand capacity in RMCs, and broker complicated transactions (African Development Report, 2011). Aside the provision of financing for infrastructure development projects, there is also an introduction of quasi-equity instruments and subordinated loans to increase total return on investment and/or to improve credit structures to acceptable risk levels (African Development Report, 2011). RDBs have also been more active in issuing guarantees and participating in currency exchange markets. They also encourage capacity building in RMCs in order to construct resilient and sustainable institutions and regulatory bodies capable of developing even the most complicated projects.

12.5 Contributions and Challenges

In spite of the rising tension in the international marketplace, financial contributions to the multilateral development system are increasing. Overall funding to multilateral organisations attained an all-time high of US$ 71.9 billion in 2018. This reflects 3% real terms gain over 2017 and a 32.4% increase from 2011 to 2018. However, this expansion is being driven mostly by an increase in allocated contributions, raising concerns about the rising 'lateralisation' and diminishing quality of multilateral finance. The major MDBs increased their overall lending amounts throughout 2020. Total loan from the largest MDBs reached US$ 131 billion in 2020, up from US$ 90 billion in 2019. In terms of overall volume, this is higher than the loans made in the aftermath of the financial crisis in 2009. Although overall loan volumes grew, the overall year-on-year lending increased far more sharply in percentage terms in the aftermath of the global financial crisis.[2] We discuss some of the main contributions of MDBs as follows.

Providing stable source of finance: Multilateral outflows have progressively climbed since 2011, primarily due to non-concessional loans from MDBs. Multilateral outflows surpass inflows from DAC and non-DAC countries reporting to the system because some organisations, particularly MDBs, have access to capital markets financing. Infrastructure continues to be the largest recipient followed by the productive sectors, which have had rapid growth in recent years, particularly in banking and financial services, agriculture, and industry.

Increasing contribution of non-DAC members: Despite the fact that DAC nations continue to be the largest shareholders and donors of the multilateral development system, other official providers and non-state players are becoming increasingly prominent. Non-DAC members' portion of overall multilateral contributions to the UN system surged from 22% in 2008 to 29% in 2017. This tendency, which reflects changes in the global economy, is especially evident in some industries, including the health industry, where philanthropic foundations and other private entities make up a sizable portion of the international funding.

Support to middle-income countries: Middle-income nations have reaped the most benefits from recent increases in multilateral outflows. The increase in non-concessional flows reflects a greater emphasis on middle-income nations, particularly upper middle-income countries. On the other hand, multilateral lending appears to be less focused than in the past on least developed countries and other low-income countries, despite the fact that several recipient nations have been reclassified in recent years.

Adding value to variety of development needs: DAC members have high hopes for legacy MDBs in addressing global and socio-economic difficulties. They believe that new MDBs, such as the Asian Infrastructure Investment Bank and the New Development Bank, would assist reduce the infrastructure investment gap, and that the UN will play a stronger role in maintaining peace and security and delivering humanitarian aid.

[2] https://www.worldbank.org/en/news/press-release/2023/05/23/multilateral-development-banks-committed-3-6-billion-for-road-safety-in-developing-countries-over-5-year-period.

Offering diverse and complementary comparative advantages: The multilateral development system's disintegration has not diminished its scale benefits over bilateral aid. MDBs are more specialised than bilateral development partners and make better use of government channels. In addition, these organisations allocate a bigger proportion of their resources to fragile environments than bilateral partners.

However, the severity and frequency of numerous compounding and cascading crises, ranging from climate change to pandemics to conflict, have an impact on the ability of countries to pursue development priorities and prepare for future shocks. Consequently, governments are experiencing significant setbacks in their long-term poverty alleviation efforts and broader growth trajectories. Because of its worldwide reach and financial muscle, the MDB system, together with the IMF, has historically been vital for supporting crisis resilience and post-crisis reconstruction in most developing countries. However, these challenges will require the MDBs to evolve to remain pertinent.

Competition for resources: There is intense competition for resources among established multilateral organisations like the World Bank Group and the United Nations (UN). The UN and the World Bank Group continue to be the two cornerstones of the multilateral development system, accounting for more than three-quarters of all funds allocated to multilateral organisations. The establishment of new MDBs on the one hand and the rise of vertical funds, on the other hand, are gradually reconfiguring the multilateral financing landscape (Helble et al., 2018).

Increased ad hoc funding decisions: The diminishing ratio of core contributions to the multilateral development system demonstrates the gradual abandonment of consensus-based strategies by multilateral donors in favour of financing decisions made on ad hoc basis to address particular development issues. This trend reflects, in large part, the principal shareholders' increasingly diverse opinions and lack of common vision. Finally, there is a concern that this tendency will result in a shift of decision-making and accountability from MDB governing boards to a smaller group of multilateral donors who can influence agendas (Barder et al., 2019).

Funding vulnerability: Some MDBs are extremely vulnerable to funding. This is especially true for several UN organisations dedicated to humanitarian assistance, owing to their relatively concentrated donor bases and a significant share of allocated funds. The United States' recent withdrawal from the World Health Organization (WHO) in response to allegations of the organization's close relationship with China exemplifies how a high reliance on a few large donors and low funding quality can undermine MBDs independence and the sustainability of their programmes. These problems necessitate increasing attention from DAC nations to guarantee that budgetary contributions are based on collective interests and include adequate flexibility. This would ensure programme viability and allow organisations to retain impartiality.

The proliferation of alternatives to MDBs: There is a clear growth of alternatives to MDBs in terms of both financial and technical expertise. Many have remarked that private global capital flows outnumber official flows, and the gap between official flows and what is required to meet the SDGs will never be covered with public development funds. This realisation is causing a fundamental shift in how MDB performance is evaluated. Whereas MDBs were originally rated by the volume of finance they offered and disbursed, they are now increasingly assessed by the amount of finance they catalyse from other sources, including the private sector and domestic resources.

Geographical distribution of power: The success of China, India and other emerging economies in reducing poverty means that poverty in the twenty-first century will be concentrated in nations with the most demanding conditions and the poorest capabilities in sustaining progress. By 2030, an estimated 40–60% of the world's impoverished will be living in fragile regions (Chandy et al., 2013). As a result, MDBs' poverty-reduction performance will increasingly be measured in areas where effectiveness is most difficult to attain.

12.6 The Way Forward

There is a substantial and urgent need to increase funding for climate and development efforts. The MDB system must be at the forefront of this investment effort. However, it must act differently and emphasise large-scale investments in global challenges that cross national borders, such as climate mitigation and adaptation, as well as post-pandemic adaptation. The greater emphasis on harmonising national and global demands will manifest differently among MDB borrowers and MDBs themselves. Many countries will require assistance to invest more in risk mitigation, resilience building, and project preparation. And some will require technical assistance and grants to develop a low-carbon transition strategy and create an investment-friendly climate. We discuss some of the recommendations below.

Reform financing patterns: MDBs should agree on a timetable for implementing the G20 Capital Adequacy Review recommendations, including increased use of shareholder guarantees. As a result, MDBs will be able to increase their lending without risking the stability of their long-term finances. Shareholders must be actively involved in the creation, approval, and monitoring of the implementation strategy, which will rely on the technical expertise of expert groups. MDBs should also incorporate guarantees aimed at attracting new funding for climate-related loans and expanding the reach and effect of their climate projects. MDBs should leverage private capital mobilisation and support the reform of the fragmented financial intermediary framework.

Explore novel financial and policy incentives: MDBs should incentivize and encourage countries to employ MDB funding in projects that address global concerns. Differentiated lending terms, flexible guarantee programmes, enhanced financial instruments, and so forth would be useful in this regard.

Assess multilateral funding decisions: MDBs should carefully weigh the trade-offs and options to the various funding mechanisms at their disposal and use a mix of core and earmarked funds in compliance with promises made as part of the international reform agenda and good practice principles. This is because the performance and governance of the multilateral development system are significantly impacted by the quality of funding.

Improve data collection: It is crucial now than ever to ensure that multilateral money provided by non-DAC nations and other stakeholders, such as private players, is accurately recorded in the existing ODA data collection methods, like the OECD Creditor Reporting System and the upcoming TOSSD (total official support for sustainable development) framework. This is true both in terms of absolute and relative growth. Failure to do so will cause a growing gap in the vision and understanding of the multilateral development system among multilateral players.

Ensure better prioritisation of multilateral activities: In an environment of constrained resources, as is likely to arise in the aftermath of the COVID-19 pandemic, effective prioritisation of multilateral operations will be critical in ensuring the best possible use of the scarce resources. A thorough examination of how multilateral development financing complements bilateral ODA and other sources of development funding should serve as the foundation for efforts to evaluate and enhance the selectivity of this funding.

12.7 Concluding Remarks

MDBs are an important aspect of the global financial architecture and play a crucial role in development financing. In this chapter, we examined the contributions of MDBs and discussed the challenges confronting them. Some nations have established MDBs to support international development initiatives through long-term loans and grants. MDBs have a large membership that includes both developed and developing countries. MDBs obtain funding from a variety of sources, including the global capital market, contributions and special donations from members, proceeds from the issue of bonds and partnerships, etc., which help in their ability to fund their activities. MDBs' main operations include providing financing and creating knowledge products, serving also as a significant source of data collection and analysis, which results in the improvement of policy and the generation of ideas for efficient policy planning and execution. This enables MDBs to address broader agenda including regional and global challenges because of the scale of the institutions and the scope of their responsibilities.

The contributions of MDBs include providing a steady source of funding, aiding middle-income nations, meeting a range of development needs, and providing a variety of complementary comparative advantages. However, the severity and regularity of numerous crises have also created major difficulties for MDBs, including resource competition, an increase in ad hoc funding decisions, funding vulnerabilities, the proliferation of MDB alternatives, and the geographical distribution of power. Therefore, to harmonise national and global demands, MDBs can reform financing patterns, explore novel financial and policy incentives, assess multilateral funding decisions, improve data collection, and better prioritise multilateral activities.

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CHAPTER 13

The Role of Regional Development Banks: Comparing African Development Bank and Asian Development Bank

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13.1 Introduction

The World Bank defines a development bank as a bank with at least 30% state-owned shares that have been given a clear legal mandate to achieve social and economic goals in a specific region, sector, or market segment (De Luna-Martínez & Vicente, 2012). Development banks provide long-term funding to promote the growth and expansion of capital-intensive industries. By providing credit as well as a range of advisory and capacity-building services to individuals, small and medium-sized businesses, and even large private corporations whose financial needs are not sufficiently

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met by local capital markets or private commercial banks, development banks have historically played a significant role in assisting governments promote economic growth. By increasing their lending activities precisely when private banks temporarily struggled to lend to the private sector, development banks in Latin America, Asia, Africa, and Europe have played a countercyclical role throughout the financial crisis. This has rekindled attention in the importance of Development banks in times of economic hardship among policymakers in many jurisdictions. Additionally, the financial crisis sparked fresh discussions about the government's role in the economy, particularly the banking sector. They are distinctive financial institutions that focus on supplying high-risk, medium- and long-term capital for profitable investment, frequently complemented by technical support.

Regional Development Banks (RDBs) are set up to extend investment funding to small, medium-sized, and large firms in low- and middle-income nations. As a result, RDBs offer funding support to businesses in the form of grants and low-interest loans for starting businesses. The purpose of RDBs is to increase ownership and overall efficiency while providing flexible assistance to national and regional development operations. Additionally, they provide special skills on economic growth and development to member countries. Strong preferred-creditor status is a result of the unique relationship that exists between RDBs and their member countries, which encourages countries to continue repaying their debt to their bank even under difficult times. Because of proximity and strong economic ties, regional information asymmetries may be greatly reduced. This might reduce the institution's risk and boost its credit rating well above that of its member countries.

Regional institutions may be better positioned to respond to regional needs and demands and to provide more effective regional public goods,

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particularly those that necessitate considerable initial investments and regional coordinating mechanisms. Important examples include assisting in the creation of regional capital markets and harmonizing their regulatory frameworks; and coordinating and assisting in the funding of regional technological innovation projects. Regional development banks' roles in the regional economy and in solving global socioeconomic challenges have evolved over the last 60 years, and this trend is expected to continue.

In this chapter we focus on two regional banks, the AfDB (or Banque Africaine de Development (BAD)) and the ADB. The objective is to elucidate the commonalities and dissimilarities among these two institutions and to highlight potential areas of learning and revision in the operations of the banks. The remainder of the chapter is structured as follows. Section 13.2 provides a discussion on the evolution of the AfDB and the ADB. Section 13.3 presents a comparison of the mandates of these two regional banks. Section 13.4 highlights issues pertaining to the ownership, membership, and voting of the two banks. This is followed by a discussion on issues related to funding and scope and nature of operations of the banks, which is captured in Sect. 13.5. In Sect. 13.6, we discuss the contributions of AfDB and ADB in regional growth. Section 13.7 brings the chapter to an end.

13.2 Evolution of African Development Bank and Asian Development Bank

Evolution of the African Development Bank

The AfDB was established in 1964 with the goal of promoting long-term economic growth and social progress in its regional member countries (RMCs), hence assisting in the eradication of poverty. Its headquarters is located in Abidjan, Côte d'Ivoire. The primary objective of the AfDB is to raise money to support the long-term economic and social development of Africa. To do this, the Bank raises funds from within and outside of the continent to fund development activities such as building schools, hospitals, and roads, as well as supporting programs in agriculture and energy.

Despite the several interventions from international institutions, development in Africa stalled. Among the several reasons were (1) the failure on the part of international agencies to address the African specificity problem and (2) imposition of foreign development ideologies that were not in sync with the African story. Though in Africa some attempts have been made to address regional development issues, this has often been fraught with the linguistic divide. Some countries in Africa are francophone countries while others are Anglophone countries and hence lack of a common language is a barrier to regional integration and development. Several historical moments contributed to the agenda of establishing a regional bank in Africa. For example, the Tubman-Nkrumah-Toure (TNT) conference of 1958, which consisted of heads of state from Liberia, Ghana, and Guinea, was one of such milestones that contributed to the agenda of establishing a regional bank. From TNT conference, the heads of state resolved to ensure total independence of all African countries as well as solidarity. Three years after the TNT conference of 1958, another conference, Monrovia Conference of 1961, was held, which brought together a group of country heads of state and governments in Africa. This conference resulted in the formation of the Monrovia Group. Two draft charters emerged from this meeting: the first one being the Organisation of African Union (OAU), the second being the AfDB. The Executive Secretary and Vice-Secretary of the Economic Commission for Africa were instrumental in establishing the AfDB. A nine-member committee chaired by Romeo Horton was instituted representing nine countries. The committee's mandate was to visit all heads of state in Africa and present the idea of AfDB to them. The importance of Pan-African charter was affirmed from these meetings (AfDB, 2013).

In August 1963, a group of twenty-three newly independent countries signed an agreement in Khartoum, Sudan to establish the AfDB. At the time, twenty member countries agreed to provide 65% of the bank's capital reserves, totaling $250 million US dollars. The inaugural conference of the Board of Governors, which was largely made up of finance ministers from regional member countries, took place in– Lagos, Nigeria, on November 47, 1964. In March 1965, the AfDB's headquarters officially opened in Abidjan, Cote D'Ivoire, and the bank commenced operations on July 1, 1966. However, because of political unrest in Cote d'Ivoire, the bank's headquarters was temporarily moved to Tunisia from 2003 to 2013 when it was returned to Abidjan. It must be noted that the establishment of the bank faced several challenges, the desire of most African leaders to take their destiny into their own hands and dictate Africa's development being the main challenge.

The initial membership was limited to only independent African countries. Therefore, for nineteen (19) years, the AfDB depended solely on capital resources provided by member countries. The capital of the Bank was increased in 1982 to include contributions from thirteen non-African countries. The AfDB Group is made up of three sub-institutions: The African Development Fund, the Nigeria Trust Fund, and the African Development Bank. The AfDB and 13 non-African nations formed the African Development Fund on November 29, 1972, while the Federal Government of Nigeria established the Nigeria Trust Fund in 1976. The purpose of establishing the African Development Fund was to tackle two operational issues that were identified when the bank commenced operations. The first is the nature of lending and the second is the terms of lending particularly for long-term projects or projects with non-financial returns such as education, health, and roads, among others.

Evolution of the Asian Development Bank

The ADB was conceived in 1956, following the success of the Marshall Plan in rebuilding post-war Europe. The Minister of Finance of Japan held earlier talks with the Secretary of State of America on the idea to establish a financing and development institute specifically for the Asia–Pacific region. Even though Japan was willing to provide the bulk of the initial capital, this idea was boycotted by the US government. The notion of establishing an Asia–Pacific development bank was rekindled in 1962, when a group of leading economists from Japan was charged with the task to analyze the potential of creating a development bank in Asia. However, this second attempt failed because it was not supported by the World Bank. The United Nations Commission for Asia and the Far East hosted a ministerial meeting on Asian Economic Cooperation in 1963. The main agenda was to pass a resolution about the creation of a regional development bank in the Asia–Pacific. The idea of the creation of the ADB gained a monumental acceptance in the US as the President Lyndon Johnson saw the creation of ADB as an avenue to entrench US support to Asia. Therefore, the US supported the establishment of the ADB and in 1966 the first president Takeshi Watanabe was elected. The ADB started operations with its headquarters in Manila, Philippines against the expectation of hosting it in Japan, where it started with 31 members, including 11 non-Asian developed members. In April 2014, the ADB opened branches in Nay Pyi Taw and Yangon all in Myanmar. Plans to merge the Asian Development Fund's lending activities with the ADB's regular capital resources were made public in May 2014.

Just like AfDB, the ADB was set up due to the regional need to have a development finance bank that would spearhead the development and growth processes as well as economic cooperation in Asia and the Far East. This again was born out of the failure of international institutions to address the regional specificity development needs such as poverty reduction and infrastructure development. Since its inception, the ADB has championed development support within the region with an initial focus on the agricultural sector. However, this mandate has evolved to include other equally important facets of development requirements needed for the growth, development, and economic cooperation of countries in Asia and the Far East.

The road map to establishing AfDB and ADB has been rough and challenging. Both shared common struggles but also have distinct challenges that pertained to the region of operation. One common struggle was the resistance from international institutions, as the establishment of these regional institutions were seen as eroding completely the total dependence of economies in Asia and Africa on developed economies in Europe and America and presenting likely competition in the area of international finance.

13.3 Comparing the Mandates

The Mandate of the African Development Bank

The AfDB Group's primary responsibility is to assist economic development and growth in Africa, both individually and collectively, by providing capital support for both public and private investment. The AfDB relies on internal and external resources as well as co-financing arrangement with bilateral and multilateral development agencies. The AfDB Group is also mandated to provide technical support services, capacity building, policy formulation and design, and knowledge sharing and to promote international dialogue on regional development. While the core mandate is to spearhead development in Africa, the Bank has evolved in adopting different strategies to achieve the goal of economic development. Beginning in 2006, the Bank increased its focus on important issues such as regional integration, private sector support for economic and governance reforms, infrastructure investment, and economic and governance changes supported by the private sector (AfDB, Charter).

The AfDB performs the following essential core duties in order to accomplish the aforementioned goals:

- Utilization of available funds to support investment projects and initiatives that are geared toward the social and economic advancement of the region's members. Projects with many members, those that advance complementary economies, and those that encourage the smooth expansion of international trade should be given priority.
- Selecting, researching, and preparing projects, businesses, and activities that contribute to regional growth.
- Increasing funding for investment projects and initiatives that help the economic and social development of its citizens by gathering resources both inside and outside of Africa.
- Encouraging public and private investment in Africa in projects or programs with the aim of contributing to the economic and social development of its regional members.
- Providing technical assistance in Africa as required to aid in the planning, preparation, financing, and implementation of development initiatives or programs.
- Performing related activities and providing additional services that promote its mission.

The Mandate of the Asian Development Bank

The main mandate of the ADB is to foster economic growth and integration in Asia and the Far East region collectively and individually through supporting poverty-reducing programs. This mandate is executed in joint partnership with other similar development agencies with similar or connected growth and poverty-reducing mandates. Like the AfDB, the ADB also supports private and public projects through financing interventions. However, due to the dominant nature of agriculture in the area, the initial sector focus of the bank was stakeholders in the agricultural sector by providing support services to and injecting capital into both public and private-driven programs. The following functions have been set up by the bank to guide its operation:

- Fostering investment in the region for the purpose of development, both from public and private sources.

- Utilizing available financial resources to accelerate development projects in developing member countries in the region, with a focus on regional, sub-regional, and national projects and programs that will contribute to the harmonious economic growth of the entire region, especially less developed member countries.
- Responding to requests made by regional members by assisting them in coordinating their development policies and plans to make better use of their resources, promote economic complementarity, and to facilitate orderly expansion of foreign trade, particularly intra-regional trade.
- Offering technical support in the planning, financing, and implementation of development projects and programs, including the development of specific project proposals.
- Collaborating with the UN, its organs and subsidiary bodies (especially the Economic Commission for Asia and the Far East), as well as public and private international organizations and institutions concerned with investing in the region, in ways that align with the bank's agreement, to promote new investment and assistance opportunities.
- Undertaking any other activity or service that will advance the bank's purpose.

13.4 Ownership, Membership, and Voting

African Development Bank Ownership, Membership, and Voting

Shareholding of AfDB is determined by members' contribution. The total bank capital is made up of paid-up and callable capital. The former is the capital that is due over a period of time, and the Board of Governors will decide what that period will be. The later capital refers to payment as it is necessary to satisfy borrowing commitments. As a result, the callable capital serves as a guarantee issued by the bank in cases where the bank is unable to meet its financial obligations.[1] Regarding ownership, the regional member banks control 60% of the total capital of the bank while the balance of 40% is controlled by the non-regional

[1] https://www.afdb.org/en/about-us/corporate-information/financial-information/investor-resources/afdb-capital-subscriptions#:~:text=The%20regional%20members%20hold%2060,%2Dup%20and%2094%25%20callable.

members. As at the end of 2015, Nigeria remained the single largest shareholder controlling about 9% of the total capital stock followed by United States of America with a capital contribution share of 6.6%. Other major shareholders include Canada (3.8%), France (3.8%), Egypt (5.4%), Japan (5.5%), South Africa (5%), Algeria (4.2%), Germany (4.1%), and Cote d'lvoire (3.7%) (AfDB, 2016). Cumulatively these top 10 countries control a share of approximately 50%.

The AfDB obtains its membership from two sources: (1) countries in the African region and (2) non-regional countries. In Article 64 of the Agreement establishing the bank in paragraphs 1 and 2, the procedure of obtaining membership is established. For the purposes of the bank's membership and development activities, the African region comprises the African continent and its neighboring islands. Non-regional countries that are members of the African Development Fund or have contributed to it under terms and conditions comparable to the Agreement establishing the African Development Fund are also eligible for admission to the AfDB. The general guidelines for admitting non-regional nations are established by the Board of Governors, and they can only be changed by a decision of the Board of Governors that is approved by a two-thirds majority of all governors, including two-thirds of the governors of non-regional members, who together account for at least three-fourths of the member countries' total voting power. Currently, the AfDB is subscribed by eighty (80) countries. Out of these 80, 54 countries are from Africa and the remaining 26 are non-regional/African countries. Table 13.1 shows the individual countries that are members of the AfDB.

Voting in AfDB is determined by the shares held among the regional and non-regional country members. Thus, voting rights are determined by a country's shares. In terms of regional voting rights, the regional members have a voting power of 60% while the non-regional members have a voting power of 40%. In terms of countries, Nigeria has the largest voting right of about 9%. "The United States is the AfDB's largest non-regional shareholder, accounting for 6.6% of the total number of shares." Table 13.2 shows the voting powers of top 20 countries both regional and non-regional members as of September 2021. Among the regional members, the top-five countries with higher voting powers are Nigeria, Egypt, South Africa, Algeria, and Morocco. Cumulatively, these countries have a voting power of approximately 30%. Among the non-regional members, the top-five countries with higher voting powers are USA, Japan, Germany, Canada, and France. These countries cumulatively have

Table 13.1 Regional and non-regional member of the AfDB

Regional member countries	*Non-regional member countries*
Algeria	Argentina
Egypt	Austria
Libya	Belgium
Mauritania	Brazil
Morocco	Canada
Tunisia	China
Benin	Denmark
Burkina Faso	Finland
Cabo Verde	France
Côte d'Ivoire	Germany
Gambia	India
Ghana	Italy
Guinea	Ireland
Guinea-Bissau	Japan
Liberia	Korea
Mali	Kuwait
Niger	Luxembourg
Nigeria	Netherlands
Senegal	Norway
Sierra Leone	Portugal
Togo	Saudi Arabia
Burundi	Spain
Comoros	Sweden
Djibouti	Switzerland
Eritrea	Turkey
Ethiopia	United Kingdom
Kenya	United States of America
Rwanda	United Arab Emirates (ADF only)
Seychelles	
Somalia	
Sudan	

a voting power of approximately 24%. Voting rights are weighted so that smaller members receive a higher percentage of the total vote than is proportionate to their size. Each member has a total of 625 votes, plus one vote for each share owned (Fig. 13.1).

Table 13.2 The AfDB's 20 largest countries by voting power as at 2021

Ranking	*Countries*	*Voting power as a percentage of total*
	World	100.00
1	Nigeria	10.077
2	USA	7.581
3	Japan	6.284
4	South Africa	5.863
5	Algeria	5.758
6	Germany	4.779
7	Canada	4.395
8	Morocco	4.368
9	France	4.299
10	Egypt	3.062
11	Italy	2.780
12	Libya	2.749
13	Ghana	2.552
14	UK	2.083
15	Cote Divoire	1.988
16	Sweden	1.802
17	Switzerland	1.683
18	Kenya	1.660
19	China	1.389
20	Denmark	1.351
	All Remaining	**23.479**

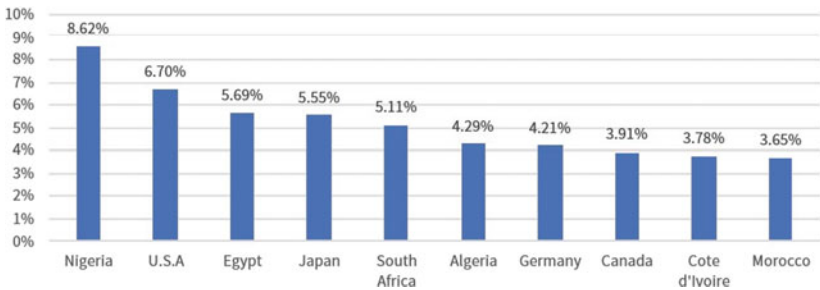

Fig. 13.1 AfDB shareholders, voting power percentage (*Source* Distribution of Voting Power by Executive Director Statement of Voting Power as at 31 July 2018, African Development Bank)

Asian Development Bank Ownership, Membership, and Voting

The shareholding ownership similar to AfDB consists of regional and non-regional members. Largely, the regional member countries control a larger share than the non-regional members. Among the member countries, Japan is the single largest shareholder followed by the USA. These two countries cumulatively contribute about 30% of the bank's capita1. China, India, and Australia, which are the other major shareholders of the Bank, contribute a cumulative share of about 18% of the total bank capital. Table 13.3 presents the details of shareholding powers of member countries of the bank as of December 2020. It is clear from the table that the balance of shareholding powers tilted toward the regional member countries controlling about 63% of the total bank capital compared to about 37% for non-regional members. This mimics the balance of shareholding powers of the AfDB. Table 13.4 shows the non-borrowing and borrowing shareholdings of the bank as at 2021. The non-borrowing shareholders consisting of 27 countries contribute about 67%, while borrowing shareholders consisting of 41 countries contribute about 33% of the shares of the Bank.

During its establishment in 1966, the bank was subscribed by 31 members and this over the years has grown to 68 members. Of these members, 49 come from Asia and the Pacific region while the remaining 19 are non-regional members of the bank. Table 13.5 shows the list of regional and non-regional members of the ADB. Membership of ADB is determined by Article 3 in the ADB Charter.

Similar to the AfDB, the voting power of members of ADB is determined by the balance of shareholder powers held by members. Currently, with regional members dominating in terms of shareholder power, voting power is tilted to regional members. Table 13.6 shows the voting powers of member countries as of December 2020. Regional members have voting power of about 65% and about 35% is for non-regional members. Cumulatively, Japan and USA have voting power of 25.5%. This has had implications on who becomes the president of the bank. Due to the dominance of Japan consistently since the start of the bank, presidents of the Bank have come from Japan.

The top 20 nations are given in Table 13.7 below based on their subscribed capital and voting power at the ADB as of December 2021.

Table 13.3 Shareholder shares of ADB 2020 for regional members

Regional member countries	*Subscribed capital (% of total)*	*Non-regional member countries*	*Subscribed capital (% of total)*
Afghanistan	0.034	Austria	0.34
Armenia	0.298	Belgium	0.34
Australia	5.773	Canada	5.219
Azerbaijan	0.444	Denmark	0.34
Bangladesh	1.019	Finland	0.34
Bhutan	0.006	France	2.322
Brunei Darussalam	0.351	Germany	4.316
Cambodia	0.049	Ireland	0.34
China	6.429	Italy	1.803
Cook Islands	0.003	Luxembourg	0.34
Fiji	0.068	The Netherlands	1.023
Georgia	0.341	Norway	0.34
Hong Kong, China	0.543	Portugal	0.34
India	6.317	Spain	0.34
Indonesia	5.434	Sweden	0.34
Japan	15.571	Switzerland	0.582
Kazakhstan	0.805	Turkey	0.34
Kiribati	0.004	United Kingdom	2.038
Korea, Republic of	5.026	United States	15.571
Kyrgyz Republic	0.298	Subtotal	36.61
Lao People's Democratic Republic	0.014	TOTAL	100
Malaysia	2.717		
Maldives	0.004		
Marshall Islands	0.003		
Micronesia, Federated	0.004		
Mongolia	0.015		
Myanmar	0.543		
Nauru	0.004		
Nepal	0.147		
New Zealand	1.532		
Niue	0.001		
Pakistan	2.174		
Palau	0.003		
Papua New Guinea	0.094		
Philippines	2.377		

(continued)

Table 13.3 (continued)

Regional member countries	*Subscribed capital (% of total)*	*Non-regional member countries*	*Subscribed capital (% of total)*
Samoa	0.003		
Singapore	0.34		
Solomon Islands	0.007		
Sri Lanka	0.579		
Taipei,China	1.087		
Tajikistan	0.286		
Thailand	1.358		
Timor-Leste	0.01		
Tonga	0.004		
Turkmenistan	0.253		
Tuvalu	0.001		
Uzbekistan	0.672		
Vanuatu	0.007		
Viet Nam	0.341		
Subtotal	**63.39**		

Source Asian Development Bank (2020)

Table 13.4 Non-borrowing shareholders and borrowing shareholders

Non-borrowing shareholders	*Shareholders, 2021 (%)*	*Borrowing shareholders*	*Shareholders, 2021 (%)*
Japan	15.60	People's Republic of China	6.40
United States	15.60	India	6.30
Australia	5.80	Indonesia	5.40
Canada	5.20	Malaysia	2.70
Republic of Korea	5.00	Philippines	2.40
Germany	4.30	Pakistan	2.20
France	2.30	Thailand	1.40
United Kingdom	2.00	Bangladesh	1.00
Italy	1.80	Others	5.30
New Zealand	1.50		
Others	7.70		
27 Countries	66.80	41 Countries	33.20

Table 13.5 List of regional and non-regional member countries and year of membership

Regional members		*Non-regional members*	
Member	*Year of membership*	*Member*	*Year of membership*
Afghanistan	1966	Austria	1966
Armenia	2005	Belgium	1966
Australia	1966	Canada	1966
Azerbaijan	1999	Denmark	1966
Bangladesh	1973	Finland	1966
Bhutan	1982	France	1970
Brunei Darussalam	2006	Germany	1966
Cambodia	1966	Ireland	2006
Cook Islands	1976	Italy	1966
Federated States of Micronesia	1990	Luxembourg	2003
Fiji	1970	Netherlands	1966
Georgia	2007	Norway	1966
Hong Kong, China	1969	Portugal	2002
India	1966	Spain	1986
Indonesia	1966	Sweden	1966
Japan	1966	Switzerland	1967
Kazakhstan	1994	Türkiye	1991
Kiribati	1974	United Kingdom	1966
Kyrgyz Republic	1994	United States	1966
Lao People's Democratic Republic	1966		
Malaysia	1966		
Maldives	1978		
Marshall Islands	1990		
Mongolia	1991		
Myanmar	1973		
Nauru	1991		
Nepal	1966		
New Zealand	1966		
Niue	2019		
Pakistan	1966		
Palau	2003		
Papua New Guinea	1971		
People's Republic of China	1986		
Philippines	1966		
Republic of Korea	1966		

(continued)

Table 13.5 (continued)

Regional members		*Non-regional members*	
Member	*Year of membership*	*Member*	*Year of membership*
Samoa	1966		
Singapore	1966		
Solomon Islands	1973		
Sri Lanka	1966		
Taipei, China	1966		
Tajikistan	1998		
Thailand	1966		
Timor-Leste	2002		
Tonga	1972		
Turkmenistan	2000		
Tuvalu	1993		
Uzbekistan	1995		
Vanuatu	1981		
Viet Nam	1966		

13.5 Governance Structure of African Development Bank and Asian Development Bank

The highest decision-making body of the African Development Bank (AfDB) is the Board of Governors, which is comprised of a governor and an alternate governor for each member state. The Board of Governors normally meets once a year, and the Board of Directors is in control of the bank's overall operations. There are nine Board of Directors, and the Board of Governors selected them through a procedure that incorporated the typical checks and balances to ensure a fair distribution of voting power. No director may be chosen by a single country since to be elected, a candidate must receive 10% of all votes. If a candidate receives more than 12% of the votes cast, it is considered redundant. Up until the selection of nine directors, the governors who cast these extra votes, along with the governors who backed a candidate who obtained less than 10% of the total votes, take part in the following voting. The Board of Directors selects the president, who leads the bank's executive team. The president is elected for a five-year term that may be extended, while the vice presidents are chosen by the directors based on the president's recommendations. When

Table 13.6 Voting powers of regional and non-regional members as at 2020

Regional members	*Voting power (% of total)*	*Non-regional members*	*Voting power (% of total)*
Afghanistan	0.321	Austria	0.566
Armenia	0.532	Belgium	0.566
Australia	4.913	Canada	4.469
Azerbaijan	0.649	Denmark	0.566
Bangladesh	1.109	Finland	0.566
Bhutan	0.299	France	2.152
Brunei Darussalam	0.575	Germany	3.747
Cambodia	0.334	Ireland	0.566
China, People's	5.437	Italy	1.737
Republic of Cook Islands	0.296	Luxembourg	0.566
Fiji	0.348	The Netherlands	1.113
Georgia	0.567	Norway	0.566
Hong Kong, China	0.729	Portugal	0.566
India	5.347	Spain	0.566
Indonesia	4.641	Sweden	0.566
Japan	12.751	Switzerland	0.760
Kazakhstan	0.938	Turkey	0.566
Kiribati	0.297	United Kingdom	1.924
Korea, Republic of	4.315	United States	12.751
Kyrgyz Republic	0.533	**Subtotal**	**34.876**
Lao People's Democratic Republic	0.305		
Malaysia	2.468		
Maldives	0.297		
Marshall Islands	0.296		
Micronesia, Federated	0.297		
Mongolia	0.306		
Myanmar	0.729		
Nauru	0.297		
Nepal	0.411		
New Zealand	1.520		
Niue	0.295		
Pakistan	2.033		
Palau	0.297		
Papua New Guinea	0.369		

(continued)

Table 13.6 (continued)

Regional members	*Voting power (% of total)*	*Non-regional members*	*Voting power (% of total)*
Philippines	2.196		
Samoa	0.297		
Singapore	0.566		
Solomon Islands	0.299		
Sri Lanka	0.757		
Taipei,China	1.164		
Tajikistan	0.523		
Thailand	1.381		
Timor-Leste	0.302		
Tonga	0.297		
Turkmenistan	0.496		
Tuvalu	0.295		
Uzbekistan	0.832		
Vanuatu	0.299		
Viet Nam	0.567		
Subtotal	**65.124**		

Source ADB Annual Reports (2020)

hiring positions at the bank, particularly for senior positions, the president must try to hire Africans.

On the other hand, the Board of Governors of the Asian Development Bank (ADB) is its supreme body, and each member is represented by a governor and an alternate governor. In their home countries, the majority of governors are also finance ministers. The Board of Governors has sole control over some issues and normally meets once a year. The Board of Directors has oversight over the bank's overall management. Ten directors are appointed, three by governors who represent non-regional members and seven by governors who represent regional members. At least 10% of the total votes cast for directors by regional members must go to those countries. Directors who represent non-regional members are subject to lower and upper limits of 25% and 26%, respectively. The degree to which the Board of Directors actively participates in policy creation determines the Asian bank. The directors reside in Manila and give the activities of the bank their entire attention. A simple majority of the governors, who

Table 13.7 The ADB's top 20 countries with largest capital contribution and voting rights

Ranking	*Countries*	*Subscribed capital as a % of total*	*Voting power as a % of total*
	World	100.00	100.00
1	Japan	15.571	12.751
1	USA	15.571	12.751
3	China	6.429	5.437
4	India	6.317	5.347
5	Australia	5.773	4.913
6	Indonesia	5.434	4.913
7	Canada	5.219	4.469
8	South Korea	5.026	4.315
9	Germany	4.316	3.747
10	Malaysia	2.717	2.468
11	Philippines	2.377	2.196
12	France	2.322	2.152
13	Pakistan	2.174	2.033
14	UK	2.038	1.924
15	Italy	1.803	1.737
16	New Zealand	1.532	1.520
17	Thailand	1.358	1.381
18	Taiwan	1.087	1.164
19	Netherland	1.023	1.113
20	Bangladesh	1.019	1.109
	All remaining	**10.894**	**22.832**

collectively control a majority of the voting power, elect the bank's president for a five-year term. Additionally, the president must be a national of one of the regional members.

13.6 Funding and Operations

Funding of the African Development Bank

The sources of funding for AfDB have evolved since its establishment in the 1960s. Primarily, funding resources came through member subscriptions, issuing of bonds on the international capital markets, and loan repayment. It also derives resources from African Development Fund (ADF) and Nigeria Trust Fund (NTF). The ADF derives contributions from the member states of the bank particularly the non-regional members. The ADF mainly supports productivity improvement projects. On the other hand, the NTF provides long-term low-interest loans to most under-privileged countries in the region.

Until the reform in 1980, the conventional financial instruments used by the bank were project loans, which included lines of credit and technical assistance. Different mechanisms were introduced post the structural reforms in mid-1980s to foster the credit business of the bank. This led to the introduction of Sector adjustment programs via the Structural Adjustment Loans (SALs) and Sectoral Adjustment Loans (SECALs) as well as Structural Adjustment Programmes at the macro level. Currently the financing instruments used by the Bank are six. These include project loans and credit lines, sector investment and rehabilitation loans, sector and structural adjustment loans, technical assistance activities, budget support, and country system instruments. Project or program financing refers to the first three instruments combined, whereas sectoral and structural adjustment lending refers to the fourth and fifth. It is a known fact that the Bretton Woods Institutions (BWIs) led most of these reforms, but the AfDB has now become an active partner by providing complementary services toward ensuring the success of these programs. The technical assistance support is solely funded using the ADF through the Technical Assistance Fund. The budget support instrument mainly supports financing project-related expenditures as well as public finance budget spending. This instrument is implemented through country systems and, therefore, ensures quick disbursement under some kind of conditions.

Funding of the Asian Development Bank

The ADB source of funding mainly involves the issuing of bonds on the international capital markets, contributions of its members, retained earnings from lending activities or operations of the bank, and the repayment of loans. The lion share of funding comes from regular ordinary capital resources and co-financing. Figure 13.2 shows the plot of ADB's commitment from 2017 to 2021. ADB's commitments in terms of regular OCR and co-financing though forming the largest share exhibit irregular patterns. Generally, decline in one source is somehow compensated by a rise in the other source. For example, while regular OCR declined from US$17.2 billion in 2017 to US$16.3 billion, that of co-financing increased from US$11.9 billion in 2017 to US$14.3 billion in 2018. A

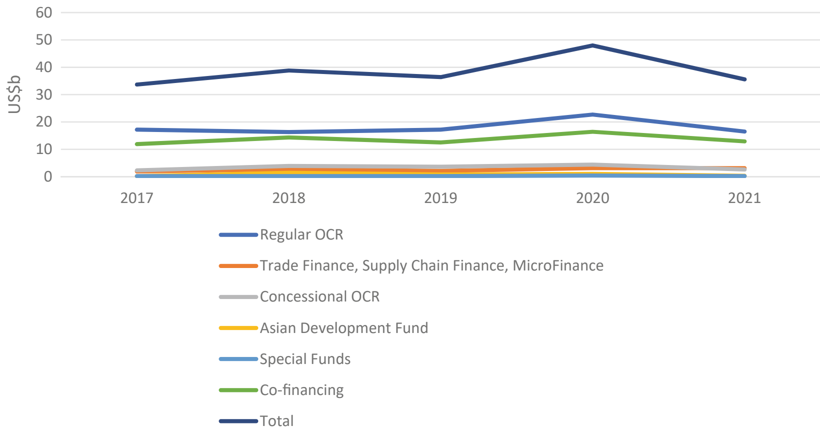

Fig. 13.2 Plot of time trend of ADB commitments (2017–2021) (*Data source* ADB Annual Reports [2022])

similar reversed trend could be seen in 2019 where regular OCR increased to US$17.2 billion but co-financing declined to US$12.5 billion. But in 2020, regular OCR and co-financing increased but declined in 2021. The overall commitment by the bank has also been irregular. Total commitment by the bank depicts a general upward trend peaking in 2020 and then declining in 2021.

Operations of the African Development Bank

The AfDB is led by the Board of Governors that is the highest decision-making body of the bank responsible for appointing the president of the bank and the conduct of the bank's general operations. The President of the bank, who is the Chief Executive Officer of the bank and the chair of the board is mainly responsible for daily management of the bank under the supervision of the Board of Governors. The president's office is supported by 30 departments with 57 organizational divisions and 6 units. A major institutional reform took place in July 2006 mainly to strengthen the operations of the bank and help position it as the center for knowledge exchange in Africa. Currently, the bank has established 25 regional offices to enhance it delivery to beneficiary states.

The main operations of the bank as enshrined in Article 13 of the AfDB Charter are two: ordinary and special operational activities of the bank. The ordinary operational activities are funded from the regular OCR while the special operational activities are funded from the special resource funds. Article 14 of the AfDB charter specifies what the operations of the bank should entail.

- Provision or facilitation of funding for any governmental entity or institution within a regional member's territory, as well as for international or regional agencies and institutions focused on Africa's development.
- Provision of direct loans using either its subscribed paid-up capital and reserves, or special resources.
- Provision of direct loans using funds acquired by the bank, either through borrowing or other means, to be included in its ordinary or special resources.
- Investing the funds mentioned in the first two points above in the equity capital of an institution or undertaking that benefits one or more regional members.
- Guaranteeing loans made by others, either partially or entirely.

The AfDB, driven by its mandate, has supported diverse projects in agriculture, health, public utilities, industry, private sector, education, transport, and telecommunications. The bank is also involved in policy-based reforms within the region and provides technical assistance and policy advice. The scope of activities of the AfDB has expanded to include new initiatives like the water and sanitation, HIV/AIDS, and the New Partnership for Africa's Development (NEPAD). The operations of the bank also include attaining sustainable debts. In the past, it has provided to tune of US5.6 billion debt forgiveness under the Highly Indebted Poor Countries Initiative. Also, in 2006, the bank canceled about US$9 billion debt owned by member countries to help them achieve the millennium development goals. In general, the AfDB has five operational priority areas which is dubbed the High 5. They include infrastructural development, regional economic integration, private sector development, governance and accountability, and Skills and Technology.

Several projects have been executed by the AfDB. The West African region has received the greatest number of projects totalling 1362 amounting to a total commitment of UA22 billion followed by East African region (964 projects totalling UA17.9 billion), Southern African region (883 projects amounting to UA16.6 billion), North African region (601 projects amounting to UA23.6 billion) and Central African region (445 projects amounting to UA8.5 billion). However, in terms of total capital commitment, the North African region leads, followed by the West African region.

Operations of the Asian Development Bank

The bank's articles give it some flexibility in its line of business while also providing it some latitude. Similarly, the articles give a relatively accurate indication of the kind of operational philosophy that was anticipated to develop. Its goal is to support the region's emerging economies. But in practice, it is not limited to that goal because it can lend money to any member as well as to any regional or other international organization that is interested in the growth of the region. Any business functioning in a member country, public or private, may receive a loan from it. It can invest in stock, guarantee loans in which it participates, or provide direct loans. The bank may (but is not required to) request a government guarantee when the borrower is not a member government. Projects that would promote regional cooperation and the smaller member nations must be given priority by the bank. There are rules established to make sure the bank does not deplete its resources. The articles do not require the bank to use a particular interest rate or amortization period. The terms of lending must be related to the special circumstances of the loan, even though it is assumed that this entails appraising the project for which the loan is meant. The bank has shown a great interest in the following industries: manufacturing, integrated development of the Mekong River basin, transport and communications, and agriculture, even though these interests were not reflected in the loans it had made by the end of 1968.

The operations of the bank, according to article 9 of ADB Charter, come in two forms: ordinary operations and special operations. The ordinary operations of the bank refer to those operations or activities financed from the bank's OCR. The special operations of the bank are financed from the Special funds resources. Article 20 of the bank's agreement stipulates what the operations of the bank shall consist of. It states that "the Bank may carry out its operations in any of the following ways:

- Making or participating in direct loans with its unimpaired paid-in capital and, except as provided in Article 17 of this Agreement, with its reserves and undistributed surplus; or with the unimpaired Special Funds resources;
- Making or participating in direct loans with funds raised by the Bank in capital markets or borrowed or otherwise acquired by the Bank for inclusion in its ordinary capital resources;
- Investment of funds referred to in (i) and (ii) of this Article in the equity capital of an institution or enterprise, provided no such investment shall be made until after the Board of Governors, by a vote of a majority of the total number of Governors, representing a majority of the total voting power of the members, shall have determined that the Bank is in a position to commence such type of operations; or
- Guaranteeing, whether as primary or secondary obligor, in whole or in part, loans for economic development participated in by the Bank" (ADB Charter, article 10).

Through the ordinary and special operations of the Bank, the Bank focuses on a number of priority sectors to drive growth and development and reduce poverty in the Asia–Pacific region. The Strategy 2030 also sets out seven priority areas with each having its own operational priority plan.

13.7 Contributions to Regional Growth

Contributions of African Development Bank to Africa

The AfDB, as mentioned earlier, has the core mandate to spearhead economic transformation that would trigger poverty reduction and economic growth. The operations of the AfDB have had a significant impact on the economies in Africa. This is evident through the many critical projects in different sectors, which have either been supported or developed by the bank. The average per capita GDP in Africa before the establishment of AfDB was US$137 in 1960 and it has increased significantly to US$1626 in 2020. Critical infrastructure has been supported by the bank in the energy, transport, and communication sectors. Through the intervention of the AfDB, critical energy projects have been undertaken to improve energy access and reduce energy poverty in the region. Examples of this type of program are the Egypt Electricity and Green Support Programme Phase 1, the Sao Tome Principe Mini Hydropower

Projects Support Program, the Burundi Support Energy for Cooking and Restoration of the Environment in Four Refugee Camps, and others, the Lesotho-Mafeteng Solar PV Project, the South Africa ESKOM II power project, the South Africa ESKOM II Loan, and the Togo-CIZO Pilot Project for off-grid rural electrification using solar kits. These energy projects and many others supported by the bank have significantly improved energy access in the region from 28.4% in 1996 for SSA to 48.2% in 2020 (World Bank, 2023), although a significant effort is needed to reach the target of universal energy for all goal as stipulated in the UN SDG 7.

Similarly, the Bank has supported many road and water infrastructure projects such as the Comoros Road Network Rehabilitation Project, Nacala Rail and Port Projects, Rwanda-Kigali Bulk Water Supply Project, and Egypt—Sharm El-Sheikh Airport Development Project, among others. These infrastructure projects have promoted the movement of goods and services, intra- and inter-regional trade, and improved water supply and access to water supply. The bank has also embarked on several other social, economic, and political interventions within the region. These include various COVID-19 support programs for member countries, Somalia Economic and Financial Reforms Support Programme, and Mali Economic Growth Support Programme II (Fig. 13.3).

The bank has also concentrated on teaching public sector employees about macroeconomics and development strategies as part of its capacity-building initiatives. Trainings in project management and in development management are the two main components of the bank's training programs in regional member countries (RMCs).

The bank has made substantial contributions in the past and is still doing so to the growth of regional infrastructure in Africa. Over 70 international projects totaling $3.8 billion have been sponsored since 2009. This has led to the construction of 467 kilometers of cross-border roads as well as the restoration of 776 kilometers of cross-border transmission lines, among other things. Physical infrastructure, however, is insufficient on its own. Regional integration also depends on the "soft" or institutional infrastructure. In Africa, there are still several non-tariff trade barriers, such as strict "rules of origin," shoddy legal systems, and restrictive procedures, which cause significant losses in regional commerce and economic progress. African nations must abolish onerous "rules of origin," streamline and harmonize convoluted and protracted trade and customs procedures, and deal with corruption and other informal trade

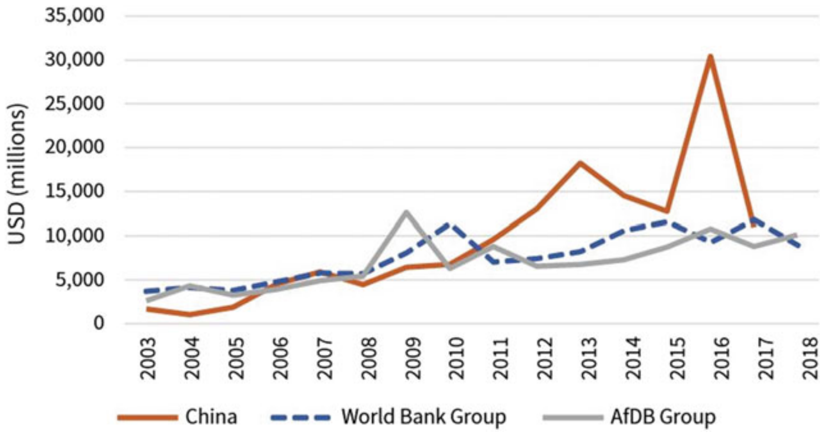

Fig. 13.3 Development finance in sub-Saharan Africa (*Source* China Africa Research Initiative [2002–2017], World Bank Group Annual Reports [2002–2018], AfDB Annual Reports [2002–2018])

barriers if they want their regional integration agendas to have any impact. Additionally, they will need to coordinate crucial institutions and policies among trading partners.

Contributions of Asian Development Bank to Asia

The ADB has facilitated the financing of projects for the region's social and economic development that were previously underfunded or inadequately funded by other sources or organizations. The ADB provides direct financial assistance to privately held enterprises in the form of loans, equity investments, and mezzanine financing for programs that clearly offer social benefits in addition to financial rewards. The ADB frequently contributes a modest amount. But by only holding up to 25% of any given agreement, it is able to use its leverage to secure a sizeable amount of funding from commercial sources. Initiatives aimed at fostering social cohesion or regional integration have not piqued the ADB's interest. Almost all of its lending has gone toward direct economic endeavors like agriculture and manufacturing or infrastructure like water supply, transportation, and power. Prior to the late 1970s, ADB loans for urban development, education, and health did not exceed 2% of overall allocations; nevertheless, they did so for the years 1977–1979, when they reached 7.8%.

The Asian Development Bank oversaw a multi-year, three-year project. The most recent initiative, which ran from 2009 to 2011, was primarily concerned with devising strategies to support emerging member nations with weak statistical systems in order to retain and increase their statistical capabilities. Technical assistance from regional and national sources is used to achieve this. In the 2000s, the Asian Development Bank strengthened its response to the humanitarian crises in Asia. The ADB vowed to assist its member countries in the achievement of the Millennium Development Goals.

A severe acute respiratory syndrome pandemic struck Asia in 2003, highlighting the importance of inter-regional cooperation in the battle against infectious diseases. The Asian Development Bank provided support for regional initiatives to combat HIV and avian flu. The Indian Ocean tsunami in December 2004 caused significant damage to Sri Lanka, India, Indonesia, and the Maldives. The ADB provided more than $775 million in reaction to the catastrophe to aid in the rehabilitation. For the victims of the 2005 earthquake in Pakistan, the ADB raised close to $400 million.

The ADB through its core functions and operations has been very instrumental to the economic transformation of the Asia–Pacific region, a region where prior to the establishment of ADB could boost a per capita GDP of US$100 lesser than the per capita GDP of Sub-Saharan Africa. Decades along the line, the region now boasts of one of the highest per capita GDP in the world. In 2021, the per capita GDP of the Asia–Pacific was US$13,042. The increase in wealth has resulted in social progress and a stable political environment. The economic transformation of Asia–Pacific links strongly to the activities of ADB. Consequently, many countries in the region are experiencing faster economic growth. Average annual gross domestic product for last decade was 7% and foreign investment was nine (9) times bigger than what was recorded in the last two decades. It has been estimated that the economic prosperity of the region supported strongly by ADB has seen about 600 million people escaping the trap of extreme poverty (Anbumozhi, 2017).

13.8 Concluding Remarks

This chapter looked at regional development banks, their operations, governance structure, membership, and contribution to economic growth using the case of AfDB and ADB. It is apparent that both banks share a very common agenda, which is to become the bank that would drive economic growth and development in their respective regions by breaking the colonial dependence on international institutions. Both banks also shared common struggles in the early days leading to their establishment. However, in terms of dealing with fragile states in their respective regions, the challenges are unique to the region of operation. Both banks derive their shareholding balance from the regional and non-regional members. In both cases, it was noticed that the balance of power is also tilted toward regional members, who sometimes control between 50% and 60% of the total capital stock of the Bank. Each of these banks has a historical leading shareholder, but in the case of ADB, the dominance of Japan has ensured that the selection of President always emerges from Japan. This lack of rotational leadership within the ADB might be problematic in the future as it strives to promote regional development. In terms of operational areas of the bank, there are commonalities but also differences, as both banks strive to expand their scope to stay relevant to their mandate. Significant investment has been made by both banks to entrench economic growth in their respective regions, by relying on innovative financing mechanisms.

The aims, operational specifications, funding, membership, and voting rights of the AfDB and the ADB are equivalent. Both banks were founded in the 1960s with the goal of promoting regional economic growth and the advancement of its member countries. The fundamental concerns with the AfDB are those of regional organization whose goal is to emphasize development among its members. The demand that led to the establishment of regional banks has not yet been fully satisfied. A strong conditioning force was applied to banks in both Asia and Africa. As a result, they have been obliged to adopt broad institutional behavior norms that are in conflict with both the criteria that led to their founding and the unique characteristics of their own structures. Although there are many options in theory, the constraints that regional banks must follow severely limit their ability to be used in practice. Conflict of interest exists among developed nations, which set demand, and wealthy nations have the resources required to meet it, leading to these restrictions.

The operating parameters of these two convergent interest groups are frequently followed by regional banks. The promotion of regional integration, which is the main political goal shared by all regional banks, has been typically avoided by these institutions. Regional banks must have a clear understanding of the political goals of developing countries. This is an important ingredient to promote the unity between developed and developing countries.

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CHAPTER 14

The Role of African Export–Import Bank in Trade Financing

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14.1 Introduction

International trade is acknowledged as an important driver of economic growth and development. Integrating it into the global economy through trade offers several potential benefits through technology transfer, adoption of global innovative production processes as well as scale up productive capacity and promote efficiency and competitiveness. Nevertheless, African countries have not been able to fully capture the growth-enhancing benefits associated with international trade. Though Africa's

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population has more than tripled over the last five decades, accounting for about 17% of the world's population, its share of global trade has reduced steadily over the same period, from about 5% to less than 3%. Another issue is the low level of intra-regional trade among African countries, compared to other regions of the world. At about 17%, intra-African trade compares unfavorably with about 68% intra-European trade, and about 55% intra-Asian trade. Apart from infrastructure deficits, tariff and non-tariff barriers, supply-side constraints and financing gaps have also contributed to limiting the growth of intra-African trade, in particular, and extra-African trade in general (AfDB-Afreximbank, 2020).

Certainly, trade finance is critical for promoting trade. The low level of trade in Africa, has largely been attributed to the deficit of financing (Nyantakyi et al., 2021). For instance, in 2019, unmet trade finance demand accounted for over 8% of the region's entire trade volume and 5.5% of the global trade financing gap, with the total African merchandise trade and the global trade finance deficit estimated at US$1 trillion and US$1.5 trillion, respectively (AfDB-Afreximbank, 2020). In 2018, average unfulfilled demand for trade credit accounted for 5.5% of global trade finance deficit, which was estimated to be USD 1.5 trillion (Oramah, 2021). To fill the financing gap, a number of African governments and development finance institutions (DFIs) have increased their support in providing trade finance. DFIs, including the African Export–Import Bank (Afreximbank), the African Development Bank (AfDB), and the International Finance Corporation (IFC) have been very active in this regard. Afreximbank in particular continues to introduce innovative instruments, specialized products, and trade facilitation initiatives in supporting especially intra-African trade, which continues to receive less attention from foreign banks—as correspondent banking services including letters of credit confirmation took a significant hit at the height of the Covid-19 outbreak (Afreximbank, 2020).

This chapter provides a case study on the role of one of such DFIs in trade financing in Africa. We focus on Afreximbank as a DFI with the mandate of promoting both intra- and extra-African trade through trade facilitation including finance. The Latin American sovereign debt crisis of the 1980s and its ramifications led to a significant withdrawal of international banks and financiers from the African trade finance landscape. The immediate response was the establishment of the African Export–Import Bank. The bank was established in 1993 *as a child of necessity* as Africa's Exim Bank to promote and finance intra- and extra-African trade. Since its establishment, the bank has supported the process of economic integration, directly financing the growth of intra-African trade, investing in trade facilitation, expanding trade-enabling infrastructure, and developing technological ecosystems to address decades-old barriers to intra-African trade and investments (Oramah, 2021).

The rest of the chapter is structured as follows. Following the introductory section, Sect. 14.2 discusses the challenges of trade financing in Africa. Section 14.3 looks at the origin and mandate of Afreximbank with Sect. 14.4 examining the ownership and membership of the bank. Section 14.5 discusses the funding and operations of Afreximbank while Sect. 14.6 discusses the contributions of the bank to trade financing in Africa. Finally, Sect. 14.7 concludes the discussions with recommendations.

Challenges of Trade Financing in Africa

Trade financing is an essential element for any nation's economic growth and development, and Africa is no exception. Africa makes up around 3% of global commerce and has the lowest intra-regional trade (as a share of total trade) compared to other regions. With most countries heavily dependent on primary commodities and natural resources, economic growth across the continent has largely been a mirror reflection of commodity price fluctuations. According to AfDB-Afreximbank (2020), a conservative assessment of 2019 projected the unmet need for trade credit at roughly US$82 billion—accounting for about 8% of the region's total trade and about 5.5% of the global trade finance gap. Although, 5.5% may look modest at first glance, it is important to remember that Africa only contributes less than 3% globally; hence, the continent's share of the global trade financing gap is disproportionately higher than the region's contribution to global trade. African countries face unique challenges in accessing trade finance due to several factors, including political instability, weak financial infrastructure, and inadequate legal frameworks. These challenges have contributed to constraining trade finance growth in Africa, with spillover effects of adversely impacting businesses, resulting in slower economic growth and further limiting trade opportunities.

Despite the relative consolidation of democratic tenets across the continent over the last two decades, pockets of forceful overthrow of government and associated instability have resulted in weak governance systems and unpredictable regulatory frameworks, making it difficult for businesses to secure trade finance. Political instability impedes both international investment and commerce, as well as foreign portfolio investment and exports (Qadri et al., 2020). Political instability erodes investor confidence, resulting in a shortage of trade finance and restricting the expansion of trade prospects. Foreign investors, who remain the principal source of funding for African governments, are less likely to invest in a country or area engulfed in political instability associated with potential conflict. For instance, one of the key contributors to the decline of FDI flow to Nigeria is the presence of terrorist-related activities perpetrated by Boko Haram and Niger Delta Avengers (Jung, 2017). Political unrest impedes trade by directly impacting income and prices and indirectly affecting investments in physical capital (Bashir et al., 2013). Conversely, countries with political stability tend to have strong and predictable regulatory frameworks that encourage investment, including trade finance. The African Union (AU) Agenda 2063 recognizes the importance of political stability in promoting trade finance in Africa. In this regard, the AU has developed structures aimed at promoting political stability on the continent, including the African Peace and Security Architecture, which seeks to prevent and resolve conflicts. Mölders (2016) demonstrates that trade policy uncertainty caused by political instability hinders effective discussions between partner nations and makes trade agreements harder to execute.

Inadequate financial infrastructure is another constraining factor in Africa. Many African countries lack robust and competitive banking systems, resulting in limited access to trade finance. Financial institutions in Africa are often characterized by high lending rates, which makes it difficult for businesses to access affordable financing. According to Nyantakyi et al. (2021), around 80% of global trade is dependent on some type of trade financing with an equitable distribution, and enterprises in low-income nations routinely rank a lack of access to finance as one of the top three export difficulties. Accordingly, it is critical to build an interoperable credit system that allows banks to exchange and access data on exporters and importers in real time. Even though this is capital intensive, it has the potential to reduce banks' AML/KYC compliance costs (Nyantakyi et al., 2021).

Additionally, the absence of credit rating bureaus in many African countries makes it hard for businesses to access loans, as lenders struggle to ascertain creditworthiness of potential borrowers. Furthermore, weak legal and regulatory frameworks in many African countries have resulted in a lack of trust in the financial system, contributing to limited access to trade finance. Lack of enforceable contracts and complex property rights have contributed to challenges faced by businesses in using them as collateral for loans—which further limit their access to financing. This has resulted in high transaction cost, including legal fees. The phenomenon of cash-based economies which is prevalent across the continent has contributed to the limited growth of trade finance as the reliance on cash transactions by businesses make it difficult to track financial records, leading to limited access to financing.

To address the challenge of inadequate financial infrastructure in Africa, governments and financial institutions need to work together to develop robust financial systems that are relevant for the unique needs of African businesses. Governments need to prioritize the development of legal frameworks that promote a conducive business environment, including transparent and enforceable contracts, and the protection of property rights. Additionally, financial institutions need to develop financial innovative products tailored to addressing the needs of SMEs and invest in technologies that promote financial inclusion.

Inadequate legal frameworks also pose a significant challenge to trade financing in Africa. Legal frameworks in many African countries are often weak and not adequately enforced, resulting in increased business risk. This has led to high transaction cost, including legal fees, which makes it expensive for businesses to access trade finance. Between 2012 and 2016, overall trade in Africa declined by an average of 6% annually, while the trade finance deficit shrank by roughly 10% during the same time period. Indeed, the entire value of African trade in 2016 was at its lowest ever level, totaling around US$848 billion, mostly as a result of the collapse in commodity prices that started in the middle of 2015 (AfDB-Afreximbank, 2020). The increase in the gap from 2016 may be due to the effects of a shifting global banking regulatory landscape. Due to more severe laws and capital requirements, banks that offer liquidity and risk-mitigation facilities that support global commerce are steadily reducing their activity in riskier areas, notably in Africa. This process is known as "de-risking." Indeed, the primary barrier to the delivery of trade credit is cited by 20% of African issuing banks as correspondent banking ties (Nyantakyi et al., 2021).

Furthermore, the prevalence of informal economies in many African countries has contributed to the limited growth of trade finance. Informal economies are often not included in formal financial systems, making it difficult for businesses operating in these sectors to access trade finance. Many businesses in Africa rely on cash transactions, which make it difficult to track their financial records, leading to limited access to financing.

In order to fill the financing gap, a number of trade finance and development finance institutions (DFIs) are playing varied roles in providing the required financing to drive trade development on the continent. Some of these institutions include the African Export–Import Bank (Afreximbank), African Development Bank (AfDB), and the International Finance Corporation (IFC). In this chapter we focus specifically on the role of Afreximbank in trade financing in Africa.

14.2 Origin and Mandate of African Export–Import Bank

The Afreximbank was established in October 1993 as a pan-African multilateral trade finance institution. The bank, which has a broad mandate of promoting African trade, owes its origin to the African Development Bank (AfDB). In Cairo, Egypt, during the 1987 Annual Meeting of the Board of Governors of the AfDB, African Ministers of Finance adopted a Resolution requesting the management of AfDB to conduct a study on the viability of establishing a regional institution to provide trade finance with a view to promoting African trade, particularly intra-African trade. The greatest concerns of the African Ministers, at the time, were the very low level of intra-African trade, the decline in financial flows to Africa, the worsening external debt situation of many African countries, and the sharp reduction in lending to Africa by international commercial banks. In this regard, there was a consensus that a specialized continental financial institution was needed to spearhead the expansion of African trade—both intra and extra. The feasibility study to ascertain the viability of its creation was initiated in 1987 and completed in 1992, forming the basis of the establishment of the Bank in Abuja, Nigeria in October 1993, when its shareholders held their First General Meeting. The bank commenced operations in September 1994 as an international public–private partnership and uses three broad services including Credit (Trade and Project Financing), Risk Bearing (Guarantees & Credit Insurance), and Trade Information and Advisory Services.

Headquartered in Cairo, Egypt, the Bank currently has 52 participating member countries spread across the continent. There are 5 regional offices in Abidjan (Cote d'Ivoire), Abuja (Nigeria), Harare

(Zimbabwe), Kampala (Uganda), and Yaoundé (Cameroon), to spearhead its regional operations. It also boasts of a regional office in Barbados in the Caribbean to drive Africa's trade and investment relations with the Caribbean.

Ownership and Membership

With 52 participating member countries spread across the continent, the African Export–Import Bank has four classes of shares—A, B, C, and D. Membership of "Class A" shares comprises African Governments/States, their public institutions, or their designated institutions, including continental, regional, and sub-regional financial institutions. "Class B" shares are held by African national financial institutions and African private investors; "Class C" shareholders include non-African international financial institutions and economic organizations, as well as non-regional financial institutions and non-African private investors; while "Class D" shares are held by any person and are structured to be freely transferrable. Afreximbank's "Class D" shares are currently issued as depositary receipts (DRs), which are listed on the Stock Exchange of Mauritius (SEM).

14.3 Funding and Operations

The global economy has been experiencing successive economic crises, resulting in a tremendous rise in global macroeconomic risks. This has caused many international financial institutions to de-risk from African markets. This, coupled with curtailed market access for African borrowers, has created demand for facilities from development finance institutions on the continent. In this regard, being a child born out of necessity, Afreximbank rises to the occasion and intervenes during periods of such economic crises. Thus, over the years, the bank has become systemically important to its member countries, playing a key countercyclical lending role. To play such a role, it requires robust and sustainable funding programs that ensure enough resources to meet the ever-increasing demand for its facilities and services. To this end, the bank has delivered trade finance solutions by using funds raised from both international and local markets.

Afreximbank uses a mix of debt and equity to finance its activities in order to optimize its financial position and performance as well as meet the financing requirements of customers. Out of the total funding the bank raised to finance trade in Africa, the dollar component of the funding (including dollar-denominated pipeline) has accounted for circa 85% of the total funds raised in US dollars and euro funding averaging circa 15%. The bank raises finance mainly from money markets for short-term funding and the international capital market for long-term financing. In the international capital market space, the bank has in place, a Global Medium-Term Note (GMTN) Programme through which it issues long-term debt instruments. The bank also borrows from the international loan market through syndications and club facilities from its international partners. In addition, development finance institutions (DFIs) and export credit agencies (ECAs) have proven to be reliable sources of funding during crisis periods. The bank has often leveraged its strong relationships with DFIs and ECAs to raise medium to long-term funding. This has helped the bank in elongating tenors for loans, especially for project finance-related and trade-enabling infrastructure transactions.

To further diversify its sources of hard currency funding and increase its resilience to external shocks, the bank launched its Central Bank Deposit Programme (CENDEP) in 2014. The program attracts part of the foreign exchange reserves of some African Central Banks, held outside Africa, to directly finance viable trade and project ventures in the continent. The CENDEP Initiative has performed tremendously well and has attracted over 57 African Institutions which have invested in the bank's deposit program mobilizing over US$35 billion in cumulative deposits since its launch.

While, traditionally Afreximbank's interventions have been through hard currency-denominated instruments, there has been a growing demand for local currency funding, largely by entities that in most cases do not generate hard currency receivables. In this regard, Afreximbank has developed a framework for the mobilization and supply of local currency to meet the needs of clients. Lending in local currency allows for easier and relatively feasible trading without the need to source relatively scarce foreign currencies. It helps to mitigate foreign currency exposures among African firms. Lending in local currency also enhances the creditworthiness of trade finance-related projects, which merely generate income in local currency, as it minimizes such foreign exchange risks. Afreximbank's loan provision in local currency plays a critical role in promoting the development of domestic capital markets. As a financial obligation of an investment grade rated credit quality, the bank's bond issuances help in defining an interest rate benchmark, which serves as an alternative to the government bond market (i.e. mostly illiquid). These benchmarks are useful in defining the pricing of other debt instruments in the financial market. Also, the development of money markets is essential for evolving a system of primary dealers, which helps in developing a corporate bond market. Moreover, the issuance of bonds and similar securities introduces innovative and high-standard procedures to the capital market that helps in fostering its wider development. Further, Afreximbank's bonds in local markets help in ensuring a more efficient allocation of risk in the domestic financial markets—and at the same time the bond issuances by the Bank also allow new investors gain exposure to the local currency without being exposed to local credit risk. This serves as a precursor for new investors (mostly foreign investors) to participate in the local government, corporate, and bank debt markets.

Afreximbank's Contributions to Trade Financing in Africa

There is no gainsaying that trade is a major driver of economic growth and development through the exchange of goods and services, capital movements, and technology transfer, and that it promotes cultural links among participating parties at the same time. Again, intra-regional trade is a major catalyst for regional economic integration, as well as contributes to poverty alleviation and societal wellbeing. Notwithstanding the well-documented benefits of trade, Africa's share of global trade is estimated at below 3%—with intra-African trade at about 17% of total African trade, which compares unfavorably with other regions including about 68% for Europe, 53% for Asia, and about 33% for North America.

Accordingly, the continent is yet to fully benefit from the growth-enhancing benefits of trade as a result key constraint to trade promotion. These include low US dollar liquidity, high costs and complexities of regulatory compliance, inability to assess the creditworthiness of potential borrowers, and insufficient collateral. In this regard, expanding trade within Africa and with the rest of the world remains a challenge due in large part to financing constraint. Across the continent, the annual trade finance gap is estimated at about US$100 billion. Bridging this gap, therefore, requires a deliberate effort on the part of major stakeholders to address the challenges confronting African banks in their efforts to expand access to trade finance.

As the premier trade finance bank for Africa, Afreximbank continues to contribute to addressing the perennial trade finance problem confronting the continent. It deploys key instruments and product offerings, including lines of credit and direct financing, as well as innovative products and strategic interventions in support of its member states. Some of the instruments the bank uses are trade finance (export–import), pre- and post-export financing, letters of credit confirmation and refinancing, and reimbursement guarantee facilities. On account of recurring global shocks with adverse implications for its member states, the bank augments its regular suites of offerings with strategic interventions to address specific challenges associated with global shocks such as the 2014–2016 end of commodity supercycle, the recent Covid-19 pandemic, and the ongoing Ukraine crisis and Gaza conflicts, among others. These interventions are usually more focused on the immediate and potential impact of the shocks on member countries. Some of these innovative interventions include Afreximbank Counter-cyclical trade liquidity facility (COLTRAF) which was introduced to address the liquidity challenges occasioned by the 2014–2016 end of commodity supercycle; the Pandemic Trade Impact Mitigation Facility (PATIMFA) introduced to address the effect of Covid-19 on African countries; the Ukraine Crisis Adjustment Trade Financing Programme for Africa (UKAFPA), a program of credit facilities that the bank developed to manage the impact of the Ukraine crisis on African economies and businesses, in addition to its commitment under the ever-expanding Afreximbank Trade Facilitation Programme Facility (AFTRAF). There are several instruments and products in the bank's bouquet of offerings designed to contribute to addressing the continent's trade finance deficit. In this regard, the bank has approved and disbursed over USD140 billion and USD100 billion respectively since inception.

The bank also pursues initiatives designed to reverse unfavorable capital flows out of the continent, while at the same time supporting those that aim at increasing the inflow of forex. For example, its medical centers of excellence program are intended to address medical tourism which contributes to excessive outflow of forex from the continent. The bank's export development program also contributes to expanding export capacity of existing entities, while supporting the development of export capacities of firms with a view to enhancing the inflow of foreign exchange for Africa.

14.4 Conclusion

Trade will remain pivotal to the development aspirations of countries. While Africa continues to perform poorly on both total trade and especially intra-regional trade, several constraints, including complexities and high regulatory and compliance costs, difficulty in assessing creditworthiness of potential borrowers, inadequate collateral, and low US dollar liquidity, have contributed low bank intermediation in the continent's trade finance space. Accordingly, limited access to trade finance emerges as a major constraint to facilitating and expanding Africa's trade. Required financing is estimated at about USD100 billion per year. The African Export–Import Bank, since its establishment, has contributed to addressing the continent's trade finance deficit by designing and deploying innovative instruments and facilities. The bank also deploys strategic initiatives and interventions to capacitate corporates in its member states to seamlessly circumvent the adverse impact of recurring global shocks. Despite Afreximbank's contributions in Africa's trade finance landscape, there remains a significant gap to be closed. To this end, it is our recommendation for a holistic review of the banking regulatory environment including the development of credit referencing bureaus, introduction of bespoke AML/KYC structures to reduce regulatory and compliance costs, as well as appropriate incentives, with a view to capacitating banks and financial institutions to increase their trade finance operations.

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CHAPTER 15

The ECOWAS Bank for Investment and Development: Major Achievements and Challenges

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15.1 Introduction

The role of development banks in implementing modern global finance and financial assistance to developing countries, typically in the form of loans and grants, for investment projects and policy-based loans has

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become evident in the last two decades (Engen & Prizzon, 2018). A policy discussion of the need for international development architecture prompted by the prolonged economic instability and resulting crises of developing countries and the fact that access to global private financial markets is virtually blocked for some developing countries (ACET, 2022). Given that national development banks are too small to supply the major financing needs of developing countries, the main long-term objective should be integrating developing countries into setting up private financial markets and international financial institutions to promote the development of the private and public sectors. Resolving the instability problem, although comes with diverse benefits on its own, is a prerequisite to meeting the global Sustainable Development Goals (SDGs). In view of that, many international financial institutions including the ECOWAS Bank for Investment and Development (EBID), have emerged to champion the economic and financial development of developing countries and emerging economies through the financing of regional projects and programs (ACET, 2022; World Bank, 2023).

The need for international financial institutions has become pressing because the official development finance institutions—International Monetary Fund (IMF), the World Bank, the regional development banks (RDBs), and particularly those in Africa—have worked on economic and financial instability for over two decades without a solution. Thus, the discussion in the policy space largely centers on how to increase the effectiveness of the complementary efforts of international financial institutions in solving these problems and making significant contributions to the SDGs (ACET, 2022; World Bank, 2023). Given the importance of sustained access of developing countries to both the public and private markets as well as the level of investments and development financing needed to build a resilient financial and economic system, some regional blocks, including the West African community, have been established to unlock the opportunities for economic growth and financial stability through access to development financing and the public and private markets in the region (Akperan & Kayode, 2010). EBID is one of the international financial institutions set up by the 15 member Economic Community of West African States (ECOWAS) to lead investment development financing and make significant contributions to the economic development of West Africa. It plays an important role in maintaining stability and establishing sustained economic growth through the private and public sectors in the region (Derreumaux, 2020). The bank is particularly valuable for target sectors of the economy among the member states. It is able to partner with international Development Finance Institutions (DFIs) and other global institutions, and has the capacity to negotiate with large global institutions.

The chapter presents the overview of EBID by discussing its evolution and mandate, ownership and membership, funding and operations, significant achievements and challenges.

15.2 Evolution and Mandate

In 1975, the Economic Community of West African States (ECOWAS) Fund for Cooperation, Compensation and Development was established and started operations in 1979. Its establishment occurred at the same time as the erstwhile Executive Secretariat of ECOWAS, now ECOWAS Commission. The Fund for Cooperation, Compensation and Development of the ECOWAS was later transformed into a banking group known as the ECOWAS Bank for Investment and Development (EBID) in 1999 (see Akperan & Kayode, 2010).

The bank is owned by all the 15 member states of the West African Community, with the head office in Lomé, Togo. In 1999, EBID started operations as a holding company with specialized subsidiaries: (1) ECOWAS Regional Development Fund (ERDF) for financing the public sector; and (2) ECOWAS Regional Development Fund (ERDF) for financing the private sector. To expand the bank's services to a broader range of stakeholders involved in sustainable economic development activities and programs at national and regional levels, the Authority of Heads of State and Government of ECOWAS, in 2006, agreed to reorganize the EBID Group into a single entity with two windows: one for the promotion of the private sector and the other for the development of the public sector.

The bank has a core mandate to be the premier regional bank for financing investment and development in West Africa; an effective financial organization to support and finance the region's private sector; and an effective tool for reducing poverty, generating wealth, and improving the well-being of the people of the region (Derreumaux, 2020). EBID's mission is to help create conditions conducive to the emergence of an economically strong, industrialized and prosperous West Africa, seamlessly integrated both internally and into the global economic system to benefit from the opportunities presented by tapping into the opportunities and prospects of globalization (Engen & Prizzon, 2018). Its main objective is to contribute to the economic development of West Africa by funding ECOWAS projects and programs, including programs in the fields of transport, energy, telecommunications, industry, poverty alleviation, environment, and natural resources. According to its statutes, the bank has objectives specific to supporting infrastructure projects related to regional integration or other public and private sector development projects; and community development by funding special programs.

The corporate mandate of EBID is to grant loans and guarantees to finance projects and investment programs for the economic and social development of the member states. It mobilizes resources inside and outside the community to finance ECOWAS' investments and projects. The bank supports the Community with technical assistance to review, prepare, finance, and carry out initiatives and development programs. Additionally, the bank manages any specific community funds for specific projects and some community contribution resources designed to finance community development initiatives. The bank collaborates with community-based national and sub-regional development groups as part of its overall mission. It further collaborates with local and international organizations engaged in community development with comparable objectives (see, Adaku et al., 2022; Humphrey, 2019; Niţescu & Murgu, 2022).

15.3 Ownership, Membership, and Governance

Development Finance Institutions (DFIs) generally can have one of two ownership structures: either the government or member states entirely own them, or they are jointly owned by the government and private shareholders (Abor, 2023). For instance, regional development banks are owned by member states, including both regional and non-regional countries (Bruszt & Palestini, 2016; Humphrey, 2019). These ownership structures have an impact on how those banks are regulated. Member states hold shares in the institution. Generally speaking, a member state's voting rights and degree of board representation are determined by the size of its economy and financial support to the organization (Abor, 2023).

EBID, the financial arm of ECOWAS, is an international financial institution set up by the governments of ECOWAS. The shareholders of EBID are the 15 member states of the ECOWAS community, who are also fully eligible for financing operations. The member states are Benin, Burkina Faso, Cabo Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo. Each member state's share in the bank's capital is based on its economic weight within the West African community (expressed in terms of GDP) at its accession (see, Bruszt & Palestini, 2016).

The Board of Governors is the highest decision-making body. It consists of one governor for each member country, generally, the finance, planning, or regional integration ministers of the fifteen ECOWAS member states. The Board of Directors is in charge of the bank's general operations. The Articles of Association specify the Chairman of the Board of Directors' authority and assigns him the daily management of EBID. Two vice presidents—the Vice President of Operations and the Vice President of Finance and Corporate Services—serve as the president's deputies.

15.4 Funding and Operations

EBID relies on the 15 ECOWAS Member States for financing, as well as other sources of funding, including borrowing from international financial institutions. The governors delegate the day-to-day operations, lending, and other business activities to the President and Chairman of the bank's Board of Directors. The main development partners of EBID include the West African Economic and Monetary Union (WAEMU) Market; African Export–Import Bank (Afreximbank), Egypt; Arab Bank for Economic Development in Africa (BADEA), Sudan; the Government of India; and Islamic Bank of Development (IsDB), Saudi Arabia. EBID contributes to the sustainable development of Member States of the ECOWAS Community by funding regional and national projects (public and private). For instance, the bank commits to a minimum amount of US$ 1.5 million and a maximum amount of US$ 30 million for national public sector projects; a maximum amount of US$ 45 million for regional public sector projects, and a maximum amount of US$ 22.5 million for private sector projects.

The mode of funding includes the issuance of direct short, medium, and long-term concessionary or non-concessionary loans to the public sector; issuance of direct short, medium, and long-term loans to the private sector; and equity participation through equity or quasi-equity (convertible bonds and participatory loans). The bank also intervenes by financing financial institutions of member states through lines of credit, granting and/or guaranteeing of debenture loans, bonds, notes, and other debt instruments and securities, as well as providing financial services. Equity and member states' contribution to capital is a key source of funding for the bank. With a total of US$2.5 billion (US$3.5 billion) in authorized capital, 30% (US$1.05 million) is available for subscription by non-regional members while 70% is set aside for regional members (15 ECOWAS Member States).

In addition, the bank intervenes in intra-regional trade to enhance trade among member states; supports agriculture to achieve food self-sufficiency; promotes financing of Clean Development Mechanism (CDM) projects, renewable energy projects, and the carbon market through its contribution to the establishment of the African Bio-Fuels and Renewable Energies Fund.

15.5 Major Achievements, Interventions, and Challenges

Over the past years, EBID has become a key lever for transforming the economic development of West Africa through major ECOWAS funding projects and programs. To promote trade and become the leader in investment and development finance among member States, EBID also participated in the financing of intra-regional trade (Humphrey, 2019). It has promoted financing of Clean Development Mechanism (CDM) projects, particularly those relating to energy efficiency, renewable energies, and the carbon market, through its contribution to the establishment of the African Biofuels and Renewable Energies Fund with the help of the World Bank and other development partners (Niţescu & Murgu, 2022).

The bank has contributed to the development of some key sectors of the economy. Some of the key achievements and intervention projects of EBID across the West African Community have been described in Box 15.1

Box 15.1 Key Achievements and Intervention Projects of EBID

Key Achievements

- Decades of experience in project financing within and among ECOWAS Member States

- Major partner for regional integration programs and implementation of Public–Private Sector partnerships in Member States
- Initiator of the African Biofuels and Renewable Energy Fund (ABREF), now ABREC
- Partner and Manager of the Cultural Industries Guarantee Fund (CIGF)
- Founding shareholder in ASKY Airlines
- Largest founding shareholder in Ecobank Transnational Inc. (ETI)

Intervention Projects in Member States

	Country
Public Sector	
• Interconnection of the Mali-Côte d'Ivoire Electricity Network	Mali
• Construction of the Samendeni Dam and Hydroelectric Power Station	Burkina Faso
• Rehabilitation of the Akatsi-Aflao Road	Ghana
• Rehabilitation and Equipping of Health Facilities	Togo
• Enhancement of the Portable Water Supply System in Tafire Town and the Surrounding Communities of Badikaha and N'golodougou	Côte d'Ivoire
• Construction of a 120 MW Thermal Station at Maria Gleta	Benin
Private Sector	
• Creation of the Cement Factory in Kagbelen by Diamond Cement Company	Guinea
• Installation and Operation of an Intravenous Fluids Factory at Aveta by DO PHARMA	Togo
• Construction of a 220 MW Thermal Power Plant and Dual Fuel Conversion Component of the Mines Reserve Plan at Kpone and Tema by the Volta River Authority	Ghana
• Construction of Kempinski Hotel	
• Procurement and Operation of the 3rd Global Telecommunications License by Alpha Télécommunication SA	Mali
• Line of Credit to la Banque Malienne de Solidarité to Enhance Medium Term Loans	
• Extension and Densification of SONATEL Fixed and Mobile Telecommunication Networks	Senegal
• Line of Credit to La Banque de 'l'Habitat in Senegal to Enhance the Refinancing of Housing Loans	
• Construction of a Turn-Key 60 MW Kounoune 2 Station Diesel Station by SENELEC	
• Construction and Operation of the Henry Konan Bédié Toll Bridge by SOCOPRIM S.A	Côte d'Ivoire
• Construction and Operation of a 5 star Hotel Complex in the Radisson Blu Chain	

Source EBID in Brief, 2021; https://www.bidc-ebid.org/en/home/aboutus/

The goal of EBID's trade finance interventions is to develop market and finance trade flows (commodity production, processing, and trading) among ECOWAS Member States and their trading partners on a regional and global scale. The following are the several trade financing services that EBID provides:

- Offering fully collateralized short-term loans backed by underlying physical commodities;
- Financing the time between the production or warehousing of a commodity and delivery to the off-taker;
- Exercising complete custodianship over the value chain from production or warehousing to delivery;
- Financing products such as input finance, stock finance, export and import finance with or without processing of goods.

EBID's trade finance engagements are in two ways: (i) trade finance under direct projects financed by the bank and (ii) structured commodities trade finance. The bank has committed US$ 394,563,305 in trade finance under direct investment projects including projects with funding from the Indian Exim Bank. About US$160,140,229 has been committed under structured commodities trade finance covering fertilizer, rice, and petroleum products.

Although EBID has made significant contributions to the ECOWAS region, the bank is faced with many project implementation challenges in the priority sectors. Examples include issues relating to obtaining investment rating by the international rating agencies; access to cheaper (competitive) sources of funding (leading to the generally high cost of funds); single office location without a physical presence in other countries—making supervision of projects difficult and expensive—maintaining the development agenda while remaining profitable. In the case of concessionary funding, countries that require low-interest rates erode the bank's interest margin. In addition, there are general economic challenges in the ECOWAS sub-region. This means that the major macro fundamental indicators like exchange rates, inflation, impacts of the COVID-19 pandemic, and external shocks from the global market that affect the region also affect the bank.

15.6 Concluding Remarks

The chapter provides an overview of EBID by discussing the evolution and mandate, ownership and membership, funding and operations, and major achievements and challenges of the bank. In general, EBID seeks to support West Africa's economic growth by funding ECOWAS projects and initiatives, particularly those that deal with energy, telecommunications, industry, poverty alleviation, the environment, and natural resources. The bank has a core mandate to be the premier regional bank for financing investment and development in West Africa, an effective financial organization to support and finance the region's private sector, and an effective tool for reducing poverty, generating wealth, and improving the well-being of the people of the region. The corporate mandate of EBID is to grant loans and guarantees to finance projects and investment programs for the economic and social development of its member states. The shareholders of EBID are the 15 member states of the ECOWAS zone and are fully eligible for financing operations. The funding sources include equity, grants, guarantees, and debt instruments with the target industry of the bank consisting of agro-industry, mining, and others while the target service sector includes financial services, Information Technology services, and hospitality services (e.g., hotels, etc.). The goal of EBID's trade finance interventions is to develop market and finance trade flows (commodity production, processing, and trading) among ECOWAS Member States and their trading partners on a regional and global scale. The general economic challenges in the ECOWAS sub-region also affect the bank.

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CHAPTER 16

Development Banking in East Africa: The Case of the East African Development Bank

Jared Osoro, Roseline N. Misati, and Samuel Tiriongo

16.1 Introduction

Development banking in East Africa, when taken in a historical context, is aligned to the prosperity aspirations of the region's economies since their respective independence in the early 1960s. The three initial members of the East African Community (EAC) namely Kenya, Uganda, and Tanzania recognized that, while long-term finance was critical in promoting long-term growth, it was seldom available (Hu et al., 2022). That underpins their setting up of development banks at national levels as

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well as the East African Development Bank (EADB) with an EAC-wide mandate. The development banks, being government-sponsored financial institutions, were mandated to intermediate long-term capital for development.

The inspiration of the development banks in East Africa has been the success cases of similar institutions in Europe, Asia, and Latin America where they have spearheaded rapid industrialization (De Aghion, 1999). Like any other less-developed region, the replication of such successes in East Africa has been difficult. This is even more prevalent at the regional level where geopolitics and competing national interest sometimes override regional aspirations which remains a bane of the region. Further, even as development banking is considered to be a specialized space given its long-term financing orientation, the financial sector dynamism is increasingly eroding their comparative advantage.

In pursuit of their profit motives, leading commercial banks in East Africa have benefited from long-term funding from international financial Institutions (IFIs). In the process the boundaries distinguishing development banks from commercial banks become blurred. Beyond long-term finance, commercial banks have increasingly embraced sustainable financial principles, hitherto considered a development banking *forte* whereby social and environmental considerations are elevated in lending to commercial enterprises.

The governance and regulatory framework of international development finance institutions (DFIs) has underpinned a three-pronged approach towards long-term financing in East Africa. The first approach includes the traditional lines of credit, initially to development banks but increasingly availed to commercial banks. The second is equity capital whereby such DFIs take shareholding position with a view to enabling the beneficiary banks, whether development or commercial, enhance their leverage. The third is direct lending to non-financial sector actors, especially where the funding requirements are substantially higher than the balance sheets of individual financial intermediaries can bear, pointing to the scale inadequacy of individual development banks in East Africa. The ability of the development banks in East Africa to attain scale through leveraging government sponsorship in the form of equity by the region's governments is core to assessing the extent of their success in delivering on their respective mandates.

On the backdrop of the development banking landscape in East Africa, this chapter focuses on the EADB case. The focus is informed by the evident commonality of the development aspirations of the EAC members given the long history of their pursuit of economic integration that goes as far back as 1917.[1] The EADB being a creation of the EAC motivates the expectations of it being considered a flagship development bank in the East African region.

An assessment of whether the EADB has lived up to the expectations is undertaken in four sequential stages. Section 16.2 provides a discussion of the foundational aspects of the EADB and its evolution over time. Section 16.3 delineates the EADB's contribution to the region's development, incorporating a discussion of the implications of commercial banks' foray into aspects of development finance on such contribution. Section 16.4 highlights the key challenges that the EADB has faced in the pursuit of its mandate and precedes the concluding thoughts in Sect. 16.5.

16.2 The Establishment and Evolving Mandate of the EADB

The EADB was established in June 1967 following the signing of the Treaty of the East African Cooperation.[2] The Treaty came into effect on 1st December 1967 and effectively ushered in the East African Community (EAC). Therefore, the EADB, was founded within the provision of the EAC Treaty. Prior to that, the economies of Kenya, Uganda, and Tanzania had a long history of integration, its depth increasing at every stage of the process but not devoid of inhibitions especially over the two years prior to the coming into effect of EAC Treaty.

Following the formation of a customs union between Kenya and Uganda in 1917, the East African Currency Board (EACB) was established in 1919. Tanganyika joined the EACB in 1921 and then acceded to the Customs Union and the common external tariff in 2022. In 1923, the three economies eliminated internal tariffs within the bloc. A key milestone in the East African integration process was the introduction of the East African Shilling in 1936.

Tanganyika attained its independence in 1961 and in 1964 merged with Zanzibar to form the United Republic of Tanzania. The attainment

[1] The "*History of EAC*". https://www.eac.int/eac-history.

[2] EAC (1967) The *Treaty for East African Co-operation*, June.

of independence of Kenya and Uganda in 1963 was seen as critical in shaping the momentum of the integration agenda of the three countries. However, the following two years represented a rollback of the integration progress. A 1964 Agreement to reduce trade imbalances among them was not implemented. This was followed in 1965 by Tanzania and Uganda imposing restrictions on intra-East African trade. A year later, the East African Currency Board was abolished as each country established its own central bank and the respective national currencies replacing the East African Shilling at Par.

The foregoing historical chronology of the East African integration leading up to 1967 has an important context to the foundational mandate of the EADB. Even on the back of the elaborate integration arrangements, there was a shared perspective that these initiatives did not culminate in an equitable distribution of benefits among the EAC partners. This did not only necessitate the establishment of the EAC under the 1967 Treaty but most notably the establishment of the EADB as a principal instrument designated to address industrial imbalances among the partner states.

With industrial equity as the centrepiece of the EADB's mandate, its specific objectives were spelled out as follows[3]:

- to provide financial and technical assistance to promote industrial development of the partner states.
- to give priority, in accordance with the operating principles contained in the EADB's Charter, to industrial development in the less industrially developed partner states, thereby endeavouring to reduce the substantial industrial imbalances between them.
- to further the aims of the EAC by financing, wherever possible, projects designed to make the economies of the partner states increasingly complementary in the industrial field.
- to supplement the activities of the national development agencies of the Partner States through joint financing of operations and by use of such agencies as channels for financing specific projects.

[3] The establishment of the EADB is as per Article 21 of the Treaty for East African Cooperation of 6 June 1967 (hereinafter referred to as the Treaty of 1967), while its initial objectives were spelled out in the EADB Charter that was set out as Annex VI of the said Treaty.

- to cooperate, within the terms of the EADB's Charter, with other institutions and organizations, public or private, national or international, which are interested in the industrial development of the partner states.

It was explicit from the objectives of the EADB that industrial development was a key aspiration of the EAC economies. This was justifiable because the industrial sector in East Africa was then relatively small, and hitherto played a little but gradually increasing role in the three economies. The development plans of the respective partner states at the time recognized that industrialization was an essential ingredient for sustained economic growth. Besides providing employment, the endeavour to promote the partner states' industrialization was meant to reduce dependency on agricultural sector that is vulnerable to weather and unpredictable international prices.

At the time of the EADB's establishment, manufacturing accounted for about 15 percent of Kenya's Gross Domestic Product (GDP) and about 11 percent and 8 percent of GDP for Uganda and Tanzania.[4] Except for a few industries in Kenya that produced intermediate and capital goods, most of the manufacturing in East Africa at the time were either processing raw materials for export or using local materials to produce import substitutes. While the operations of the EADB were guided by banking and commercial principles, the Bank was required in its project selection to give priority to the less industrially developed Partners in the EAC. The differential investment formula that required 77.5 percent of the EADB's lending to be allocated to Uganda and Tanzania in equal proportion and the balance of 22.5 percent allocated to Kenya in every five years was anticipated to reduce the then-existing industrial imbalances.[5]

Membership, Funding, and First Decade of Operation

With the task of the EADB laid out, the member states' backing in the form of equity subscription facilitated the commencement of operations. The EADB's authorized share capital was an equivalent of USD 57.5

[4] Data from official statistics of the respective economies.

[5] EADB (1968). Annual Report.

million. External participation in the EADB's equity capital was envisaged and pursued right from inception, provided that the member states have a majority of the Bank's equity stake.

External equity participation was important for two reasons. One, it augmented the resource base of the Bank; and two, it enabled the Bank to take advantage of the experiences of older and longer established financial institutions on its governance as well as inspire international confidence in the new institution. National and Grindlays Bank was the first institution in the external equity participant category to join the EADB in 1969. By the end of 1970, four other financial institutions, namely the African Development Bank, Commercial Bank of Africa, Standard Bank, and Barclays Bank International, became members of the EADB, alongside a Consortium of Yugoslav Institutions. In 1974, Post-Och Kredit Banken of Sweden Joined the Bank. The shareholding structure of the bank by the end of 1974 is reported in Table 16.1:

Additionally, the EADB supports its operations through the mobilization of lines of credit and other forms of funding. Notably, in the period 1972–1977, EADB secured lines of credit from the African Development

Table 16.1 EADB shareholding structure 1974

	Paid in shares		
	No	*Amount (USD)*	*% of Total*
CLASS A			
Kenya	400	5,992,547	30.70%
Tanzania	400	5,992,547	30.70%
Uganda	400	5,992,547	30.70%
	1,200	*17,977,640*	*92.20%*
CLASS B			
African Development Bank	35	524,348	2.70%
Barclays Bank International	2	29,963	0.20%
Commercial Bank of Africa	5	74,907	0.40%
Consortium of Yugoslav Institutions	28	419,478	2.20%
National and Grindlays Bank	24	359,553	1.80%
Standard Bank	2	29,963	0.20%
Post-Och Kredit Banken	5	74,907	0.40%
	101	*1,513,118*	*7.80%*
Total	1,301	19,490,758	100.00%

Source EADB Annual Report 1974

Bank (AfDB), the International Bank for Reconstruction and Development (IBRD), and now the World Bank and the Swedish International Development Authority (SIDA).

The EADB's pioneering role was evident from the product range on offer, with its principal intervention mechanism being direct loans to projects. These loans, mainly long-term and in a mix of local and convertible currencies, allowed the Bank to support the industrial aspirations of the Partner States. The direct loans were complemented by convertible loans, equity participation, lines of credit to national development institutions, and guarantees. These products, especially equity participation, were in many respects unconventional given the limited depth of the region's financial sector during the period.

The level of investment approvals over the first decade of the EADB's operations reflects the Bank's modest start. It is however worth appreciating that the role and impact of institutions such as the EADB were at its formative stage not to be judged on the magnitude of resources that they individually commit to projects but rather on the total investments which—along with other financial institutions—they helped generate.

The EADB's achievements during its first decade were to some extent constrained by the operating environment. Most notable was the global economic crisis from 1972/73 to 1975/76 that was characterized by the international oil crisis and the subsequent pressure on the balance of payments of non-oil producing economies including the EADB member states. The global challenges aggravated the problems facing each of the member states, inevitably weakening their systems to cooperate further. The political environment in Uganda from 1971 created anxiety among investors. These circumstances adversely affected the EADB's investments in the region's industrial sector. The tea and coffee boom of 1976/77 somewhat eased the adverse economic conditions as it resulted in interstate commerce. The lowest moment in the EADB's first decade was signified by the collapse of the EAC in July 1977.

The subsequent assessment of the extent to which the expectations of EAC—and by extension the EADB—were realized during the 1967–1977 period returned a negative verdict (Eken, 1979). On account of differentials in levels of economic development, market mechanisms exacerbated inequality. The benefits from the union remained skewed in favour of Kenya, arising principally from the enlarged market of its relatively developed manufacturing industries. The loss of revenue from import duties by Uganda and Tanzania was not compensated for by the pursuit of industrial development. The industrial imbalances that underpinned the EADB's founding mandate prevailed at the end of its first decade of operations.

An Expanded Mandate

The EADB's 10th Anniversary coincided with the collapse of the EAC under whose auspices the bank was established. However, as a demonstration of confidence in EADB, and with the conviction that the EADB had a critical role to play in the development of the East African economies, the Member States and other equity subscribers continued to support its operations post the collapse of the EAC. Beyond confidence, the closure of the EADB could have entailed repayment of the lines of credit, in which event there could have been substantial foreign capital outflow at a time when the East African economy could least afford. It was therefore necessary for the Bank to have a new legal foundation in the form of the East African Development Bank Treaty and Charter of 1980. The period between 1977 and 1980 when the new EADB legal instrument came into effect was therefore transitional and characterized by minimal activity.

The EADB's new Treaty and Charter provided for a wider scope of cooperation among the member states, with the Bank's new mandate being to finance projects in all key sectors of the regional economy—including tourism, agriculture, energy infrastructure, and services—unlike the previous mandate that was restricted to industry and agro-processing. It also opened its membership to include other interested states in Eastern Africa.

Under the new treaty, the EADB was no longer required to address industrial imbalances among the member states. The differential investment formula that required the Bank to allocate 22.5 percent of its resources to Kenya and 38.75 percent each to Tanzania and Uganda in every five years did not result in substantial changes in industrial imbalance. The bank's contribution estimated at 4 percent of industrial capital formation in each member state, although not negligible, could not do much to smoothen out the imbalance that was high ab initio.

While the basis of the EADB's original mandate to focus on industrial development was justified, the Bank's initial 10 years' experience demonstrated that a regional economy predominated by agriculture necessitated that the agricultural sector be mainstreamed so as to have a balanced development strategy. The bank's non-participation in agriculture implies that the opportunity to exploit useful complementarities between industry and agriculture was forgone. Therefore, the EADB's expanded mandate as spelled out in the bank's new Treaty and Charter allowed for the pursuit of an integrated development strategy that would stimulate industrial development.

Further, the bank's broader mandate implied a move away from the import substitution industrialization pursuit that had been proven to be economically costly to the Member States. The Bank's earlier experience with import substitution industries was that such enterprises were sustained by quotas and tariff protection by the national governments. This essentially resulted in near-monopoly situations without adequate controls, and higher prices for the end users of their products. The higher prices implied an erosion of real incomes of households that consume the final products, and compromised competitiveness for export-oriented enterprises that use such products as intermediate inputs.

By 1985, it was apparent that the resource base of the EADB needed to be broadened as a way of enhancing the bank's ability to accomplish the broadened mandate. In 1986, the Governing Council—the Bank's highest policy organ—approved the doubling of the bank's authorized capital from SDR 40 million to SDR 80 million.

EADB During a Period of Economic Policy and Structural Reforms

By the end of the second decade, the EADB had made cumulative investment approvals worth SDR 149 million. The EADB commenced its next decade on the back of fundamental economic policy and structural reforms that the member states were implementing. The pace of these reforms, which included price liberalization across all markets as well as government divestiture of state-owned enterprises, picked up in early 1990s.

The EADB's portfolio during 1988–1997 represents investments across all the key sectors of the economy of East Africa. The bank supported the rehabilitation of industries in the member states, including those that were slated for divestiture. At the same time, the bank started to gradually grow its investments in the social sectors of health and education. This was against the background of the reforms in the financial sector that were meant to remove interest rate and exchange controls that were inhibiting optimum operations. Commercial banks, which dominate the financial system in East Africa, were allowed to determine interest rates based on market circumstances. Similarly, they were also allowed to accept deposits and lend in convertible currencies unlike during the foreign exchange control regimes.

The financial sector reforms were aimed at enabling commercial banks support investments in the region through venturing into longer tenor loans. The structure of the commercial banks' balance sheets where liabilities are dominated by short-term deposits implies that a quick venture into longer tenor loans would result in risky mismatches. In essence, the dominant market players were not amenable to long-term loans while the investor, especially those targeting local markets, were seeking long-term credit in local currency. It was, therefore, a developmental necessity that the EADB explore modalities of addressing the long-term local currency "missing market".

As the member states continued to implement reforms aimed at deepening the financial sector, the EADB was exploring modalities of enabling the long-term credit market in local currency. This effort culminated in the EADB pioneering the issuing of local currency corporate bonds in the region in 1996. Since then, the bank became a regular issuer of bonds, in the process mobilizing over USD 86 million as shown in Table 16.2. Not only did this initiative encourage other institutions to issue corporate bonds in the region but also it supported the development of the capital markets in the region, especially the nascent markets of Uganda and Tanzania. The EADB bond was the first and, for some time, the only security traded in Uganda's capital market.

Table 16.2 EADB bonds

Issue date	*Country*	*Amount in local currency*	*USD equivalent*
22-Nov-96	Kenya	KES 820,000,000	9,838,032
1-Dec-97	Uganda	UGX 10,000,000,000	4,192,872
15-Jan-99	Kenya	KES 1,200,000,000	14,397,121
12-Oct-99	Tanzania	TZS 10,000,000,000	6,297,229
25-Apr-01	Kenya	KES 2,000,000,000	23,995,201
19-Jul-04	Kenya	KES 800,000,000	9,598,080
27-Apr-05	Tanzania	TZS 15,000,000,000	9,445,844
5-Dec-05	Uganda	UGX 20,000,000,000	8,385,744
Total			86,150,124

Source EADB Annual Reports

The EADB also spearheaded the development of asset finance lease in the region. Prior to 1996, when the EADB introduced finance lease, the region was dominated by hire purchase as a mechanism for equipment acquisition other than through loans. Asset finance lease addressed the inherent weaknesses of hire purchase, especially the fact that it mainly targeted consumer-based equipment and light commercial equipment. Through leasing, the EADB has been able to support acquisition of equipment in agro-processing, construction, aviation and transport and, in the process, contributed towards the promotion of infrastructure development, value addition to agriculture, and regional mobility of people and goods.

EADB Under Renewed EAC Integration

The re-establishment of a more ambitious EAC in 1999 provided an opportunity for the EADB to contribute towards catalyzing the integration process.[6] Even amidst scepticism, the new EAC has pursued an aggressive agenda such that by 2005 the EAC Customs Union was in place (Fitzke, 1999). Rwanda and Burundi joined the EAC in 2007 and the region's common market protocol came into effect in 2010.

The EAC membership growth with the joining of South Sudan and the Democratic Republic of Congo (DRC) in 2016 and 2022, respectively, has not translated into automatic joining of the EADB membership. Among the new EAC members, its only Rwanda that joined the EADB membership in 2008. Before Rwanda, the other notable entries to EADB's membership were Germany's Deutsche Investitions- und Entwicklungsgesellschaft (DEG) and Netherlands' Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO) that joined in 1988.

An assessment of the EADB's membership structure in Table 16.3 shows no significant changes in composition; a pointer to limited traction of the intention of resource base augmentation and the beneficial effect of diversified ownership from a governance standpoint. The bulk of shareholding remains with the member states that have subscribed to Class A shares of the EADB, their portion of the shareholding marginally

[6] EAC (1999). *The Treaty for the Establishment of the East African Community*, November.

declining to 88 percent by the end of 2020 compared to 92 percent in the mid-1970s.

The implication of the shareholding structure is two-fold. One, the EADB's continued reliance on member states' capital implies that its increased capitalization is a function of how it is deemed as compelling vis-à-vis other needs of the countries. Illustratively, while the EADB's authorized capital in 2004 increased from USD270 million to USD1.08 billion, the paid-in proportion as at the end of 2020 was a paltry 18 percent.[7] Two, the extent to which the non-state members have benefited from the EADB's international credit rating has been minimal, notwithstanding that some of them have the highest credit international

Table 16.3 EADB shareholding structure 2020

		Paid in shares	
	No	*Amount (USD,000)*	*% of Total*
CLASS A			
Kenya	3,800	51,300	26.2%
Tanzania	3,800	51,300	26.2%
Uganda	3,800	51,300	26.2%
Rwanda	1,337	18,050	9.2%
	12,737	171,950	87.7%
CLASS B			
African Development Bank	1,240	16,740	8.5%
FMO—Netherlands Development Finance Company	375	5,063	2.6%
DEG—Deutsche Investitions-und Entwicklungsgesellschaft	100	1,350	0.7%
Yugoslavia Consortium	28	378	0.2%
SBIC—Africa Holdings	24	324	0.2%
NCBA (formerly Commercial Bank of Africa)	5	67.5	0.0%
Nordea Bank Sweden	5	67.5	0.0%
Standard Chartered Bank London	2	27	0.0%
Barclays Bank PLC London	2	27	0.0%
	1,781	24,044	12.3%
Total	14,518	195,994	100.0%

Source EADB Annual Report 2020

[7] EADB (2004) Annual Reports; EADB (2020). Annual Report.

ratings.[8] The EADB's international credit rating by both Fitch Ratings and Moody's has been in the speculative grade.[9]

The tepid capitalization of the EADB reveals itself in slow asset growth. The recent trend of EADB's asset trajectory reflects two linked aspects. First, the assets level is modest for a development bank that has been in existence for more than five decades, being at USD376 million as at the end of 2020. By the end of 2020, the Eastern and Southern Africa Trade and Development Bank (TDB) established in 1985 but with a wider geographical coverage than EADB, had a balance sheet size of USD7.2 billion. This points to the balance sheet constraint to seizing opportunities that the revived EAC presents.

As Fig. 16.1 shows, assets' growth in the recent past has been stagnant. Second, EADB's evident conservative approach of placement in commercial banks closely tracking, and in instances, overtaking loans and lease receivables as has been the case since 2018. The defensive approach of liquidity preference to long-term assets is a harbinger of trading the potential to invest for development with returns from treasury operations, and revels itself in the slow balance sheet growth. Further, it masks the extent to which the asset quality is an issue of concern, as is the case with many development banks in developing economies (De Aghion, 1999).

16.3 Commercial Banks' Foray into Development Finance

As the EADB evidently continues to operate below potential, commercial banks are increasingly seeing opportunity buttressed by both the renewed EAC and the financial policy reforms of the 1990s. The EAC integration agenda envisions linkages in the financial markets, notably commercial banks that dominate the sector. The regional expansion of commercial banks in East Africa is underpinned by the pursuit of economies of scale, the push factor being relatively higher competition in the primary market and the benefits of relative efficiency (Kodongo et al., 2015). On that account, commercial banks from Kenya are expanding across East Africa without reciprocal venture from other markets, and at best

[8] African Development Bank, EADB's largest non-state member is investment grade rated by S&P Global Ratings, Moody's and Fitch Ratings.

[9] Fitch Ratings and Moody's annual rating review reports.

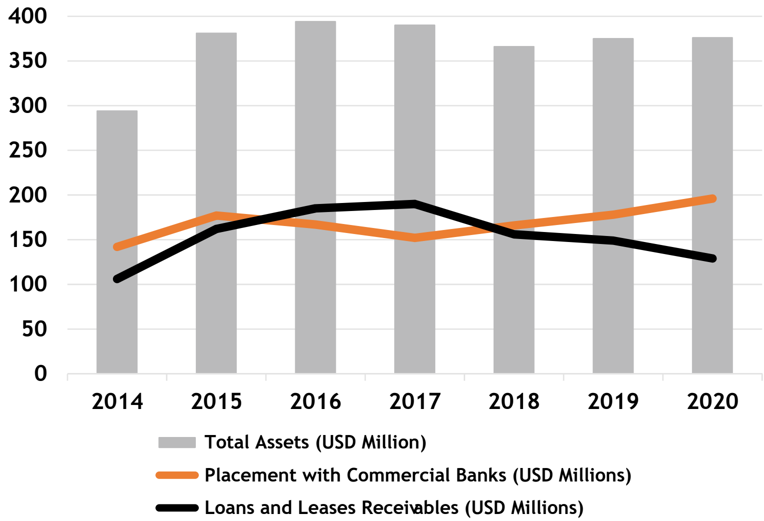

Fig. 16.1 Recent evolution of the EADB balance sheet (*Source* EADB Annual Report; various issues)

limited cross border expansion among the other economies.[10] Bank of Kigali, a commercial bank based in Rwanda and regulated by the National Bank of Rwanda, is the only commercial bank from the EAC region to have a presence in Kenya, albeit operating a representative office and not a fully-fledged commercial operation.[11] Two Tanzanian-based banks, CRDB Plc and Exim Bank, have expanded out of their primary market, with the former operating in Burundi and DRC and the latter in Uganda, Comoros, Ethiopia, and Djibouti.

Table 16.4 shows the evolution of the combined assets and deposits of five banks estimated to account for 40 percent of the market share that have ventured into the regional market. These banks are KCB Group,

[10] Crane Bank Limited, a Uganda-based commercial bank, established and owned subsidiary in Rwanda, Crane Bank Rwanda. In 2016, the Bank of Uganda, the regulator, declared Crane Bank Limited to be undercapitalized. This triggered its acquisition by DFCU that in turn sold its Rwandan subsidiary to Commercial Bank of Africa, a Kenyan based bank.

[11] CBK (2013). Press Release: CBK Grants Authority to the Seventh Representative Office in Kenya—Bank of Kigali, February.

Table 16.4 Assets, deposits, and branch network for selected Kenyan banks

	Total assets (KES millions)	*Total deposits (KES millions)*	*Subsidiaries' branch network*
2017	1,443,695	1,091,490	306
2018	1,596,231	1,246,845	306
2019	1,752,410	1,353,779	316
2020	2,053,020	1,569,021	343
2021	2,372,290	1,781,789	494

Source CBK Bank Supervision Annual Report, various issues

Equity Group, Diamond Trust Bank (DTB), I&M Bank, and Guaranty Trust Bank. The assets of these banks have maintained a positive trend, rising by about 64 percent over the period 2017–2021. The increase in assets is boosted by regional expansions through mergers and acquisitions.

While the regional expansion of the banks has largely been within the initial three EAC members, the joining of Burundi, Rwanda, South Sudan, and DRC has provided new impetus for outreach to new markets. Equity Group acquired Banque Commerciale du Congo in DRC in 2020 while KCB Group acquired BPR in Rwanda in 2021. Out of the total assets of all the subsidiaries operating in the region, DRC Congo accounted for the highest share at 34.5 percent in 2021 compared to 8.14 percent in 2017 while Southern Sudan and Burundi accounted for the least at 2.6 percent and 1.3 percent, respectively in 2021.

The expansion of the branch network associated with the mergers and acquisitions and the development of new digitally based channels have seen deposits of these cluster of banks rise by about 63 percent over the 2017–2021 period. In the process of pursuing their commercial motives, the "*local presence*" of these banks across the region, accompanied by scale arising from financial strength, has drawn the interest of DFIs. In addition to the EADB, they provide an avenue for collaboration as the DFIs seek to channel development finance to the region.

The intermediation of development finance through the EADB has been premised on the ability to provide deeper understanding of the eventual beneficiaries based on proximity. The EADB has operated country offices that are seen as enablers of the proximity, in Uganda and Tanzania from 1971 and in Rwanda from 2008. The regional expansion of commercial banks has enhanced that proximity, with the international

DFIs revealing a preference of channelling the line of credit through them for the benefit of targeted economic sectors.

Table 16.5 reports the evolution of consolidated credit lines by international DFIs to the cluster of banks with a regional presence. The five banks reviewed have credit lines with six DFIs as follows: International Finance Corporation (IFC), AfDB, European Investment Bank (EIB), DEG, Agence Française de Développement (AFD), and FMO. The IFC is the most dominant lender both in terms of amount and coverage with four out of the five banks in the sample having benefited in the last 5 years. During the period, Equity Bank accessed nearly half of the amount borrowed from IFC, over 65 percent of the AfDB and over 90 percent of the EIB funds.

The banks with wider branch networks, notably KCB, Equity, and DTB, attract more credit lines with international DFIs. Although DTB has the highest number of international credit lines in our sample (including IFC, AfDB, DEG, and AFD), it received less in terms of amount, accounting for 11 percent from IFC, and less than 30 percent each of the total amount from AfDB and AFD over the five-year period. Based on the reviewed data, DTB is however the largest beneficiary of DEG with a share of 72 percent while I & M bank has only one credit line from FMO, accounting for over 80 percent of the FMO lending to the banks under review.

The funds from the international DFIs to various banks are for the purposes of supporting Micro Small and Medium Enterprises (MSMEs), and financing climate and infrastructure. Specifically, funds to the Equity Bank from IFC, AfDB, and EIB mainly support lending operations to

Table 16.5 International credit lines for selected banks with a regional presence (USD millions)

	IFC	*AfDB*	*EIB*	*DEG*	*AFD*	*FMO*	*Total*
2017	416.9	150.7	189.0	95.3	54.5	6.2	912.6
2018	386.4	262.4	117.9	41.5	44.4	16.3	868.9
2019	316.5	140.8	94.3	7.6	33.6		592.8
2020	490.6	124.6	72.4	43.3	23.7	25.0	779.6
2021	401.0	85.5	250.7	14.1	12.7		764.0
Total	2011.4	764.0	724.3	201.8	168.9	47.5	3917.9

Source Respective banks integrated reports and financial statements, various

MSMEs and climate finance operations that assist renewable energy, green buildings, energy efficiency, and climate smart agricultural projects (IFC Press Release, 2019; Equity Bank Report, 2018). The funds from AfDB specifically targeted the expansion of Equity bank holdings across Eastern and Central Africa to enlarge the capital base for MSMEs with a focus on women and the youth entrepreneurs in the context of enhancing resilience during the COVID-19 pandemic period (AfDB Press release, 2021).

Funding from the AfDB to KCB is aimed at providing liquidity support for the development of infrastructure, agriculture and energy projects as well as for value addition in manufacturing. The AfDB resources is, therefore, an important contribution towards enhancing job creation as well as facilitating financial access to businesses. Additionally, the lines of credit from the AfDB facilitated KCB to bridge any currency mismatch considering that most infrastructure projects require substantial amount of hard currency while the bulk of the bank's funding is in the local currency. Similar to the international DFI's funding to Equity bank, the AfDB financing is also aimed at boosting KCB's strategy of supporting the youth by investing its own resources to enrich their skills and further link them with business ownership or employment opportunities (AfDB, 2017).

The EIB credit lines to Equity Bank are mainly focused on supporting technical assistance to strengthen Equity Bank's capacity to support longer-term agricultural value chain investment projects, further develop the provision of long-term financing for agriculture, and support the bank's strategy of transforming branches into SME business centres. In 2021, EIB provided Equity with a long-term loan facility equivalent to EUR 125 million to support MSMEs to recover, sustain, and scale up their operations, allowing them to become more agile during the COVID-19 pandemic.

Commercial Banks and Sustainable Finance

Beyond credit lines that intermediate development finance, commercial banks in East Africa, especially those in Kenya, have embraced sustainability principles that are closely intertwined with the environmental and social considerations in commercial enterprises. The East African countries' financial sectors are at various levels of adoption of sustainable finance principles under the global green agenda. Dominating this development has been some strides in capacity building and sensitization engagements of financial institutions on the need to structure sustainable finance principles in their operations.

The global pursuit of UN global Sustainable Development Goals (SDGs) elevated the need to pursue *Profit* while addressing *Planet* sustainability and *People* sustainability agenda. These concerns have ignited efforts by regulators and other government authorities to formulate policies and regulations that guide markets towards achieving sustainability of societies and the environment. In Kenya, for instance, the government has provided guidelines to support the adoption of sustainable finance principles in the financial sector. Kenyan National Treasury published a draft Green Fiscal Incentives Policy Framework in January that is meant to steer the economy towards the desired low carbon, climate-resilient, and green development pathway.

The issuance of the CBK Guidance Note on Climate-related risk management framework for banks in 2021 is a guide for banks in their integration of climate-related risks in their strategies, governance structures, and risk management and disclosure frameworks.[12] This is anticipated to promote the financing of climate change mitigation and adaptation efforts as part of the overall risk management by the banking sector and support economic and social sustainability. To progress this agenda, the banking industry, through the Kenya Bankers Association (KBA), has established partnerships with agencies such as the United Nations Environment Programme Financial Initiative (UNEP-FI), FMO, and IFC towards building capacity and aligning with global practices.

The commercial banks' evident enthusiasm towards this initiative is revealed in the KBA's championing the adoption of sustainable banking principles in Kenya through its sustainable finance initiative (SFI) since 2018. Through the initiative, the industry has rolled out SFI e-learning modules aimed at building capacity on areas related to risk management aligned to the CBK Guidance as well as on the issuance of green bonds as sustainable models of raising capital. Since 2015, KBA has been a member of the IFC-led Sustainable Banking and Finance Network (SBFN) that offers a platform for knowledge sharing and capacity building on sustainable finance for financial sector regulators and industry associations across emerging markets.

[12] CBK (2021). Guidance on Climate-Related Risk Management, October.

KBA tracks shared value propositions by the banking sector highlighting the developments in the sector that create value for the economy and society. The KBA Banking Industry Shared Value Report (2019) showcases how banks are working with the various stakeholders in the public and private sectors, aligning to the national development agenda and country's Vision 2030 aspirations. Other initiatives that have been nurtured in Kenya supporting social and environmental sustainability include the Green Bonds Program—Kenya, 2023. The program is an initiative of the banking industry, steered by KBA and supported by Nairobi Securities Exchange (NSE), Climate Bonds Initiative (CBI), FSD-Africa, and FMO—Dutch Development Bank. The program seeks to promote an upscaling strategy for green bonds, support potential issuers of Green and SDG-linked bonds, market awareness creation, and capacity building on opportunities for green bonds for banks.

The pursuit of upscaling issuance of green bonds in the country has seen the introduction of NSE green bond listing rules that have received regulatory approval from the Capital Markets Authority and the creation of a pool of local-based verifiers of green assets in line with the green bond principles and the CBI Climate bond certification scheme. Kenya's First Green Bond was Issued in October 2019, when Acorn Holding, a real estate company, issued the East and Central Africa's first green bond. The green bond raised USD 43 million for the development of environmentally friendly student accommodation.

16.4 Key Challenges Facing the EADB

It is evident from the EADB's history which spans over five decades that limited financial capacity constrains the ability to be impactful. A balance sheet size of less than USD 400 million,[13] implying a growth of less than USD 10 per year, does not allow EADB to undertake big development projects at national levels, much less at a regional level. Even at the local level, the EADB's comparative advantage over commercial banks in long-term finance is not obvious. Its authorized capital of USD USD1.08 billion is accompanied by less than 20 percent paid in portion. This points to the existence of a scope to enhance the EADB's financial strength through additional funds' injection. As a result of the competing resource

[13] EADB (2021). Annual Report.

needs of the EADB, it has the challenge of not being able to inject more capital into the bank. At the same time, the EADB's member states have competing development interests that make them keen on strengthening their national development banks.[14]

Owing to EADB's limited capacity, many regional projects that support the EAC integration agenda are funded by multilateral development banks such as the World Bank and the AfDB.[15] Caught in between a constrained capacity to play at the regional level and the apparent competition for capital from national DFIs, EADB's momentum for innovation is somewhat constrained. It is noticeable that as a pioneer issuer of corporate bonds in the region, the EADB has neither been in the market for a new issuance since December 2005, nor has it featured in new financing frontiers such as enabling the growth of the green bond program in the East African region.

The EADB's developmental mandate demands that it remains on the frontier of creativity given the dynamic environment under which it operates. The differentials in levels of development among the EAC members under whose auspice the expectations on the EADB are drawn, coupled with the region's geopolitical dynamics necessitates a scaling up and mainstreaming of its operations. Data from the EADB's member states illustrate that the individual and collective share of the manufacturing sector to GDP remains under 10 percent. Appreciating that no single organization can address the issues around the manufacturing sector, the contribution of the EADB even with an enlarged mandate can be boosted through scale enhancement. Otherwise, a wider mandate, with limited capital and big expectations on the EADB presents a conundrum.

[14] Various Budget Statements by Uganda's Ministry of Finance, Planning and National Development point to the keenness to strengthen Uganda Development Bank. The same case holds for Tanzania where the revamping of TIB Development Bank, National Development Corporation (NDC) and Tanzania Agricultural Development Bank (TADB) are evident. In Kenya, a Report of The Presidential Taskforce on Parastatal Reforms (2013) proposes the setting up of Kenya Development Bank through the merger of various sector-based national DFIs.

[15] The East African Community (EAC)—Payments and Settlement Systems Integration Project (2023) funded by the AfDB, and World Bank's funding towards enhancing EAC's Regional Digital Integration (2022).

16.5 Concluding Remarks

It is clear from the foregoing discussions that the motivation for establishing development banks in East Africa is the recognition that while long-term finance is critical in promoting long-term growth, it was seldom readily available. Pursuant to the commonality of the development aspirations among the East African countries with a long history of economic integration, the EADB was mandated to champion the funding of the region's development.

The increasing funding needs coupled with the East Africa integration agenda puts the EADB's ability to deliver on its mandate on the spotlight. The EADB's lack of scale is an obvious constraint to its ability to meaningfully contribute to the funding needs of the region. The EADB's case has been undermined by the inability of its member states to inject more capital given their competing resource needs. Similarly, the assumption that the EADB member states pursue a clear common development agenda runs counter to the fact that the economies have competing development interests as revealed in their respective keenness to strengthen their national development banks.

The demand for the EADB to be on the frontier of creativity given the dynamic environment under which it operates is critical. With a constrained scale, the EADB's comparative advantage does not stem from the provision of long-term finance. With leading commercial banks in East Africa attracting long-term finance from IFIs, the boundaries distinguishing development banks from commercial banks are increasingly getting blurred.

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CHAPTER 17

The New Development Bank

Matthew Kofi Ocran

17.1 Introduction

Populations need basic services such as potable water, sanitation services, electricity for lighting and heating among others for the maintenance of well-being. Beyond basic services, people need connectivity infrastructure such as roads, sea ports, airports and telecommunication services. The state of infrastructure in all sectors of the economy in developing countries leaves much to be desired. The poor state of road, sea, rail and marine transport, limited access to potable water and electricity are the bane of development in many low and middle-income countries.

To provide the necessary services for social and economic development, Governments require considerable financial resources. But most countries, especially developing countries, often have constraints in raising the needed financial resources to fund the needed infrastructure. For example, transport has long been recognized as a key driver of economic growth. Transport connects people to essential services such as education, health and access to centres of economic activity. By easing the movement of

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people and goods from one place to the other, it eases access to opportunities. Good transport networks also reduces the cost of doing business by reducing transaction costs. Indeed, Infrastructure and connectivity are the backbone of a functioning economy. They stimulate employment creation, economic growth and development. Since most emerging economies and developing countries lack the resources to fund infrastructure investment, accessing external sources of funding is imperative. The foremost multilateral development finance institutions, the World Bank and its affiliates, have been unable to sufficiently address the infrastructure needs of the developing world. And even when they provide funding, they come with conditionalities. Again, the support from the World Bank has not been adequate to meet all the funding needs of developing countries. For example, according to Global Infrastructure Outlook, an initiative of the G20 group of countries, there is \$15 trn global investment gap.[1]

Over the years, regional and national Development Finance Institutions (DFIs) have emerged to address peculiar challenges of infrastructure and development financing. The first among these was the European Investment Bank (EIB) established in 1958. It has a capital subscription of \$275 billion and this rival the World Bank in size. The EIB's membership is 27, these are all European Union member states. The EIB do not have members outside the European Union. Developed countries hardly resort to the World Bank because they have other sources of funding. The EIB has a development wing, the European Bank for Reconstruction and Development (EBRD). The EBRD has 71 member countries from 5 continents. The members include China and India, with some North African countries.

After the wave of independence in the 1960s, the World Bank supported the establishment of regional development banks. These multilateral development finance institutions are meant to provide technical support and funding for infrastructure development. The Inter-American Development Bank, in the Americas, was established in 1959. It has 48 members, 22 of which are non-borrowers and non-regional members. These include the USA, 12 European countries among others and institutions. The African Development Bank (AfDB) was formed in 1964, with 81 members of which 54 come from the African region. The Asian Development Bank was also set up in 1966 and is owned by 68 members, 49

[1] https://outlook.gihub.org/.

of these are regional members. Many national development banks have been created across the world to assist in mobilizing funding to bridge the investment gap. In Africa we have the national development banks in most countries. The big one, in terms of stated capital is the Development Bank of South Africa (DBSA).

Even though the World Bank's Articles of Agreements prohibit political activity, the Bank's decision-making considers political considerations. In recent times, political conditionalities and policy conditionalities have routinely influenced disbursements from the Bank and its affiliates (Cohen, 1974; Kilby, 2009; Molenaers et al., 2015). The Bank has attracted criticisms. For instance, some have argued that the Bretton-Woods institutions were designed with colonial principles in mind and remain colonial in character even now (Hickel, 2020). The governance structure of the Bretton-Woods institutions[2] have attracted many criticisms. Even though it has over 180 member countries, only a handful of developed countries control the institutions. For example, the seven major Western economies: USA, Japan, France, UK, Germany, Italy and Canada have 40% of the voting power. Thus, less than 5% of the member countries account for 40% of the World Bank's voting rights.

Many in the Global South have sought alternative sources of finance mostly to circumvent the Bretton-Woods institutions and to safeguard policy independence and their sovereignty. The rise of China and other major emerging economies have sparked interest in creating analogous development finance institutions drawing on South-South cooperation. The Asian Infrastructure Investment Bank (AIIB) is one such multilateral bank. China, the dominant member, accounts for 27% of the membership subscription and vote. India, the second major member has 8% and Russia comes next with 7%. The three emerging economies: China, India and Russia account for more than 40% of the voting power. The total subscription for the regional members (including China and India) is 73% while the non-regional memers account for the remaining subscription. The Total membership of the AII is 106: 42 from Asia, 26 in Europe, 21 in Africa, 8 from Oceania, 8 from South America and one from North

[2] The World Bank and International Monetary Fund, IMF.

America. The stated capital of the AIIB is $100 billion. The Bank is touted as a rival to the World Bank.[3]

It is important to look at the landscape of multilateral development banks in terms of size by finance assets to ascertain how the banks compare with one another. The European Development Bank is by far the largest bank. It's assets as at 2020 was U$770 bn. The World Bank comes second with US$537 bn. The Asian Development, the third largest, has assets in the region of US$270 bn. The Inter-American Bank with US$148 bn comes next. The International Financial Cooperation, the private sector arm of the World Bank, has US$105 bn in assets. The European Bank for Reconstruction and Development has an asset base of US$85 bn while the African Development Bank has US$50 bn. The New Development Bank also has US$19 bn in assets as at 2020. At US$19.3 billion, the African Export–Import Bank has an asset base comparable to the New Development Bank (UNCTAD, 2023).

The 35 regional and inter-regional banks in the world constitute a major source of finance for long-term development in emerging market economies and developing countries. In recent times, there has been many years when the total disbursements from the regional and inter-regional banks have exceeded that of the World Bank. The leading multilateral development banks, in terms of number of membership and reach.

There is an increasing quest by countries of the Global South to side-step the Bretton-Woods institutions because of the issues raised thus. The emergence of the New Development Bank, sometimes referred to as the BRICs Bank, can be looked at from the perspective articulated above. Others have also argued, even though it's not the official position of the promoters of the New Development that the Bank is meant to challenge the hegemony of the US dollar as the preeminent currency of world trade and a tool for global financial dominance by Wall Street and proponents of Western liberal economic ideology.

[3] Dahir, Latif A. 2018. Kenya joins China led Asian Infrastructure Investment Bank AIIB (qz.com).

17.2 Evolution, Mandate and Membership

Jim O'Neil, a banker with Goldman Sachs, came up with the term BRIC in 2001. He used the term to represent a group of four fast-growing emerging economies (Brazil, Russia, India and China) that he expected to dominate[4] the world economy in 50 years. The group now represents 44% of the World's population, 30% of the landmass, 23% of world trade and 33% of the world's GDP. Subsequently, the four countries decided to set up a formal organization in 2006 to pursue shared political and economic interests. Tom Hankook, a journalist with Bloomberg, suggests that the first meeting of the BRIC countries was initiated by their foreign ministers. The meeting was called by Russia on the sidelines of the United Nations General Assembly meeting in 2006. The first Heads of State conference of the BRIC partners was held in Russia in 2009. The BRIC countries then invited South Africa to join in late 2010 after the Russia meeting. An "S" was appended to BRIC to represent South Africa, hence the acronym BRICS.

The objectives of the BRICS group revolve around political and security collaboration, financial and economic partnership, cultural and people-to-people cooperation. The BRICS countries, in their bid to pursue the economic and financial partnership objective established a multilateral development finance institution, the New Development Bank (NDB), in 2015.

The idea to set up a bank by the BRICS members was mooted during the Heads of State meeting in Durban, South Africa in 2013. Indeed, the Summit had as its theme, "mobilizing resources for sustainable development projects in BRICS and other developing economies" (BRICS, 2013: paragraph 9).

Following a meeting at Forteleza, Brazil in 2015, the members of BRICS signed the Articles of Agreement (AoA) of the New Development Bank. Article 1 of the agreement states the purpose of NDB by suggesting that "the Bank shall mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries, complementing the existing efforts of multilateral and regional financial institutions for global growth and development".

[4] 25 years down the line, the growth outcomes in all the countries, except India, has slowed considerably and it is highly unlikely that the countries, Brazil, Russia, India, China and South Africa together can dominate the world economy in 2050.

The AoA further argues that to achieve its stated objectives of NDB, "it shall support public or private projects through loans, guarantees, equity participation and other financial instruments. It shall also cooperate with international organizations and other financial entities, and provide technical assistance for projects to be supported by the Bank" (NDB, 2016).

Even though membership is open to all member countries of the United Nations, only a few have been admitted so far. Formal negotiations were concluded with Bangladesh, Egypt, United Arab Emirates and Uruguay in 2021. The countries then applied formally through a submission of letters of application. The Board of Governors subsequently admitted United Arab Emirates as a non-borrowing member and the other three as borrowing members. NDB argues that expansion of the bank's membership will remain a strategic objective because it believes that expansion will come with an increased capital base, diversified project portfolio, a bigger talent pool and a wide range of development experiences. NDB also intends to pursue the expansion of its membership base in a gradualist and balanced approach. It seeks to ensure geographic representation, a mix of countries with varying sizes and stages of development.

One of the unique features and a strong appeal of NDB is that unlike most multilateral development finance institutions, no member wields a veto in voting rights. Another plus is that it has sought to provide financial safeguards to protect member countries in times of crisis. This is a demonstration of the NDB's aspiration to supplant the International Monetary Fund's traditional role of supporting countries with the balance of payments challenge. NDB's safety net is the Contingent Reserve Arrangement (CRA). The main objective[5] of the CRA is to provide liquidity support and currency protection in times of crisis to BRICS member countries. The support is expected to be provided using currency swaps.[6] The treaty that established the CRA was signed in Forteleza, Brazil in 2015. The treaty commits members to contribute to a pool of funds (the CRA) to the tune of $100 billion. China accounts for

[5] *"Treaty for the Establishment of a BRICS Contingent Reserve Arrangement". Government of Brazil. Archived from the original on 25 September 2015.* Retrieved *28 July* 2023.

[6] Currency swap is a contract to exchange interest and or principal in different currencies.

41% of the resources for CRA. Brazil, Russia and India underwrite 18% each, and South Africa 5%. The maximum amount that each country can access is as follows: China, 50% of contribution; Brazil, Russia and India, 100%; South Africa 200%. Out of the $85 bn of the capital contribution can be assessed.

The NDB is also meant to contribute to the closing of the short-term financing gap that exists in the global financial architecture. The International Monetary Fund, IMF, provides short-term liquidity to countries in times of balance of payments and liquidity crisis. In practise, however, The policy conditionalities and the influence of Western governments regarding which developing countries get support is well-documented. Some of the conditionalities that are routinely imposed on countries in dire straits have been criticised and described as inappropriate (Griffith-Jones, 2014). Another important issue that bedevils developing countries is the incidence of sharp capital flow reversals whenever global risks are heightened. The sudden outflows pose serious liquidity challenges for many countries in the Global South.

The motivation for the establishment of the NDB includes the need to contribute to addressing the massive infrastructure gap that exists in member countries and to engender sustainable development. The role of infrastructure development in the spurring economic growth, development and structural change is well-documented in the literature.

17.3 Ownership and Governance Arrangement

The five founding members each has a shareholding of 18.98%, i.e., equal capital subscription among them. Bangladesh, Egypt and United Arab Emirates have shareholding of 1.79%, 2.27% and 1.06% respectively. The paid-in capital as at December 2021 was US$10 bn with a callable capital of US$40 bn. The number of shares, excisable votes and the subscribed amounts are presented in Table 17.1. NDB's initial authorised capital is USD100 billion. The capital is divided into one million shares. Each share has a par value of USD 100,000. NDB provided founding members 500,000 shares (USD 50 billion). The initial share subscription includes paid-in capital of USD10 billion and 400,000 shares that correspond to callable capital of USD40 billion.

Following the reduction in the capital subscription of the founding members after the expansion, it is expected that as more members join the

Table 17.1 Capital structure and subscription

Country	*Number of shares*	*Excisable votes*	*Subscribed capital Amount (million USD)*	*Share of subscribed capital (%)*
Brazil	100,000	100,000	10,000	18.98
Russia	100,000	100,000	10,000	18.98
India	100,000	100,000	10,000	18.98
China	100,000	100,000	10,000	18.98
South Africa	100,000	100,000	10,000	18.98
Bangladesh	9,420	9,420	942.0	1.79
Egypt	11,960	11,960	1,196.0	2.27
United Arab Emirates	5,560	5,560	556.0	1.06

Source NDB website, accessed on 13 October 2023

Bank, the founding member's capital subscription will reduce. Nonetheless, the Bank has unique selling points. The fact that no member holds veto power is a marked departure from the governance practise of most global, regional and inter-regional development banks. The NDB also offers its shareholders preferential treatment with extensive immunities, privileges and exemptions.

The governance structure draws on best practices in an effort to ensure accountability, independence and transparency. Board of Governors are drawn from member countries with each country appointing a Governor, usually someone at the ministerial level. Member countries determine the term of its Governor. The Board of Governors oversee the Board of Directors. Founding members appoint one Director and one Alternative Director. The cap on the number of directors is 10. The tenure of directorship is two years. The term of Directors are renewable, that is, they may be re-elected. The Board of Directors are charged with the day-to-day operations of the Bank. The Board of Governors of founding members elect the President on a rotational basis. The President has a 5-year non-renewable term. Each founding member has the opportunity to appoint at least one Vice-President and this excludes the country that provides the President. The President and Vice-Presidents make up the Senior Management team. Presently, the organizational structure is made up of four Vice-Presidents, Departments headed by Director Generals and Divisions with Chiefs.

17.4 Funding and Operations

NDB's funding strategy aims to build a strong balance sheet with sufficient resources to meet liquidity requirements at a minimum cost. The expanding portfolio and the need for refinancing constitute the thrust of the bank's financing strategy. NDB seeks to establish a curve through regular benchmark issuances in the leading vehicles currencies such as the USD, the euro and CHF. It also tries to maintain a presence in the major funding markets.

Funding Approach

NDB uses a diversified source of funding. The funding sources cover the use of USD Regulation S, (Reg S); local or domestic currency of BRICS countries, Euro Commercial Paper (ECP), bilateral and repo among others. NBD has established Euro Medium Term Note (EMTN) to the tune of USD 50 billion. EMTNs are flexible debt securities issued and traded outside the United States. NDB's EMTN is listed on the London Stock Exchange and it is exempted from the Financial Conduct Authority in the UK (NDB, 2023). NDB also has a ECP programme of USD8 billion. The outstanding borrowings of NDB in USD benchmarks account for 63% of its total borrowings. Chinese renminbi benchmarks represent 34%. The remaining 3% comes from private placements. The USD benchmarks of the private placements are 65%, Hong Kong dollar, 14%, British pound, 10% and the Australian dollar, 11%. The outstanding amounts on the EMTN and ECP programmes are USD8.2 billion and USD3 billion.

The RUB, CNY and ZAR bond programmes are based on the domestic markets of Russia, China and South Africa. The sizes of these programmes are USD equivalents of USD 1.3 billion unlimited programme of 20 year tenor listed on the Moscow Stock Exchange. The CNY bond programme is valid for 2 years and it is listed on the China intermarket Bond Market (CIBM). The ZAR bond programme has unlimited validity and it is valued at USD 0.6 billion. There is no restriction to the ZAR bond's tenor and it is listed on the Johannesburg Stock Exchange. The outstanding amounts on the Chinese domestic market is RMB 28 billion (USD 4 billion equivalent). There has been no issuance in the Russian and South African markets yet (NDB, 2023).

Table 17.2 Distribution of callable and paid-in capital

Member country	*Callable Capital (USD million)*	*Paid-in capital (USD million)*	*Paid-in-capital received (USD million)*	*Paid-in capital outstanding (USD million)*
Brazil	8,000	2,000	2,000	
Russia	8,000	2,000	2,000	
India	8,000	2,000	2,000	
China	8,000	2,000	2,000	
South Africa	8,000	2,000	2,000	
Bangladesh	754	188	38	150
United Arab Emirates	445	111	22	89
Arab Republic of Egypt	957	239		239
Total	42,156	10,538	10,060	478

Source NDB (2023)

The paid-in capital as March 31, 2023 was USD 10.5 billion. Each of the founding members has paid-in USD 2 billion. The callable capital is distributed as in Table 17.2. The amount attributed to each founding member is USD 8 billion.

Portfolio by Country

NDB has lent USD8.1 bn to its five founding members since it began operations in 2016. The largest share of the portfolio is held by India. It accounts for 28% of NDB's loan disbursements. The next largest borrower is China (25%). Loans to Russia and China each represent 16% of total loan disbursement. Over the period 2016 to 2021, the loan book of the Bank has increased from a low of US$180 million in 2016 to US$5.2 bn in 2021 (Fig. 17.1). The portfolio held by the founding members doubled between 2016 and 2017, from USD1.5 bn to USD 3.4 billion. Indeed, the portfolio has been doubling yearly from 2016 to 2019. The slowest growth was seen between 2020 and 2021 where the portfolio increased from USD25 bn to USD29 billion.

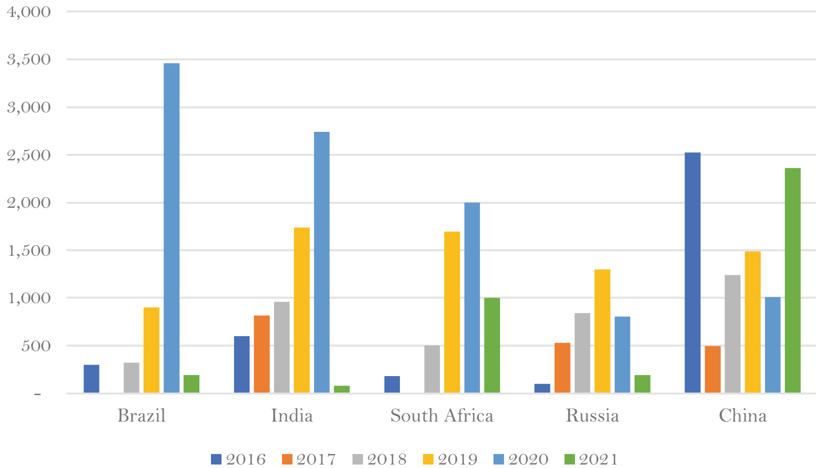

Fig. 17.1 Loan Approvals, 2016–2021 (million USD) (*Source* NDB [2021])

Portfolio by Type of Operation

Loans to sovereign's account for the lion's share of NDB's loan portfolio. The share of loans to BRICS governments is 80% on the average, with the rest going to non-sovereigns. Equity investments are less than half of a percentage. The size of loans to Governments has grown tremendously over the past six years (Fig. 17.2). The portfolio increased from USD1 billion in 2016 to USD 25.6 billion by 31st December 2021. On the contrary, non-sovereign portfolio that amounted to USD100 million in 2019 when the first loans were disbursed has stagnated at USD200 million between 2020 and 2021.

Portfolio by Area of Operation

NDB's loan portfolio can be considered under nine key areas of operation. If we include the Covid-19 emergency assistance that was provided to founding member countries from 2019 and exclude the equity investment portfolio, the value of then loan portfolio is USD28 billion. Transport infrastructure accounts for the bulk of the disbursements (24%)—USD15.5 billion. Urban development attracted 14% of the portfolio with irrigation, water resource management and sanitation representing 11% at

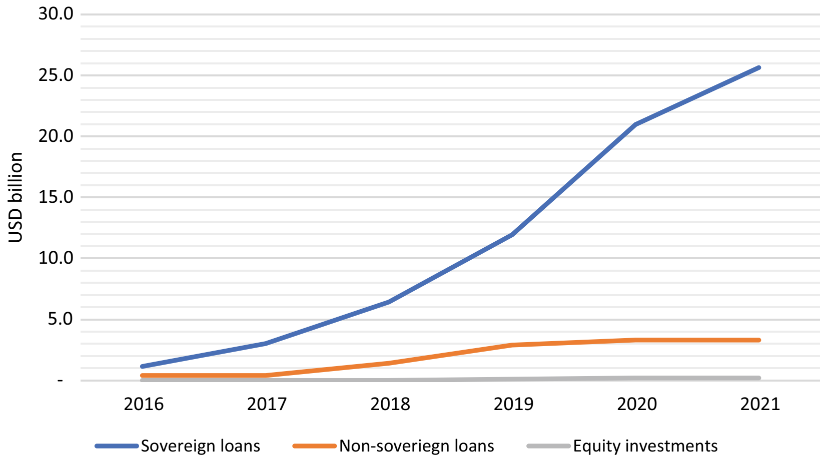

Fig. 17.2 Evolution of the portfolio by type of operation (USD million, as at December 31, 2021) (*Source* NDB [2021])

USD8.4 billion. Environmental efficiency, and social infrastructure each account for 5% (Fig. 17.3).

Portfolio by Financing Currency

NDB's ability to lend in domestic currencies of the founding members is quite unique and an attractive proposition. However, China is the only member that has a greater share (70%) of its debt denominated in its domestic currency, the renminbi (RMB). But most of the loans are denoted in hard currency: the United States dollar, USD, the Swiss franc, CHF and the Euro. The USD is the dominant financing currency. USD financing has however fallen from a peak of 80% in 2017 and 2018 to 65% in 2021 (Fig. 17.4). RMB is the next most important financing currency. A greater proportion of the portfolio of the other borrowers is denoted in hard currency, mostly the USD and euro. Altogether, the share of domestic currency financing in the portfolio increased marginally from 21 to 23% between 2020 and 2021 (NDB, 2021).

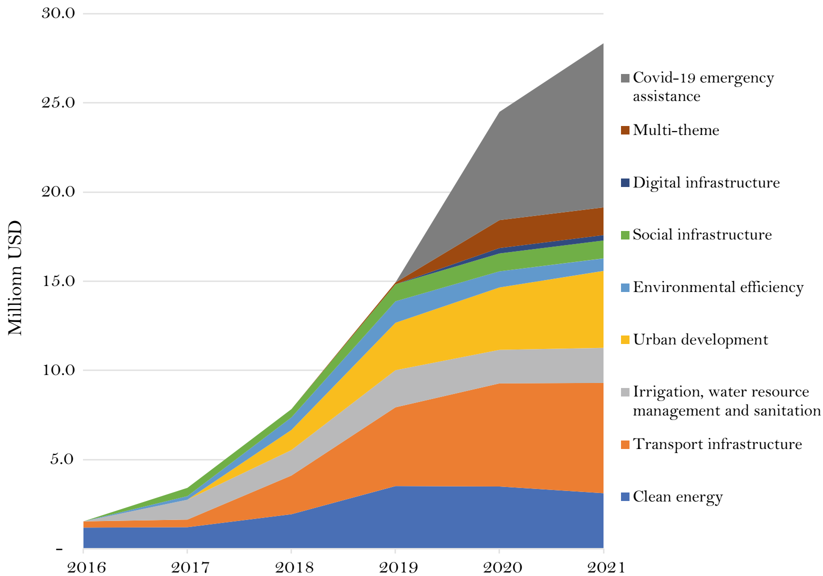

Fig. 17.3 Evolution of portfolio by area of operation (USD million as at December 31, 2021) (*Source* Author's based data from NDB datafiles)

17.5 Contributions to the Development of the Global South

The bank's contribution to the development of Global South is limited because the NDB has very limited borrowing members.[1] Nonetheless, given the combined population of China, India, Brazil and South Africa, NDB's reach is significant. NDB is making valuable contribution to the attainment of the Sustainable Development Goals (SDGs) by its borrowing members: Brazil, Russia, India, China and South Africa. A consideration of the bank's portfolio alignment with the SDGs is instructive. Direct link can be ascertained between the portfolio and 11 SDGs.

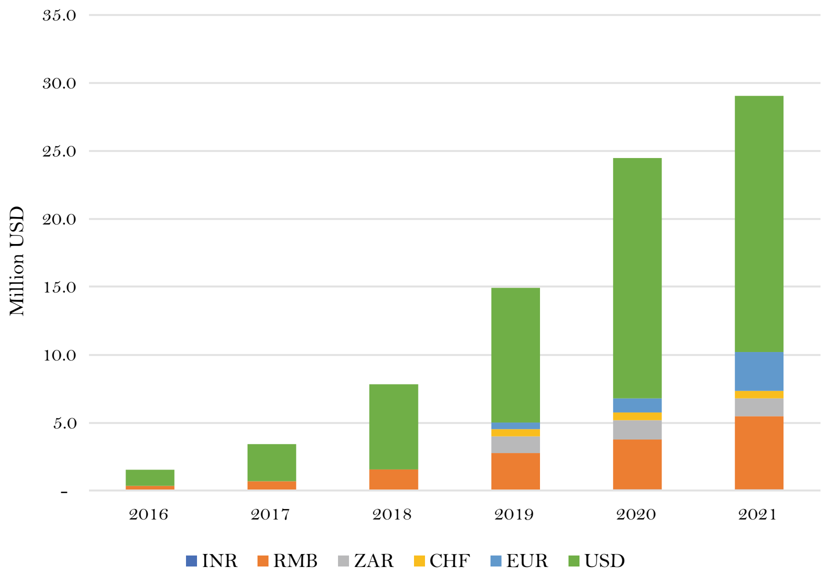

Fig. 17.4 Evolution of portfolio by financing currency, 2016–2021 (*Source* Author's based data from NDB datafiles. *Note* INR is Indian rupee; RMB is the Chinese renminbi; ZAR, South African rand; CHF, Swiss franc; EUR, euro and USD, the United States dollar)

These are Goals,[7] 1 to 4, Goals 6 to 9, Goal 11, 13 and 16. SDG 9, Industry, innovation and infrastructure accounts for a large proportion of the portfolio (Fig. 17.5). Thirty one per cent of the portfolio (USD 25 bn) has gone into infrastructure financing. Lending for infrastructure development is a priority area of operation for NDB. Affordable and clean energy-related loans amount to USD15 bn of NDB's loan book.

As at the end of 2021, the NDB had 75 projects in its portfolio. The expected development outcomes for selected projects financed by NDB, as at 31 December 2021, in collaboration with her partners were

[7] SDG 1, no poverty; SDG 2, Zero Hunger; SDG 3, Good Health and Well-being; SDG 4, Quality Education; SDG 6, Clean water and Sanitation; SDG 7, Affordable and Clean Energy; SDG 8, Decent Work and Economic Growth; SDG 9, Industry, Innovation and Infrastructure; SDG 11, Sustainable Cities and Communities; SDG 13, Climate Action; SDG 14, Life Below Water; SDG 16, Peace, Justice and Strong Institutions.

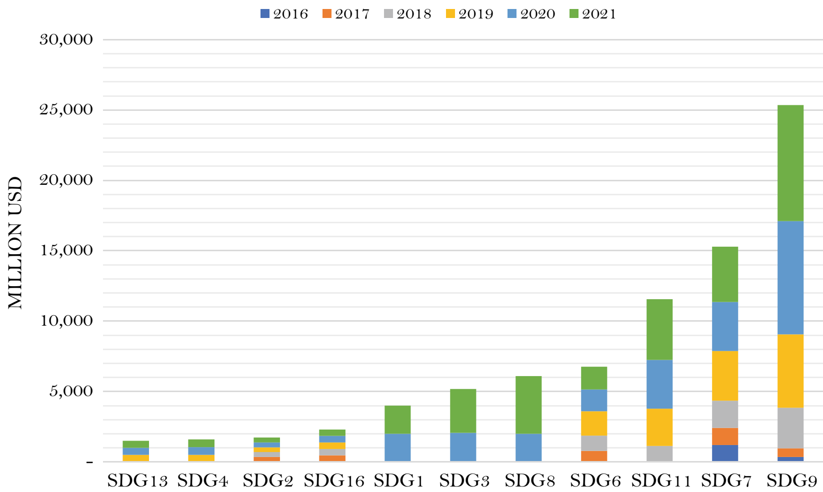

Fig. 17.5 Portfolio by primary SDG alignment (USD million, as at December 31, 2021) (*Source* NDB Annual Reports)

promising.[8] The list include 260 km of urban railway network, 1,300 km of water tunnel/canal infrastructure to be built or upgraded. The bank is also funding 15,700 km road construction and or upgrades. Investment in the provisioning of portable water is considerable. NDB is making funding contribution to the expansion of drinking water supply capacity by 209,000 m^3/day. Forty two (42) cities are also expected to benefit from NDB's urban development projects. There are 35,000 housing units that the bank is funding in the various founding member countries (NDB, 2021).

17.6 Main Challenges of the New Development Bank

The increasingly fraught relations between leading BRICS economies—China and Russia—and the West may have negative impact on the bank's operations. For example, the imposition of financial sanctions on Russia,

[8] Here we do not indicate the Bank's share of the financing cost.

has affected NDB's ability to provide Russia with loans. The bank had to freeze all new loans to Russia following the invasion of Ukraine by Russia in February 2022 (Saeedy & Wei, 2023). NDB's has taken expensive debt to service old borrowings in order to maintain its current liquidity in the wake of the Western sanctions against Russia. The cost of the USD 1.25 billion bond it floated in April 2022 was almost five times more expensive than previous borrowings. The challenge here is that when the cost of borrowing for the bank rises, it will have to be passed onto its borrowing members. In the end, the cost of credit from NDB will be high, thus defeating its attempt to provide affordable credit to borrowers in the Global South.

Fitch Ratings' downgrade of NDB in July 2022, and the suggestion that its access to dollar-bond markets is constrained constitute a risk regarding the bank's access to credit. NDB's dependence on Western capital markets to raise loanable funds suggest that the bank will be beholden to the norms of Western-led capital markets. If the relationship between China, Russia and the Global North continues to fray, the risk of de-coupling of Chinese supply chains from the Western countries will increase.

Another important challenge facing the NDB is associated with its dependence on USD as vehicle currency for raising funding and lending. The continued dependence of the bank on dollar-denominated bonds in the international capital market is a challenge that needs to be addressed in the medium to long run. In practise, this will be difficult to achieve because of the dollar hegemony and the fact that most of the important international capital markets are in Western countries. Indeed, the structures of the international financial architecture are controlled by Western countries. This reality provides the USD and the other hard currencies such as euro, the Japanese yen, British pound and the Swiss franc exceptional importance in the capital markets.

The fact that the NDB's USD100 bn Contingent Reserve Arrangement, CRA is dependent on an IMF intervention after 30% of the quota is borrowed is problematic. Patrick Bond argues, "in this context the NDB would appear close to Bretton-Woods Institution model, promoting frenetic extractivist calculations based on US dollar financing and hence more pressure to export" (Bond, 2016). NDB has to find ways to enhance its capability to provide a fully fledged financial safety to support members when hit by the balance of payment shocks.

Contrary to the stated objective of NDB in its Articles of Agreement, after eight years of operation, it is yet to lend to any emerging economies and developing countries outside its five founding member countries. NBD has to expand its membership significantly from the present membership of eight (founding members and newly admitted members, Egypt, Bangladesh and United Arab Emirates). More developing countries should be admitted into membership and provided the opportunity to borrow from the bank. This will increase the reach of NDB and equally increase its developmental impact across the Global South.

17.7 Concluding Remarks

The chapter examined the evolution of NDB, its structure, funding and contributions to sustainable development in the Global South. The chapter analyzed the evolution of NDB's portfolio relating to loan disbursement, borrowing by country, financing currency and areas of operation. NDB's loan book is aligned with the Sustainable Development Goals. The NDB's financial risk safety net, the Contingent Reserve Arrangement, is notable. NDB has built up a portfolio of USD81 billion after 6 years of commencing operations. But the infrastructure needs of the Global South is immense. Therefore, any new multilateral development finance institution that emerges provide additional resources to bridge the existing financing gap. NDB member countries constitute over 40% of the world's population. However with less than ten member countries, the membership of NDB has to be expanded considerably to increase the geographical reach of the bank. NDB also has to diversify its portfolio and reduce its reliance on sovereign loans. While credit risk with sovereigns is much better than that of non-sovereigns, it is important that a good balance is maintained. Despite the areas where NDB needs to improve, the bank has made considerable strides.

Notes

1. The term, Global South, has three definitions. The term is often used by intergovernmental development organisations, particularly by those that have roots in the non-aligned movement during the cold-war. It is used as a designation for economically disadvantaged countries and as an alternative for the derogatory label, the "The

Third World". More recently, the term is being used to categorise countries and peoples who are negatively affected by the contemporary capitalist globalization. The Global South also represents deterroteralised geography of capitalism's negative externalities and seeks to account for oppressed peoples within borders of rich countries leading to a situation where we can have economic Souths in the geographic North and Norths in the geographic South. The third definition relates to the resistant imaginary of a transnational political subject that emanates from a shared heritage and experience of subjugation under contemporary capitalism (Mahler, 2017).

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CHAPTER 18

Islamic Development Bank: An Instrument for Alternative Development Financing in Africa

Abdul Nashiru Issahaku, Jabir Ibrahim Mohammed, and Sherif Sulemana

18.1 Introduction

Development financing plays an important role in the development of countries, particularly in developing countries. Sub-Saharan Africa is seen as the highest recipient of development finance assistance such as concessionary loans, official development assistance, remittances, and, increasingly in recent times, commercial Eurobonds and Foreign Bondsissued to finance developmental needs. This is because most SSA countries lack sufficient savings and investments to meet developmental needs and to bridge the global poverty gap, leaving an ever-widening investment

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gap in health, education, agriculture, social protection, and infrastructure (Abor et al., 2020; United Nations, 2012). According to Quartey (2017), development finance funds are driven from multiple sources such as concessional development assistance, private external funds, non-concessional loans, and domestic resource mobilization. The concessional sources of funds come from bilateral, development aid, and concessionary loans which are used to support most government budgets in developing countries. Most low-income countries and lower-middle-income countries, especially in Africa, fund their budgets with donor grants mainly from concessionary sources. The government also obtains non-concessional financing in the form of commercial loans by issuing domestic bonds and external bonds (Eurobonds and foreign bonds) to close the budget deficit. Again, the budget is also financed using taxes such as personal income tax, corporate taxes, value-added taxes, excise taxes, natural resource tax, Central Bank Finance, and a host of others. Many African countries, nonetheless, are unable to raise adequate amounts of revenue from taxes (Okunogbe & Santoro, 2023). Data shows that tax revenue to GDP in Africa averaged 16% in the last decade, according to the OECD and African Union Commission report on revenue statistics in Africa 2022. Figures 18.1 and 18.2 show the tax-to-GDP ratios of some selected African countries and the yearly average between 2010 and 2018 respectively.

For the period 2010–2018, Namibia, Seychelles, and South Africa had tax-to-GDP ratios in excess of 20%, with 31%, 30%, and 24%, respectively. Equatorial Guinea, Ethiopia, and Congo Republic had tax-to-GDP ratios of less than 10%, recording 7.8%, 8.4%, and 9.5% respectively. In 2018, 61% of African countries had tax-to-GDP ratios below the average of 16.3%

Figure 18.2 shows the average tax-to-GDP ratios of African countries between 2010 and 2018. The highest yearly average was recorded in 2014, 17.19% and the lowest was in 2010, 15.45%. The rest of the period has been between 16.21% and 16.8%, respectively.

Other sources of development finance in Africa include private capital flows such as foreign direct investment, equity capital flows, and debt capital flows. These funding sources come to support critical private sector development such as activities related to mining, the petroleum sector, commerce, telecommunication, banking, agriculture, etc.

However, the recent development in the African debt markets, due to government increasing demand for commercial sources of financing

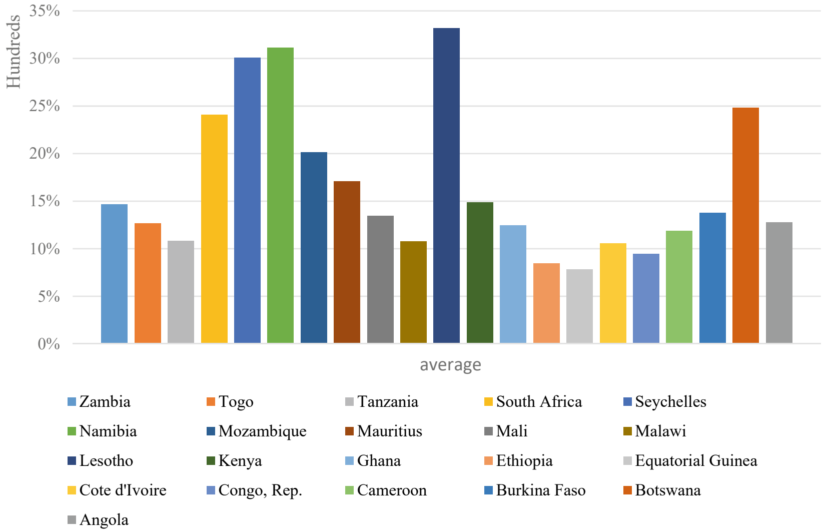

Fig. 18.1 Average tax-to-GDP ratios of selected African countries 2010–2018 (*Source* Authors' construct from WDI, 2023)

through Eurobonds, syndicated loans and foreign bonds, have left most African countries in debt traps due to the rising costs of debt financing and the unsustainable nature of these commercial loans. According to the IMF, most African countries have failed to meet their debt sustainability thresholds thereby requiring bail-outs and debt restructuring activities. These recent developments in the African debt market calls for finding alternative cheaper sources of financing development in African countries. As a result of this, there is the need for a paradigm shift in financing development in Africa. Moyo (2020) argues that African countries need to move from poverty management perspectives to development management approaches which will best ensure sustained growth and development in Africa. Similarly, Chandler (2023) notes that illicit financial flows have been the major obstacle to African development financing architecture because Africa continues to lose approximately USD$100 billion annually through illicit financial flows. Apart from that, the global economic crisis has been a major challenge in African access to cheaper sources of finance. This means that there is the need for African

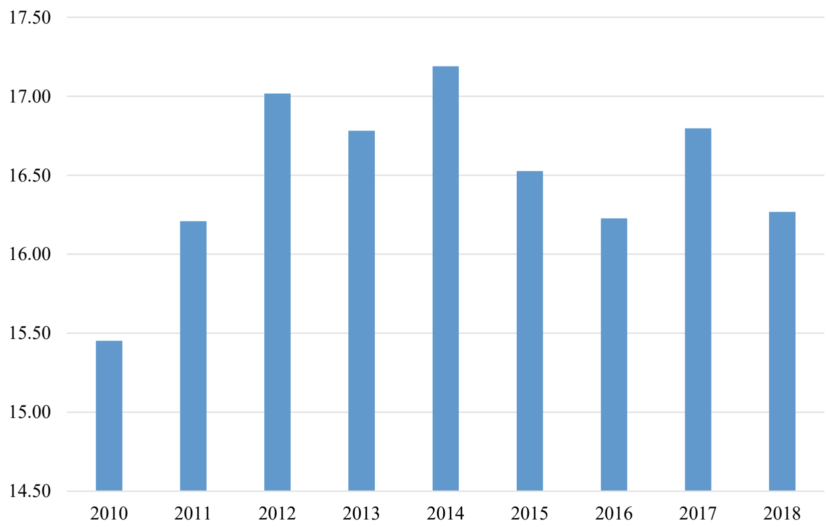

Fig. 18.2 Tax-to-GDP ratio in years (*Source* Authors' construct from WDI, 2023)

countries to explore more to identify and access other cheaper development financing sources since conventional finance often comes with higher interest burdens that make it much more unsustainable for most of these countries.

Paradoxically, Islamic finance has emerged as a solution to funding development challenges and provides favourable investment opportunities that are interest-free and shariah compliant. It has strict guiding principles and requirements that ensure ethical financial behaviour and real asset-backed transactions between the lender and the borrower or the investor and entrepreneur. Islamic finance prevents usury (interest-free) and guarantees certainty in financial transaction agreements. Hassan et al. (2022) argue that Islamic finance has the potential to provide effective solutions to the huge infrastructure project financing needs of Africa and to help alleviate poverty through financial inclusion. Islamic finance also has the potential to grow Small Medium Scale Enterprises (SMEs) which are the engine for job creation and for improving the standards of living of ordinary African people. It also has the potential to equitably redistribute wealth and to remove majority of the vulnerable and poor from below the established poverty levels through access to finance at affordable and well-arranged payment terms.

The Islamic Development Bank (IsDB) is a shariah compliant development finance institution which provides Islamic financial products and services in line with Islamic principles. It has been the main promoter of Islamic finance in the world providing all the Islamic finance products both privately and publicly. It has also been developing all the shariah- compliant principles upon which all Islamic banking, finance, and economics relies upon. The IsDB was set up with the mission to promote comprehensive human development with a focus on the priority areas of alleviating poverty, improving health, promoting education, improving governance, and prospering the people.

Its membership spreads across the globe with a current membership of 57 countries. Africa has close to half (27) of the member countries. Since its inception, the IsDB has been financing development projects across its member countries, and Africa is no exception to this. Since 1975, IsDB has supported the African development finance space for Infrastructure and trade-finance to a tune of USD$65 billion.

In recent times, some three (3) African countries have significantly benefited from infrastructural financing and technical assistance from the IsDB. For instance, at the 344th Board of Executive Directors meeting of the IsDB on 13 February 2022, the board approved a total of EUR297.67 million for 3 Member Countries in Africa under the Regional Hub of Dakar. These include EUR35.14 million for Phase 3 of the Hydro-Agricultural Development Project in Upper Sassadra and Fromager Regions in Cote d'Ivoire, EUR24.30 million for Phase 2 of the Development of a Technical and Vocational Education Project in Guinea, and EUR 238.23 million for the Construction of Dakar Tiyaouane—Saint Louis Highway/Mékhé—Saint Louis Project in Senegal.

With the help of the IsDB, under its current effort in supporting development financing in Africa, multilateral organizations and governments, efforts should be intensified to accelerate and support the progress of establishing Islamic banks in African countries. To fully reap the benefits of Islamic finance in Africa, countries must enact a shariah governance framework to provide the legal and regulatory basis for Islamic finance in Africa. Deliberate efforts must be put in place to train adequate human resources and acquire experts to manage the industry. The Islamic Development Bank will provide technical assistance for the rest of the African countries who want to begin to use Islamic finance products to raise the needed funding for their infrastructural needs and to close their budget deficits.

Following this line of discussion, the rest of the chapter is structured according to the outlined plan. An overview of financial products and services is given in Sect. 18.2. Section 18.3 highlights IsDB membership and governance. Section 18.4 focuses on IsDB financing schemes for Africa, while Sect. 18.5 looks at IsDB finance models for Africa. Section 18.6 deals with Islamic banking services for the unbanked. Section 18.7 underscores the need for a risk management and compliance framework for the IsDB. Section 18.8 focuses on IsDB sustainable development finance models for Africa, and Sect. 18.9 concludes and provides policy implications.

18.2 Overview of Islamic Financial Products and Services

Islamic financial products (IFP) are offered to meet the varied needs of clients including sales, financing, and investments. These product offerings must necessarily conform to the objectives and operational limits of the Qur'anic principles and tenets. IFP should be in line with the five key principles of Islamic banking set out as follows:

- Prohibition of interest (*riba*);
- Profit and loss sharing agreement;
- Asset-backed financial transactions;
- Prohibition of speculation; and
- Contracts must be *Shari'ah*-approved and sacred.

Islamic financial products take different forms and provide elaborate mechanisms and methods to identify the sources and uses of money, including sales, trade-finance, and investment. These include Murabahah (cost-plus financing), Mudarabah (profit sharing), Musharakah (partnership), Ijarah (leasing), Qard (loan) Istisna', Takaful, Sukuk. These instruments serve as the foundation for the development of a diverse range of more sophisticated financial instruments, implying that there is much room for financial innovation and expansion in Islamic financial markets.

Murabahah: Murabahah is a cost-plus financing arrangement where the bank purchases an asset and sells it to the customer at a pre-agreed profit markup, allowing for instalment payments without interest (Ayub, 2013). Islamic banks operate two types of Murabahah products. In the first case, the Islamic bank buys the goods and puts them out for sale. In the second case, a third-party request for the good and the Islamic bank orders for it for the customer. The second case is the most practised among Islamic banks. Since Murabaha is a sale contract, it is expected that it should satisfy the requirement of a sale contract with the seller expressly telling the purchaser the cost he incurred in acquiring the asset (Usmani, 2021).

Mudarabah: Mudarabah is a profit-sharing arrangement where one party, the Islamic bank, provides the capital and resources (Rab-ul-Maal), and another party, the entrepreneur, manages the investment project (Mudarib) (Usmani, 2021). Profits in this arrangement accrue from how much the final value of assets exceeds the capital investment at current market price and this is shared based on a pre-agreed ratio (Zawawi et al., 2014). While loses are borne by the Islamic bank or investor, the Mudarib sacrifices only his expertise and efforts. The investor (bank) may either specify the business to invest in or leave it to the other partner to undertake whatever business he deems fit. Profit distribution is agreed at the beginning based on an agreed proportion by the consent of the parties. Islamic banks use the Mudarabah to source funds from savings and investment accounts.

Musharakah: Musharakah is a partnership-based financing arrangement where two or more parties contribute capital to finance a project (Zawawi et al., 2014). It is an equity participation contract where the parties jointly run an enterprise and share profits and losses in proportion to the initial capital contribution or to a predetermined formula with the free consent of the partners (Kettell, 2011). Unlike fixed rates of return in the conventional system which allows for interest payment irrespective of profit or loss, Musharakah allows for shares in the loss by the financier (Bank). According to Usmani and Taqī ʻU̱smānī (2002), Islam identifies interests as unjust instruments to either the creditor or the debtor. Except in a diminishing musharakah where the bank's share in the venture is gradually paid off by the other partner who eventually retains full control and ownership, the bank remains a permanent partner.

Ijarah: Ijarah refers to leasing or rental contracts where the Islamic bank or investor provides assets such as equipment or property for a specified period, with rental payments made by the lessee (Ahmed, 2010). One party transfers ownership of a service for an agreed consideration. This differs from sale in that the ownership of the object of interest still remains with the lessor, whereas the right to use is transferred to the lessee. Ijarah must meet three key principles: offer and consent, two parties, and the object of the contract. It is argued that rental payments could be flexible and made to reflect the changing economic and business situations.

Istisna': Istisna' is a contract for the manufacture or construction of an asset based on the buyer's specifications, where the price can be paid in instalments. It is a financing method where one party requests for the production of specified goods or for the construction of an asset, the price and delivery date of which are specified at the date of the contract. It is instructive to note that both price and object are deferred which shows the importance of manufacturing and how the sharia accommodates that. For Istisna'to be valid, the asset must exist and be owned by the seller at the time of sale and there should be no ambiguity in respect of specifications. The liability of either party, i.e. the purchaser to make payment and the developer to make delivery, are deferred to future dates when the contract is fulfilled and approved or accepted by the purchaser.

Takaful: Islamic insurance practised under Sharia principles where participants contribute to a pool with the objective of paying defined loss from a designated fund. Takaful is under a mutual guarantee based on principles defined by people of common interest where each participant contributes sufficient amounts to cover expected claims. It is an alternative to conventional insurance consolidating shared responsibility, common benefit, and mutual solidarity. The Takaful firm is the trustee and claims are paid to policy holders from the fund, while the surplus or deficit is shared by participants. Examples of such contracts include the Wakalah and Mudarabah. Wakalah is an agency contract where one party appoints another to conduct defined legal action on his behalf, for a specified fee or commission.

Qard: Qard transactions are unprofitable loans. The borrower is only required to repay the principal amount borrowed but may pay an additional sum as a show of appreciation at his or her exclusive discretion. The bank can leverage on this system to create money because of the fractional reserve required ratio of banks. It can also be used as a collateral-backed security to current account holders.

Sukuks: Sukuks are Islamic debt financial instruments issued by sovereign and corporate entities to fund trade or the production of tangible assets. They are asset based with a maturity date and holders are entitled to regular revenue over the lifespan of the sukuk (Godlewski et al., 2013). Sukuks can be backed by an underlying asset such as real estate property, or regular stream of income from taxes in the case of a sovereign state. Banks cannot raise capital through the issuance of generic fixed or floating coupon-bearing bonds. Banks can securitize the cash flows generated by Ijarahs or Murabahas and then issue a Sukuk based on the bundled cashflows. In recent times, various structures of sukuk based on ijarah, musharakah, Mudarabah and hybrids including sukuk based on combination of ijarah with istisna have emerged in the Islamic financial markets (Al-Amine, 2008). Since Sukuks are issued both locally and internationally, they are rated by rating agencies such as Standard & Poor's, Fitch and Moody's. The IsDB sukuk was rated Aaa/AAA/AAA by S&P, Moody's and Fitch.

18.3 The Islamic Development Bank Membership Shares and Corporate Governance

The Islamic Development Group is comprised of five operational entities: the Islamic Development Bank (IsDB), Islamic Research and Training Institute (IRTI), Islamic Corporation for the Development of the Private Sector (ICD), Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), and International Islamic Trade Finance Corporation (ITFC). The board of directors are composed of 14 members divided into 7 appointments by the major shareholders and 7 elected on the basis of geographical representation (Fig. 18.3)

Membership of the bank is made up of 57 sovereign states from the continent of Africa, Asia, Europe, and Latin America. To be a member of the bank, a country has to accept the terms and conditions decided by the board of governors. African countries make up close to half of the number, twenty-seven (27). Saudi Arabia has the highest share in the IsDB with are total share of 24.4%, followed by Libya 9.8%, with Kuwait (6.5%) being the least. Apart from these eight (8) keys shareholders of the IsDB, 18.9% of the shares are owned by the other 49 member countries.

The IsDB group's governance structure includes a president, a board of governors, a board of executive directors, and senior management. The

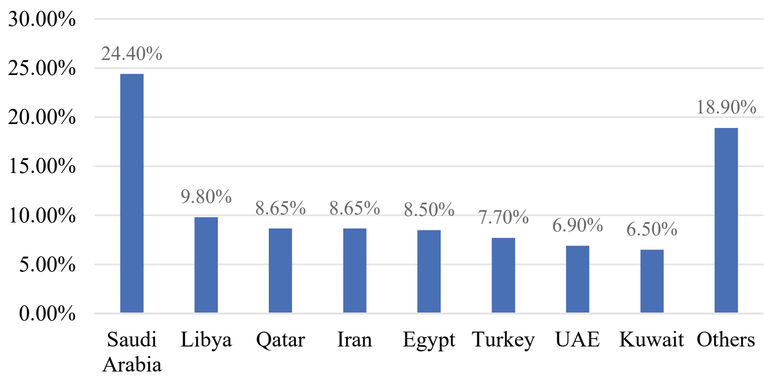

Fig. 18.3 Islamic Development Bank share ownership (*Source* Author's compilation from IsDB website, 2023)

board of governors is the highest authority of the bank and has representatives from each of the member countries. Meetings of the board are held annually to deliberate on policies and approve financial statements.

The Board of Executive Directors (BED) is the body responsible for the direction of the general operations and policies of the Islamic Development Bank. The BED is currently composed of eighteen (18) members. They include nine (9) Executive Directors appointed by their countries, which are main shareholders, while nine (9) others are elected by the Governors of other countries. The tenure of office for members of the BED is a renewable period of three years.

The president is the chairman of the BED and the legal representative of the Islamic Development Bank. He is voted by not less than a two-thirds (2/3) majority of the board of governors. The president is not a governor or an executive director.

18.4 IsDB Financing Schemes for Africa

Financing schemes for development in Africa should be anchored on long-term, sustainable, and ethical financial behaviour and Islamic principles. IsDB financing is in the form of loans and credits to countries in Africa to facilitate social and physical infrastructure development needs

(Muhtar, 2022).[1] It is clear that countries in Africa are at different levels of development and thus require different resources and capacities. The IsDB also supports private sector projects and investments to help the private sector assume its place as the engine of growth. We discuss the various financing schemes currently ongoing in the IsDB towards its members.

Equity Financing: A financing technique introduced in 1976 where the bank participates in the share of capital of various companies. The level of IsDB's participation does not exceed one-third (1/3) of the equity capital project.

Investment Project Financing (Itisna'a): This is medium-term financing introduced in 1996 for projects in the manufacturing or construction sector. This scheme is aimed at helping private manufacturing firms raise capital with soft terms and conditions to work and then have their profits shared. In this contract, the IsDB provides an equipment to the construction or manufacturing firm on agreed terms where IsDB buys the equipment based on the firm's specifications, and the firm pays back on instalment basis.

Concessional Project Loans: This mode of financing, which was introduced in 1976, is concessionary in nature and is given to member countries to finance projects. The IsDB gives interest-free loans with a repayment period spread between 15 to 30 years with a grace period of 3 to 10 years. These loans carry administrative charges or service fees of 1.5% to 2.5%.

Programme Loans: IsDB gives the opportunity to member African countries to come out with programmes they want the bank to support. These programmes are reviewed by the Member Partnership Strategic Committee, after which, upon meeting the bank's objectives, they are sponsored. As of 2022, the IsDB has undergone several financing schemes for development in various African countries. The IsDB invested 31.5% of their project portfolio in Sub-Saharan Africa alone. Figure 18.4 shows the investment in projects of SSA member countries with the IsDB group.

With the total portfolio of project loans given by the IsDB group limited, Senegal received USD$700.2 (23.1%) of the total portfolio, followed by Burkina Faso USD$522.8 (17.2%), with the least being Niger

[1] Mansur Muhtar https://www.un.org/africarenewal/magazine/october-2022/how-islamic-development-bank-financing-projects-africa.

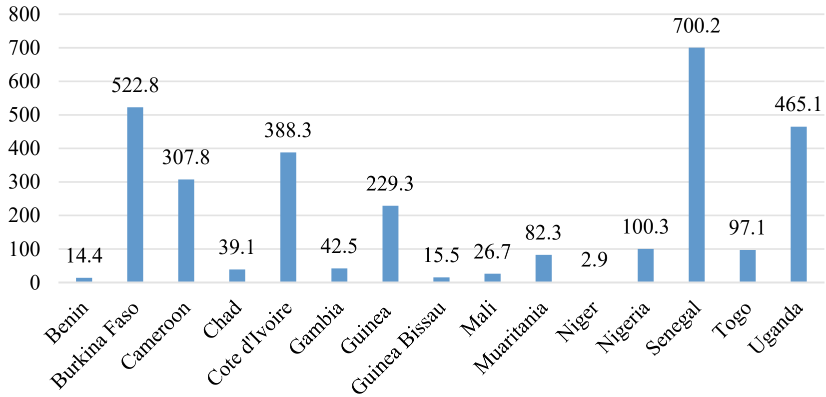

Fig. 18.4 IsDB project finance (2022) for SSA USD$ million (*Source* IsDB, 2022)

USD$2.9 (0.001%). The rest of the SSA countries and what they received for the 2022 fiscal year for project financing are shown in the graph above.

18.5 IsDB Finance Models for Africa

Islamic Capital Markets

The Islamic capital market (ICM) is a dedicated capital market that supports capital projects and infrastructure by providing funds in a manner that does not contradict the tenets of Islamic principles. The market is, thus, free from activities frowned upon by sharia, including usury, gambling, and uncertainty. It is set up to provide medium to long-term securities for financing productive activities. It is an important part of the Islamic financial system serving the capital requirements and complementing the activities of the banking sector (SEC Nigeria, 2017).[2] Participants in the ICM include issuers, investors, regulators, intermediaries, and advisory and certification boards. Sukuk are issued to raise funds from the market to support member countries. Sukuk is a shariah compliant asset-backed security.

[2] SEC Nigeria, Understanding ICM.

The International Islamic Financial Market (IIFM) provides market research reports on the International and Domestic Sukuk market developments, the structural preferences, and other relevant factors based on verified Sukuk issuance data from the global Sukuk market. The report for each year highlights the performance of both short-term and long-term Sukuk, based on Sharian compliant principles. It provides Sukuk templates for Sukuk Al-Ijarah and Sukuk Al Mudarabah. IIFM also provides information on hedging standards, liquidity management standards, and Trade Finance Standards for the Islamic Capital Market.

Box 18.1 Islamic Financial Instrument (Sukuk Market)

The first sukuk was issued in 1990 by a Malaysian company and it was not until 1996 that another firm in Malaysia (Kuala Lumpur Airport Company) issued another sukuk. Since 1999, many sukuk have been issued by a number of private and public institutions. Malaysia then became the main driver of the sukuk market for many years. Bahrain became the second sukuk issuer when it entered the market in mid-2001. Later in 2004, the Western government, the State of Saxony-Ahalt of Germany issued a sukuk debt instrument. Subsequently, the United Kingdom and other countries have since issued Sukuk instruments.

The Islamic Capital Market issued a quantum of Sukuk both domestically and internationally for short- and long-term Sukuk. According to IIFM (2023), the sukuk market reached USD$182.7 billion for the 2022 financial year with a dip of 2.96% over the 2021 financial year due to global inflationary and economic turmoil. Between January 2001–December 2022, Sukuk issuance stood at USD$1.79 trillion. Figure 18.5 illustrates the performance of global sukuk issuance for all tenors between 2017 and 2022, with 2021 recording the highest issuance of sukuk in the capital market.

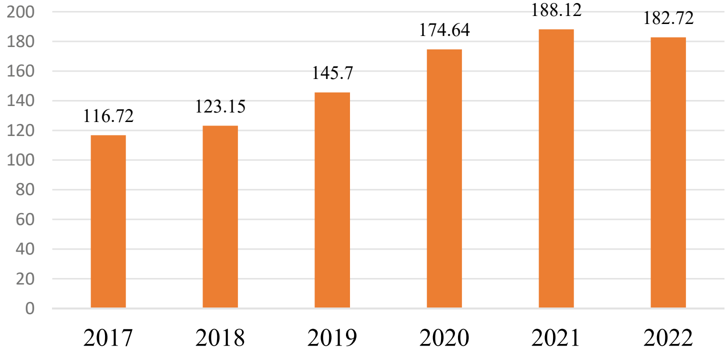

Fig. 18.5 Total global Sukuk issuance, all tenors, all currencies in USD$ billion(*Source* IIFM Sukuk database, 2023)

According to Fitch, the default rate in Sukuk was as low as 0.21% of all the issues in 2022. Currently, there are Green and Environment, Social and Governance (ESG) aligned sukuk instruments being introduced over the last five years and these have gained greater strides in the market. Outstanding ESG sukuk volumes expanded 62.9% in 2022 mainly due to low-base effects, reaching USD$24.5 billion (13.4% of global sukuk volumes). Therefore, regulators in the market see these as important financing instruments and have subsequently launched ESG sukuk and bond issuance frameworks and strategies. For instance, outstanding Fitch-rated Sukuk was USD$139 billion in 2022 up to 4.9% up from 2021. Out of this issuance, Fitch noted that 78.1% were investment grade, 20.6% had a Positive Outlook, and 69.9% had a Stable Outlook (Fitch, 2023).

Despite the strides that sukuk issuance seems to be making, there are still some hurdles like higher issuance costs, time-to-market and complexity compared with conventional bonds and bank loans and standardization gaps. Despite these challenges, African countries can still leverage on Sukuk instruments to help finance their developmental projects. However, political risk and lower global investor interest in most emerging-market debts may affect African countries' fortunes. But the future is still bright for African countries who want to explore the Sukuk market to finance very important infrastructural projects.

Islamic Infrastructure Finance

Project finance has been largely based on the principle of debt-leveraged payment/receipt of interest on loans. Islamic Project finance is a sub-set of the Islamic financial system financing large-scale public infrastructural projects. Islamic Project Finance is unique because it repudiates interest and institutes a partnership-based system where the provider of the fund partners with the entrepreneur based on a predetermined profit and loss sharing formula.[3] IPF holds huge potential for countries in Africa to adopt for public infrastructure projects as opposed to conventional financing which is associated with huge risk.

The nature of Islamic Project Finance will depend on the type of project being financed, whether it is a brownfield or a greenfield. For a brownfield, it is typically on a sales or leaseback arrangement whereas a greenfield project is typically structured as a sale contract. The Box 18.2 depicts classic illustration of the IsDB project financing scheme structure for Africa.

Box 18.2 Islamic Development Bank Project Finance in Africa
IsDB Loan Portfolio

Since its inception in 1975 up to 2022, the IsDB has advanced financing to African countries to the tune of UD$65 billion which includes about USD$20 billion for trade financing activities. A lot of the financing also went into health, education, road transport, energy, and so on. In 2022 alone, the IsDB financed projects in Africa to the tune of USD$1 billion. The projects financed include the upgrading of roads in Uganda, Watershed Water Resources Mobilization Project in Senegal, Hydro-Agricultural Development Project in Cote d'Ivoire, the provision of maternal and neonatal healthcare services in Mauritania and the development of technical and vocational education in Guinea (IsDB, 2022).

IsDB Financing to Private Sector

IsDB equally finances the private sector besides the projects it finances. The IsDB trade financing arm supports trade among African countries and between African countries and other countries in other regions. The

[3] Noor Amila Wan Abdullah Zawawi et al. Financing PF2 Projects: Opportunities for Islamic Project Finance.

IsDB provides lines of credit and financing equity investment as well as lines of finance to commercial banks in Africa for on-lending to small and medium enterprises. The IsDB also has an arm that deals with insurance to mitigate the risk of borrowing and to encourage the flow of investment and the expansion of trade in Africa.

IsDB providing risk-mitigated project finance to Africa

The IsDB is a blue-chip development finance institution with AAA credit rating. IsDB capitalizes on this rating to raise funds from the capital market through the insurance of Sukuk or Islamic bonds. In 2022 alone, IsDB raised USD$5 billion from the issuance of sukuk. Due to the AAA rating, IsDB gets the funds cheaply and are able to transfer finance to African countries and other member countries to finance critical infrastructural projects. The bank also has Islamic Solidarity Fund for Development which currently has USD$2 billion and is expecting to raise USD$10 billion. The returns from this investment are used to soften loans to Africa and other developing countries. The IsDB also partners with other development organizations such as Bill and Melinda Gates Foundation and several other Arab donors to pool funds to provide soft loans to African countries.

Project selection criteria by IsDB

The IsDB experts are drawn from member countries so that makes it undertake projects for countries with their agenda of needs in mind. The IsDB then prepares for member countries a Member Country Partnership Strategy which involves engagement with shareholders to get a sense of their development priorities. This is complemented with a country study to identify the binding constraints. Then IsDB strategic teams sit down together to prioritize and see how they can align with their national priorities. The IsDB considers its comparative advantage as an institution. This then allows the bank to come out with portfolio projects. The board goes through an internal review process to ensure that the projects meet the development objectives of the countries. Thus, the project selection cycle is a very elaborate process involving diligent review.

IsDB project finance impact on Africa

The bank is of the opinion that development effectiveness is measured not by how much money is spent or the buildings or roads that are constructed, but rather by the transformation the financed project has on the lives of people in terms of improving health and wellbeing, increasing incomes, and addressing poverty issues. The IsDB also ensures environmental sustainability and social inclusive projects are financed. The bank also makes sure that women, young people, and vulnerable groups benefit from these projects as much as possible. IsDB carries out a project evaluation review whenever a project is finalized and this allows the bank to draw lessons to see how to improve on future project preparations and to safeguard the sustainability of the projects.

Source https://www.un.org/africarenewal/magazine/october-2022/how-islamic-development-bank-financing-projects-africa

18.6 IsDB Banking Services for Un-banked

Islamic Development Bank presents an opportunity to contribute to the financial inclusion efforts in Africa. Africa is home to 17% of the global unbanked population among whom religion is often cited as a reason for exclusion. Besides, the Islamic financial system can provide access to affordable finance for developing countries where high-interest payments are a major obstacle to raising finance.[4] The prohibition of interest payments in Islamic finance is an important incentive for the poor and vulnerable in society to access credit from banks and other financial institutions.

Islamic banking services are determined by both the supply and demand factors because of its peculiar requirements and special nature. An important demand factor is financial literacy, and Islamic financial literacy will provide a better understanding of financial products and services and the conditions governing Islamic financial products. Other demand factors include social influence and socioeconomic attributes. The supply factors consist of expertise, products and services, infrastructure, and regulatory framework. Islamic finance promotes risk-sharing contracts and uses Islamic microfinance to support micro-enterprises, the poor, and the vulnerable.

Financial services can be made available to the unbanked through the channel of promoting risk-sharing contracts and using instruments like Islamic microfinance to support small enterprises and the vulnerable (Iqbal & Mirakhor, 2012). Risk-sharing contracts in Islamic finance

[4] Amin Karimu et al., Islamic banking and finance in Africa.

provide an effective alternative to conventional debt-based financing which is a disincentive to poor people and discourages financial inclusion. Increasing the number of sharia compliant banks and financial institutions will promote financial inclusion by reducing barriers such as religious exclusion (Demirgüç-Kunt et al., 2013).

18.7 Risk Management and Compliance Frameworks in IsDB

Risk in finance is an unavoidable issue financial intermediaries like banks have to deal with. How well risk is managed by a financial institution determines the institution's success and survival because returns are dependent on the transaction risk. A risky financial system is prone to instability, loss of investments, collapse of institutions, and the entire financial intermediation system. It is critical to ensure risk is managed to achieve the overall objective of financial intermediation.

Islamic finance and products are generally exposed to various risks which are invariably associated with players and stakeholders including the Islamic Development Bank. These risks include credit risk, market risk, operational risk, and Shariah compliance risk. Islamic bank management must build a risk management environment by clearly identifying an institution's risk objectives and strategies, as well as systems capable of recognizing, measuring, monitoring, and managing various risk exposures (Akkizidis & Khandelwal, 2008).

There are arguments that because Islamic finance proscribes interest rates it is inherently less risky. Akkizidis and Khandelwal (2008) argue that even though Islamic banks are not directly affected by interest rates, they are exposed to risk indirectly through lease, markup, and deferred payments. The reliance of Islamic finance on equity financing makes it riskier than debt financing.

Risk in Islamic banking and finance revolves around shariah compliance risk which is the likelihood that the financial product will not comply with established principles and standards of the sharia. Contractual and structural underpinnings of products should conform to the shariah. Articles 16, 17, 18, and 19 of the IsDB article of agreement set out due diligence procedures and risk management guides to IsDB financial instruments.

For instance, Article 16 states in parts "…the bank shall pay due regard to safeguarding its interest in respect of financing, including obtaining guarantees for loans". Further, the recipient and guarantor are assessed on their ability to meet obligations under the contract. Similarly, Article 17 states "…the bank shall satisfy itself that the project or enterprise is currently or potentially revenue yielding and that it is and will be properly managed…". Again, Article 18 focuses on project loans and in making loans the bank takes into account "the projects' potential return and importance in the scheme of priorities…". Essentially, IsDB puts these risk-mitigating measures in place to ensure that loans that are granted to the bank's clients are paid in accordance with its principles. It also ensures that default risk is reduced through a well-coordinated loan processing procedure. Based on this framework, and for the IsDB to fulfil its development mandate, it is exposed to various kinds of financial and non-financial risks. To be able to mitigate those risks the bank uses various risk management approaches and maintains a strong risk management architecture which includes measures such as capital adequacy, an exposure limit management framework, an asset and liability management framework, and operational risk management framework, and an end-to-end credit process for conducting business operations (IsDB, 2022).

The risk policies and guideline of the IsDB are approved by the Board of Executive Directors, and its Finance and Risk Management Committee (RMC). These bodies, together with the Asset Liability Management Committee (ALCO) of IsDB, ensure that the risk governance framework of the bank is approved all the time. The risk management body of the bank manages risk such as credit, market, liquidity, and operational risks. In 2022, the bank implemented its Bank-wise Enterprise Risk Management project with advanced risk and finance analytics, including an integrated DataMart. The Board of the Bank approved and operationalized the Risk Appetite Framework, to articulate a comprehensive set of risk metrics and tolerances in defining the Institution's capacity and willingness to bear risk exposures to ensure the Bank's long-term sustainability (IsDB, 2022).

Other risk initiatives currently developed by the bank include Model Risk Management and Governance Framework to proactively mitigate its risk exposure; the implementation of the LIBOR transition project to minimize the impact and ensure transition to alternative benchmark rates in an advanced stage; the implementation of an Operational Risk System for automating operational risk measurement, monitoring, and management to the operation of Risk Control and Self-Assessment (RCSA), loss data and Key Risk Indicators (KRI) in its advanced stage. The bank has also made significant progress in the implementation of a cybersecurity framework to improve organizational resilience and manage cybersecurity risks effectively.

Due to this robust risk management framework put in place by the IsDB, the latter has achieved a 20-year consecutive rating of triple As (AAA) by all rating agencies such as Fitch Ratings, Moody's Investors Service, Malaysian Rating Corporation (MARC) and Standard & Poor's Global. These excellent ratings are also underpinned by the bank's extremely strong capitalization, low leverage, very robust liquidity profile and buffers, strong access to market funding, conservative risk management supported by strong risk management policies, low solvency risk, and strong member support. Due to this significant achievement, the bank is designated as a Zero-Risk Weighted Multilateral Development Bank by the Basel Committee on Banking Supervision and the European Commission which acknowledges the bank's excellent business and financial profile (IsDB, 2022).

With regard to compliance, the IsDB Compliance Division ensures the day-to-day business by ensuring that IsDB operations, investments, and activities comply with its AML/CFT/KYC systems, regulations, and processes. The bank ensures that they put in place in-service training, awareness creation among staff, and information on regulatory risks about compliance. The Compliance Division has also made contribution to Standard Request for Proposal (RfP) for Works Design and Build for rolling out of IsDB New Procurement Framework. In October, 2022, IsDB was granted Observer Status with the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL). This adds to the number of observer status rankings IsDB already has which include the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA), Inter-Governmental Action Group against Money Laundering in Central Africa (GABAC), and Asia Pacific Group on Combating Money Laundering and Financing of Terrorism (APG).

18.8 IsDB as a Sustainable Development Finance Model in Africa

The IsDB Sukuk green bonds issued since 2020 have helped finance environmentally friendly projects in all its member countries. IsDB issued its debut Green Sukuk in November 2019 to raise €1 billion and committed it to projects in renewable energy, clean transportation, energy efficiency, pollution prevention and control, environmentally sustainable management of natural living resources and land use, and sustainable water and wastewater management across its 57 Member countries. Again, in 2021, the IsDB issued its Sustainability Sukuk to raise USD$2.5 billion. A significant amount of this money (61%) was allocated to Middle East & North African Countries, with 24% going to Asia, 13% to Europe, and 2% to others, including the US offshore. This means that SSA countries received very little of Sustainability Sukuk funds. Apart from Sustainability Sukuk financing benefits, other sustainable financing models the IsDB has for Africa include:

- **Build Operate and Transfer Projects**: In member countries, IsDB provides projects that are carried out under public–private partnership (PPP) agreements of build operate and transfer. This helps to reduce financing stress in those member countries which could spend a long time to build those infrastructure.
- **Islamic Corporation for the Development of the Private Sector (ICD) Projects**: This uses Islamic sharia compliant principles in financing projects in the private sector. Some African member countries in IsDB receive such funding arrangements. In 2022, ICD approved USD$0.6 billion of such loans to member countries including those from SSA.
- **International Islamic Trade Finance Corporation (ITFC) Financing**: IsDB also has this unit which supports financing of the private sector. Most member countries receive financing from them each year. In 2022, ITFC funding amounted to US$6.8 billion.
- **The Islamic Corporation for the Insurance of Investments and Export Credit (ICIEC) Financing**: This member group also provides funds to insure investments and export credit activities of member countries' international trade sector. This helps to ensure that member countries become competitive with their peers in the international trade arena.

The principles underpinning Islamic finance make it suitable for the African continent because of its support for environmental protection, fair distribution of wealth, equal opportunities, and avoiding harm and illicit financial transactions. This provides a foundation for an inclusive financing development agenda. The Islamic Development Bank, government agencies, and private corporations can lead the fast-growing Islamic financial services in the region.

Also, the Africa Continental Free Trade Area (AfCFTA) can leverage on IsDB support on trade activities to harness trade and build a resilient financial ecosystem. Both entrepreneurs and government can leverage on IsDB products to raise funds to support free movement of goods and services on the African continent. This could help in the long run to achieve the African dream of Agenda 2063. The move is for every African country who is a member of AfCFTA to make an effort to join the IsDB to fully tap the financial benefit of interest-free loans for a continental wide business development.

Again, most African countries are currently debt strapped, requiring them to move away from using conventional commercial loans through foreign bonds, Eurobonds, and syndicated loans to finance their budget deficits as well as their infrastructural projects in the areas of health, education, and climate change in recent times. These commercial loans come with higher interest burdens making most African countries to continue to have higher budget deficits because the interest components of their commercial loans constitute a huge percentage of their expenditure line items in their respective country budgets. In Ghana for instance, interest payments on domestic and foreign debt alone constitute close to 32% of the total expenditure and this sometimes takes about 45% of total revenues generated by the government (MoF, 2022). This kind of repetitive interest expenditure burden is unsustainable for the Ghanaian government. In recent times, Ghana has had to visit the International Monetary Fund (IMF) for the 17th time due to a higher debt burden resulting from commercial loans. Also, Ghana has had to undergo a debt exchange programme for both domestic and foreign-denominated debt instruments.

Islamic capital markets present sukuk as an alternative financing instrument to relieve countries that find themselves in Ghana's situation out of debt distress. Sukuk can help to reduce the interest burden of such countries through the profit/loss sharing motive of the funds raised through Sukuk. Interestingly, countries in Africa that find themselves in a situation such as Ghana's can leverage on sovereign sukuk to finance commercial projects that can generate money and become self-financing to repay their own costs of operation. It must be noted that sovereign sukuk should not be issued for the purposes of financing recurrent budgets since recurrent expenditure is not a revenue-generating venture that can raise funds to meet a shariah compliant debt instrument. African countries that want to leverage on sovereign Sukuk must be ready to invest in projects that can become self-financing, and thus repay their own costs of operation.

However, there are potential challenges in using Islamic finance models in most countries in the African continent due to the lack of regulatory frameworks, legal documentation, and implementation procedures which are not yet laid out by their central banks. The development of an Islamic capital market will require targeted policies and programmes given the high asset intensity and the concentration in specific sectors. There is, therefore, the need to invest in strategic research, support programs in the industry, and support the development of appropriate Islamic financial products in these countries if they want to use this alternative model instead of the conventional commercial loans. Financial products such as the sukuk debt instruments are best for Africa, considering the burgeoning amount of debt owed by most African countries including IsDB member countries. Some countries have debt to GDP ratio close to 71%, which is way above the IMF debt sustainability threshold level of 55%. The use of Islamic financial products will streamline most of these countries to bring down their debt burden and reduce their dependence on Eurobonds and syndicated loans that are often expensive for those countries.

18.9 Conclusion and Policy Implications

Development in Africa has been slow largely as a result of insufficient funding and lack of sustainable sources of funding. This is affecting the development progress made so far. The continent loses inflows of funds through illicit financial flow channels, raising concerns of ethics in funding and financing. The COVID-19 global health crisis has further exposed the infrastructural deficit, particularly with regard to health infrastructure. Thus, the continent is facing high risks of increased poverty levels and vulnerability. In response to these problems, stakeholders have identified Islamic banking and finance as an alternative to the continent's financing challenges and have made recommendations for countries to leverage on the products and services offered by the Islamic Banking and Finance.

The Islamic Development Bank plays a crucial role in the development of its member countries providing finance for development based on the tenets of the shariah. It presents products and services that have the potential of accelerating developmental growth in infrastructure, human development, and livelihoods. It has huge promises for financial inclusion which the World Bank has identified as a means to promote economic growth by ensuring the growth of SMEs, reducing poverty, reducing financial vulnerability, and increasing financial wellbeing and resilience. African countries are, therefore, encouraged to take advantage of Islamic banking and finance and to use Islamic debt instruments such as sukuk to raise funds in the international capital markets. This will help to reduce the huge debt burden faced by most Africa countries. More particularly, SMEs can leverage on Islamic financial products to help to build their capital buffer through interest-free financing since interests and collateral usually deter most SMEs from assessing funds from the conventional commercial banks.

To fully realize the impact of IsDB on Africa's development challenges, countries must initiate and implement policies and programmes to integrate the operations of Islamic banking, finance, and economies into their conventional banking system. Stakeholders must harmonize regulatory frameworks to meet legal requirements and shariah compliant standards. There is also the need to create awareness and understanding of the Islamic banking system among people so as to increase interest and demand for the products and services and increase inclusion. Research and training programs for experts are also important to ensure smooth and successful implementation and to also develop tailor-made products for the different needs of the population. The Islamic Development Bank is there to show the way for this new development in the African continent since they are already working with a number of African countries.

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PART IV

The Future of Development Banks

The Future of Development Banks in Africa

Joshua Yindenaba Abor and Daniel Ofori-Sasu

19.1 Introduction

The crucial need to build resilience for fragile economies and to boost African countries' capacity to deal with developments in a sustainable manner cannot be taken for granted. This is particularly true in an era when many parts of the world, particularly African countries, are severely affected by the global economic and financial crises, including the impact of the past Global Financial Crisis (GFC), the COVID-19 pandemic, geopolitical consequences of the Russia-Ukraine war, climate change, and possible future crises. These crises have necessitated recent debates on the role of development banks in addressing various financial, economic, social, and environmental challenges faced by countries and in offering long-term counter-cyclical financing, speedy recovery from financial and economic crises, and inclusive finance for the achievement of the global

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sustainable development goals (SDGs) (Abor, 2023; Epstein & Dutt, 2018; Griffith-Jones et al., 2018; te Velde, 2011; Uğurlu & Epstein, 2021; World Bank, 2018a, 2018b).

Development banks are financial institutions that usually provide long-term subsidized financing for industrial development. They are important players in many countries, and in economies with significant capital constraints, these banks mitigate capital shortages and promote businesses to expand new or existing industries. In developing countries, the interest in development banks is especially motivated by the need to finance industrialization and structural transformation, which requires long-term financing. In the case of African economies, development banks are seen as part of the policy apparatus in promoting economic growth and driving inclusive and sustainable development. To strengthen the global efforts in addressing the most pressing global challenges, it has become imperative for African governments to partner with development finance institutions (DFIs) to support the financing of the SDGs both now and in the future. Thus, development banks are considered the most significant source of development finance that enables countries to achieve sustainable development, following the numerous attempts to address the difficulties surrounding sustainable development.

Abor (2023) indicates that DFIs in Africa make up 21% of national and regional banks across the world, though they collectively account for only 1% of the total assets owned by development banks in the world. In addition, only a few African development banks control this 1%. Examples include national development banks in Egypt, South Africa, and Morocco, and regional development banks such as the African Development Bank (AfDB) and the African Export and Import Bank (Afreximbank). It is surprising that development banks' assets and influence have been limited, given their attempts to generate capital and their varied methods, and frequently conflicting mandates. Given the need to promote sustainable development, it is important to strengthen development banks and support their development mandate to spur inclusive economic growth. In this chapter, we provide an overview of the nature of Africa's development banking in contemporary times, the contributions of development banks, as well as the lessons from development banks' experiences in the continent, and suggest how the future of development banking in Africa should look like. This chapter focuses mainly on the future of national and regional development banks in Africa.

The rest of the sections is structured as follows. Section 19.2 provides an overview of the contemporary issues in development banking in Africa. Section 19.3 identifies the key features of development banks while Sect. 19.4 discusses the contributions of development banks in Africa. Section 19.5 identifies the challenges of development banks in Africa. Section 19.6 highlights the lessons from development banks' experience in Africa, while Sect. 9.7 offers recommendations to improve existing and future development banks in Africa.

19.2 Contemporary Issues in Development Banking in Africa

Development banks have a long history of promoting growth and development globally by advocating policies that promote sustainable economic growth. The extant literature identifies the main policy views with respect to the rationale for establishing development banks and their role in addressing market failures. These policy views include the industrial policy view, the social policy view, the political policy view or orthodox political view, and the dynamic view (Levy-Yeyati et al., 2004; Marois, 2022; Musacchio & Lazzarini, 2014).

The *industrial policy view* is predicated on the idea that development banks were created in response to market failures in the provision of the required financing for entrepreneurial activity and industrialization, which more generally will spur economic growth and therefore increase overall welfare in a nation. The *social policy view* is based on the fact that development banks make use of their competitive financing to ensure that businesses acknowledge their contributions to social issues, adopt reasonable restrictions on actions aggravating these issues, and implement initiatives to lessen or reverse the negative impact. The motivation here is to intervene in the capital markets in order to address certain social issues such as unemployment, lack of housing, and energy dependency. From the *political policy view*, the investment criteria for development banks are changed from closing gaps in the capital market or allocating resources to social causes to sponsoring projects that politicians find most appealing. In that sense, development banks are established mainly as instruments for serving the interest of politicians or as a means of rewarding politically connected businesspersons.

Development banking has recently attracted the attention of market participants. The term "development banking" first evolved in the 1950s when development economists postulated that income growth is directly and favorably correlated with savings. In other words, a country's GDP will increase more rapidly the more its economy is able to save and invest. Development banks have a history of fostering growth and development all over the world by advocating public policies. They are seen as an important tool for addressing market imperfections by offering subsidized, long-term financing for development. The environment in which development banks operate has changed dramatically since the late 1990s. The political, governance, institutional context, financial reforms, and economic transformation, combined with increased digitization and the changing development landscape in Africa, have generated opportunities for private sector growth. At the same time, new challenges and the increasing demand of the developing world call for the need to combine development financing and a coordinated international policy response. The changes taking place in the African context require revisiting the kind of instruments and approaches that the development banking system deploys to help countries strengthen development partnership and bolster private sector growth. This involves restructuring and redefining how different DFIs work together in partnership with African governments and what changes are needed going forward. Although, Africa is dominated by a number of development banks, very few of them contribute to the world's total asset of development banks. Hence, the need to scale up development banking through a wide-range of financing sources in order to improve the developmental capacity of Africa.

Development banks have had a significant rebirth, mostly for two reasons. First, the COVID-19 crisis, more so than the major financial crises of 2007/09, forced the development banks to significantly increase their counter-cyclical loans, among other things, which also helped to save jobs and businesses and support a long-term economic recovery. Second, development banks can help mobilize and spur important investments for the transition to a large-scale, inclusive low-carbon economy. Over the past ten years, development banks have played a crucial role in assisting development goals in the world, as well as assisted governments in greening their economies by engendering creative finance solutions for infrastructure projects and small and medium enterprises (SMEs) with terms designed to fit the low-carbon financial profile. Development banks in Africa are seen to offer loans, syndications, guarantees, equity and quasi-equity, risk management products, emergency liquidity, trade finance initiatives, and technical assistance. In several countries, development banks are active in providing the investment of risk capital for specific projects associated with their development mandate.

It is evident that only 1% of all national and regional development banks' assets worldwide are in Africa, which severely restricts the impact that development banks in Africa can have on global development (Abor, 2023). In addition, the Sustainable Development Goals (SDGs), which have become the major focus of the world, present a significant financial burden for developing countries in general and African countries in particular. Despite a global savings and liquidity glut, the chances of mobilizing the needed annual capital to achieve the SDGs by 2030 are found to be dwindling. Thus, the majority of SDG investment is required to bridge the development gaps, including prioritized sectors of the economy (health, education, infrastructure, natural resources, and governance) as well as sectors such as transportation, energy, agriculture, industrialization, and growth of SMEs in order to put the African continent on a clear path toward sustainable and inclusive economic growth. The global provision of large-scale concessional funding to Africa is overwhelming as African countries are projected to be affected severely by economic crises and climate change. Development financing has been growing, but it comes nowhere close to the estimated annual African SDG financing gap. In order to mobilize public and private investment for structural transformation and close Africa's SDG financing gap, as they have done elsewhere around the globe, additional effort is required to capacitate African national and regional development banks to bridge the gap. Thus, development banks are said to be crucial since they cover the gaps left by private financial institutions.

In response to the challenges in funding more ambitious state-led development goals, some of which are motivated by UN's 2030 Agenda for SDG and Africa's 2063 Agenda on inclusive and sustainable development, development lenders and policy makers are pushing development banks to play a larger and more significant role in defining the continent's development mandate and strategy. Over subsequent decades, the role of development banks has extended well beyond rebuilding efforts. As a result, a number of African countries has, over the years, revitalized the need to leverage development banks' potential as primary sources of funding and authorities that aid in advancing development goals. The way development banks work today is determined by the particular development contexts and economic conditions in which they operate. Development banks have a significant impact on the financing of the SDGs by acting in pro- and counter-cyclical ways, allocating funding to important projects, and encouraging private sector participation. Their goals include serving as the main tool for organizing, funding, overseeing, and assessing development initiatives in conformity with the priorities for national, regional, and global development.

19.3 Key Features of Development Banks in Africa

Development banks, typically, exhibit specialized features categorized into the nature/type and size; policy mandate, business models, ownership structure and corporate governance, and regulation and supervision.

Nature/Type and Size

Development banks are classified as multilateral development banks, regional development banks, and national development banks. Africa has a number of national development banks and multilateral banks (MDBs) or regional development banks. Development banks are generally large development finance institutions with a very huge asset. In terms of NDBs, many African countries tend to have about one or two NDBs and in some instances about three or more as in the cases of Tanzania, Nigeria, South Africa etc. There are several NDBs across the globe, with the majority located in developing countries. In fact, there are even significantly more NDBs globally than recognized MDBs. Examples of regional development banks include the African Development Bank (AfDB), the African Export and Import Bank (Afreximbank), ECOWAS Bank for Investment and Development (EBID), West African Development Bank, and East African Development Bank. Development banks are generally large development finance institutions with huge capital and asset size.

Policy Mandate

Development banks are specialized institutions set up with the mandate of providing medium and long-term loans for productive investment with the primary objective of promoting economic development, investment, and entrepreneurial activity, and serving the public interest in a developing economy. They are multi-purpose financial institutions and are essentially development-oriented banks. They promote private sector development and strive for balanced regional growth. They also provide financial support to public sector companies. NDBs in particular have a mandate that is backed by public policies, often linked to the national development plan.

Some development banks have a specific mandate that shows the sectors or activities they are required to support. Xu et al. (2021) identified seven specific mandates of development banks to include specific sectors or clients, including rural and agricultural development, international trade, social housing, infrastructure, international financing of private sector development, local government, and SMEs. Example, the Afreximbank has a specific mandate of promoting international trade through trade finance, and financing trade-enabling infrastructure. The Infrastructure Development Bank of Zimbabwe also has a specific mandate of providing medium and long-term financing for key infrastructure projects, such as transportation, housing, energy, information and communications technology (ICT), water and sanitation. Other development banks also have a broad mandate or flexible development mandate, which is formulated in general terms without identifying any specific sector, activity, or client. Examples of development banks with broad mandate include the African Development Bank, the ECOWAS Bank for Investment and Development, the West African Development Bank, the East African Development Bank, Development Bank Ghana, Development Bank of Ethiopia, and Development Bank of Rwanda.

Business Models

Development banks have the ability to facilitate funding from other investors—either directly or indirectly. This encourages viable developments through less dependence on aids and promotes good governance, good business practice, and sensitivity to the environment. Their main sources of finance include funding from member countries; development partners and international DFIs; borrowing from international capital markets and other financial institutions; official development assistance through international financial institutions like the World Bank, IMF, or any of the other regional development banks. They also have an implicit or explicit sovereign guarantee on their liabilities, which enables them to enhance their credit ratings and access to capital markets. The financing structure of NDBs is fundamentally different from other multilateral and regional development banks. They tend to rely on long-term and more stable sources of finance and their ability to raise long-term finance from the capital markets enables them to finance long-term projects. Some important functions of development banks include providing debt and equity finance, offering grants, providing credit guarantee, undertaking entrepreneurial roles, providing banking business, engaging in joint financing, extending refinance facility, and underwriting of securities. The lending model of development may include retail lending, whole sale lending or mixed model (i.e. a combination of retail and wholesale lending models).

Ownership Structure and Corporate Governance

The regional development banks are owned by member states while the NDBs are fully or partially owned by national governments. In the case of regional development banks, the African Development Bank (AfDB), for instance, has 81 member countries (owners) made up of 54 African countries and 27 non-African countries. Its Board of Governors is the highest authority with each member country represented by a governor and an alternate governor. Similarly, Afreximbank is owned by African governments through their central banks and other designated institutions. EBID, the financial arm of ECOWAS, has the 15 member states of the ECOWAS community as its shareholder. The Board of Governors of these Banks is the highest decision-making body. A development bank has a Charter that specifies the ownership and governance structure of the bank. Most of the development banks' shareholders are the borrowing countries themselves, which have limited financial resources to substantially expand their banks' capital bases. The bulk of shareholding of Eastern Africa Development Bank (EADB) remains with the Member States that have subscribed to Class A shares of the EADB. From the perspective of NDBs, the Board of Directors is responsible for the overall direction and policy of the bank. The appointments of directors and CEOs are done by the national government.

Regulation and Supervision

Development banks are regulated based on the regulatory requirements or standards of DFIs as well as the Basel III regulatory standards. NDBs are regulated and supervised by the government and/or the central bank based on a country's legislative instrument or laws (special regime or regime applicable to all banks).

19.4 Contributions of Development Banks in Africa

Given the pressing need for greatly expanding support for development projects, development banks have recently been recognized as key actors in financing local development projects in Africa. A significant attention has been paid to how the activities of development banks have become a regional force and important levers for transforming national economies. Most development banks in the region (e.g., African Development Bank, African Export–Import Bank, Uganda Development Bank, Development Bank of Rwanda, National Development Bank of Botswana, Development Bank of Southern African etc.) have stirred up the creation of new industries and offered many support to an inclusive development strategy. A new mandate and financing commitment for development banks is aimed at promoting the development-relevance of global public goods. Africa has reaped most benefits from recent development in multilateral capital flows, as well as the gains from DFIs' contributions in the development of prioritized sectors of the economy, including services, industry, agriculture, and trade. Development banks have provided huge support to countries' development strategies and fulfill their mandate through financing local development projects, climate financing, supporting international trade, financing infrastructure development, financing agriculture development, supporting SMEs development, and generating employment, and supporting affordable housing.

Finance for Development

Development banks have been instrumental in contributing to proactive growth strategy. Despite the rising tensions in the international marketplace, financial contributions to the development system are increasing. The major development banks in Africa have increased their overall lending amounts throughout the period 2020–2022. For instance, Development Bank of Rwanda (BRD) has contributed to high impact lending in the private sector with a focus on offering working capital and investment credit lines in the manufacturing sector—hence, helping to alleviate poverty, maintain sustainable financial growth and economic transformation in Rwanda. Development banks have provided a stable source of finance (primarily due to non-concessional loans from MDBs) and access to international capital markets financing. Development banks have been useful not only in addressing market weaknesses, such as long-term funding gaps due to risk and uncertainty, but also have played a role as a critical tool in supporting proactive growth strategy at the national level. They have been essential in mobilizing private sector finance to support sectors such as agriculture, international trade, infrastructure, tourism, housing, and small and medium-sized businesses. In recent years, development banks have been established to address various development challenges. They finance sectors or activities where there is significant external influence, which means that social returns are higher than those of the market.

Development banks have played a vital role in bridging the savings and financing needs of individuals, farmers, public and private companies by providing long-term finance. In addition, they advance counter-cyclical lending, making economies more resilient to financial and economic shocks and downturns. In doing so, they have supported countries by securing their production capacities for their next phase of expansion. Moreover, development banks' financing of development projects that focus on supporting productive sectors tend to have a huge development impact.

Climate Finance

In response to current climate and development demands, development banks have supported a significant increase in climate financing for sustainable infrastructure on the continent. They represent the largest source of public finance for climate change purpose. Development banks help in developing relevant policy frameworks and implement successful projects that demonstrate the sustainability of particular green investments. The financing of projects by development banks is tailored toward the introduction of adaptive technologies that are sustainable such as renewable energy. They assist in ensuring that a sustainable climate policy is fully compatible with the UN sustainable development goals and the Paris Agreement. Development banks provide climate support for combating climate change by mainstreaming climate change framework into their activities and operations, adaptation, and financing mechanisms. This can be done through the financing of projects that foster low-carbon development goals in order to help in the initiation of new green development projects. Development banks derive environmental benefits by increasing the demand for investments and finance in climate-friendly projects (pre-investment phase), promoting appropriate and stable enabling environment for investing, creating awareness, building capacity to analyze and structure climate-related interventions, and bringing projects and companies to a level of climate investment readiness. They also leverage private sector finance to finance climate change. Development banks have a very knowledgeable and long-term relationship with the private sector, which helps them to better appreciate the local barriers to investment (Morgado et al., 2019) and allows them to provide large-scale financial services that meet the needs of the private sector.

International Trade Development

Over the past years, development banks in Africa have made significant contribution to trade financing in Africa. For instance, Afreximbank has over the past five years expanded intra-African trade, spearheaded industrialization and export development in Africa, strengthened the leadership of African trade finance, and ensured that the demand of stakeholders is met. Development banks have improved the financial soundness of businesses and their growth through syndications; improve operating efficiency and the performance of their trade finance mandate; strengthened enterprise risk management and built organizational capacity. The Afreximbank has contributed to the development of trade financing through several channels, including promoting local content in Africa's extractive sector; supporting export diversification through financing of facilities for processing of commodities; leveraging external financing to support African trade; supporting intra-African trade through directing financing and promotion of air and communication links; promoting the development of service exports; supporting the development of telecommunications infrastructure in Afreximbank's member countries to enhance Africa's integration into the global economy; supporting small and medium-sized enterprises operating in export supply chains; and financing trade-supporting infrastructure in member countries.

In addition, the ECOWAS Bank for Investment and Development (EBID) has become a key lever for transforming economic development of West Africa through major ECOWAS funding projects and programs. The Bank has participated in the financing of intra-regional trade; promoted financing of Clean Development Mechanism (CDM) projects, particularly those relating to energy efficiency, renewable energies, and the carbon market through its contribution to the establishment of the African Bio-fuels and Renewable Energies Fund. This is with the help of the World Bank and other development partners. EBID has supported agriculture to help member States achieve food self-sufficiency. African Bio-fuels and Renewable Energies Company (ABREC) is the current name of the Fund. In 2021, the bank increased its involvement in trade finance by making six interventions totaling US$ 165.2 million. Lines of credit were used for both the import and supply of petroleum products as well as the import and delivery of fertilizers in these trade finance initiatives. The bank provided Burkina Faso with a US$ 10.6 million line of credit in 2022 for the import and supply of petroleum products.

Infrastructure Development

Development banks have been identified to play a significant role in providing funding for infrastructure in general, complementing governmental and private investment in infrastructure, and particularly in times of fiscal challenges. Considering the huge volume of the initial investment requirements with respect to infrastructure expansion, development banks are designed to provide long-term financing to support infrastructure development. As part of development banks' promotion and funding initiatives, they finance the construction of sector-related infrastructure in the areas of transportation, energy, electricity, shipment, and incorporating telecommunications to assist environmental, social, and economic development in its member countries. For instance, the Development Bank of Southern Africa (DBSA), over the years, has made some major achievements by promoting infrastructure development through project planning and preparation, infrastructure financing, building and maintenance of infrastructure, and supporting environmentally focused infrastructure programs. Since 2019, the Banque Nationale d'Investissement (BNI) has subscribed to State bonds totaling roughly FCFA 40 billion.

These bond subscriptions give liquidity to the state for big development initiatives. The Infrastructure Development Bank of Zimbabwe (IDBZ) has contributed significantly to infrastructure development in Zimbabwe over the years. Through its financial support, partnerships, and technical expertise, the bank has made significant contributions to improving energy access, water supply, sanitation, and renewable energy development in the country.

Agricultural Development

Development banks' contributions to agriculture cover several parts of the value chain, including creating jobs along the agriculture and agro-processing value chain. Development banks have made significant contributions to unlock agriculture financing and maximize agricultural sector, including the financing of poultry farming, crop production, livestock, piggery and fish farming, agro-industries, post-harvest infrastructure, agri-vet trade finance, and cattle farming. Development banks' investments in the agriculture sector have improved the living conditions of smallholder farmers and enhanced food sustainability—mainly in tea, coffee, cassava, corn, and others—in its member regions.

Development banks in the region have taken the lead in financing primary agriculture, an area underserved by traditional banks, through cooperatives and microfinance institutions. They have facilitated economic transformation through private sector investment in agro-processing and value creation of the agricultural value chain. They have successfully provided technical support and advisory services to SMEs, and extension services to farmers. They continue to engage various partners to identify and attract funds to support business opportunities in agriculture such as de-risking mechanisms and refinancing institutions to deepen financial inclusion and to improve the livelihood of smallholder farmers. Development banks' support through livestock farming projects have contributed to a tremendous increase in egg production across the region. This has had a positive impact on farmer's incomes and modern farming methods in Africa.

SMEs Development

Africa's SME financing landscape has in recent times undergone significant transformation due to the changing role of development banks in addressing the financing gap between the supply and demand for finance. In Africa, the financial systems are mostly unable to provide sufficient long-term finance for the development and growth of SMEs. This situation has stirred up the interest of development banks to mobilize long-term funds to finance new investments and support SMEs on the continent. For instance, the AfDB works with local financial institutions to increasingly recognize SMEs as real and viable business opportunities. In order to strengthen development assistance to SMEs in West Africa, the AfDB and the EBID have signed an agreement for a dual currency line of credit comprising of a US$ 50 million and €50 million. This is in line with EBID's strategic goal of assisting regional companies, especially SMEs, regional business cooperatives, and farmers in West Africa. The Afreximbank has also supported the financing of SMEs' investment initiatives in order to promote regional trade. Considering the Bank's mandate in supporting SMEs and trade in Africa, it signed a development-focused agreement with the China Development Bank (CDB) in August 2023 to provide a US$ 400 million term loan facility to support the financing of SMEs throughout Africa.

In supporting the development of SMEs in the region, a number of NDBs across Africa have also been instrumental in supporting SMEs. For instance, BFPME has provided financing to SMEs in Tunisia through the Support Fund for Small and Medium Enterprises (FSPME). The DBN, in 2019 disbursed US$ 243.7 million to financial intermediaries for on-lending to SMEs. During the COVID-19 pandemic, Development Bank of Mauritius (DBM) financed more than 16,000 beneficiary enterprises, including micro, small, and medium enterprises (MSMEs) with loans amounting to MUR 5.06 billion (US$ 1.52 billion). In September, 2023, Development Bank of Nigeria (DBN) committed to disburse US$ *195,058.52 to over 120,000 SMEs across the country.* Development Bank of Rwanda (BRD) has also contributed to financing SMEs through the Rwanda Innovation Fund (RIF), which has the mandate to promote an innovative economy by funding SMEs and strengthening the Rwanda's entrepreneurial and innovation ecosystem. Similarly, Ghana EXIM Bank has provided retail loans directly to SMEs since its establishment, and has recently approved GHS 417 million (US$ 88.98 million) to support SMEs under the government's industrialization initiative. Development Bank Ghana (DBG) has also disbursed about US$ 20.7 million to its partner financial institutions for on-lending to SMEs.

Employment and Affordable Housing

Development banks' financing of development projects that focus on supporting productive sectors, tend to have a huge employment impact. For instance, development banks financing of infrastructure projects, contributes to employment development as well as the entire project's value chain given that construction materials and machinery are necessary for the project. They have helped in absorbing age groups from the labor market and their contributions to employment generation are done both directly and indirectly. In terms of direct employment, they offer employment opportunities as they expand their scope of operation. They are able to make efforts to reach out to clients in important sectors. They also do this indirectly by financing projects and businesses that are able to create opportunities in generating employment. Development banks' financing of development projects that focus on supporting productive sectors, tend to have a huge employment impact.

Development banks have offered affordable housing to residents across Africa and have set up the Housing Finance Project (HFP) to provide financial support to households in the regions. They mobilize funds to finance affordable housing and also implement a strategic priority to provide affordable housing by providing creative financing solutions that have lessened the supply and demand constraints. For instance, in 2021, BRD provided a long-term finance to expand housing finance, and this was equivalent to a total of US$117 million. It also facilitated the provision of US$30 million to support infrastructure and promote eligible, decent, and affordable housing. The IDBZ has also been actively involved in financing and facilitating housing development projects across Zimbabwe.

19.5 Challenges of Development Banks in Africa

Despite the contributions of development banks to economic transformation and sustainable development, they are confronted with a number of challenges, including funding and business models, climate financing and infrastructure, governance and political interferences, designing impact evaluation framework, and macro-fundamental constraints.

Business Models and Funding Constraints

The continent's development banking sector has, however, struggled with a shortage of capital to effectively fund projects. The severity of these issues, over time, shows how unlikely it is that African development banking system would be able to survive and advance. More development finance initiatives can now be directed toward some important sectors of the economy, such as the continent's socioeconomic issues, which call for creative teamwork.

In Africa, the biggest problem a nation typically has is a lack of funding for economic change. An important source of long-term financing in Africa is development banks. However, the banks' ability to finance significant projects with a development focus on a scale that satisfies the needs of their individual sub-regions is restricted. This may be attributed to their inadequate capital base, and the fact that the majority of their owners are the borrowing countries themselves who do not have the financial muscle to significantly increase the capital bases of these banks.

Like multilateral development banks (MDBs), development banks in Africa face competition for resources, increased ad hoc funding decisions, funding vulnerability, the proliferation of alternatives to development banks—primarily in terms of both financial and technical expertise. The low margin that development projects could produce was ultimately caused by a number of factors, including the inability to control market risks; the lengthy administrative processes of all parties involved; the unsuitability of the proposed financing scheme for "greenfield" projects; and the length of time required to evaluate applications. It is argued that many projects may have been successful if the financing plans had been more flexible and the banks had appropriately addressed the need for working cash. The low bank capitalization and the lack of a refinancing capacity led some development banks to re-think and explore other avenues to ensure its survival.

It is evident from some cases in the chapter that limited financial capacity constrains the ability of development banks to be impactful. For instance, the rising funding needs in line with the integration agenda has put the Eastern African Development Bank's (EADB) ability to deliver on its mandates. The EADB's lack of scale is an obvious constraint to its ability to meaningfully contribute to the funding needs of East African countries. The EADB's limited scale stems from the inability of its member states to inject more capital given their competing resource needs. Given the competing resource needs, development banks have the challenge of not being able to inject more capital into the bank. At the same time, member states of those banks have competing development interests that make them keen on strengthening their development banks. Furthermore, the challenges that hinder its ability to fulfill its mandate include price distortions in the market space, creating an uneven playing field and impacting the Bank's lending operations. The proliferation of intervention introduces complexities in the financial system and may crowd out private sector credit. Some Banks' inadequate knowledge of wholesale lending to the business sector restricts the flow of credit.

Climate Financing and Infrastructure Development

The severity and frequency of numerous compounding and cascading crises, ranging from climate change to pandemics to conflict, have an impact on countries' ability to pursue development priorities and prepare for future shocks. As a result, African governments are experiencing significant setbacks in their long-term climate financing. Development banks' challenging strategy includes one of the main initiatives to create a pathway to access green finance through the Green Climate Fund (GCF). Development banks face the challenge of engaging the local and global private sector to support mitigation and adaptation projects in Africa.

More recently, as aggregate growth has been boosted by demand from Africa in the developing world, infrastructure shortages have become a more visible and critical impediment to sustaining that growth. For economic growth, poverty, and inequality reduction, job creation, environmental sustainability, and infrastructure are essential. Infrastructure improves welfare and has large social dividends. In the end, it is the development banks that are in charge of building the infrastructure needed to offer public services. The social contract between a government and its citizens typically covers investments in infrastructure. Poor infrastructure, particularly in developing countries, impedes development and decreases quality of life. When the demand for infrastructure services exceeds the supply, congestion or service restrictions, poor or irregular service delivery, and incomplete service to some locations arise.

Investment in infrastructure presents development banks with numerous difficulties. First, throughout the project cycle of development banks, agency issues involving several actors and adopting various forms necessitate complicated governance arrangements. Infrastructure projects occasionally include large sums of money, making them susceptible to bribery and corruption which worsens the agency problems. Due to weaknesses in the incentive framework and more broadly, the rules governing agency problems throughout the project cycle, infrastructure projects typically fall short of their schedule, financial, and service delivery expectations. Second, the majority of development banks do not spend enough to build the infrastructure required to provide universal access and fulfill the UN Sustainable Development Goals (SDGs). Additionally, the caliber of infrastructure delivery is frequently disappointing; the development of new assets is more expensive and time-consuming than anticipated, and the quality of services is subpar. Finally, development banks frequently provide poor maintenance on infrastructure assets, which raises costs and diminishes benefits.

Corporate Governance and Political Interference

Some of the major issues confronting development banks have mainly been in the areas of corporate governance structure and prudential regulations, funding and credit risks as well as monitoring and evaluation. In terms of governance, some development banks in the region lack the proper framework for selecting and appointing the Board of Directors due to political interference. National Development Banks (NDBs) have had major shortcomings, which is mainly attributed to corporate governance and political influence. Today, the NDBs operate in a more favorable political, institutional, and regulatory context for carrying out their mandate. Corporate governance issues are highlighted in particular by political interference in the management of NDBs which impedes their performance. Political influence concerning the Board and management succession and achieving financial self-sufficiency are major challenges facing development banks, especially NDBs. For instance, the political influence in appointment to the board and senior management positions are sometimes not done on merits.

Impact Evaluation

It is obvious that Monitoring and Evaluation (M&E) as well as Impact Evaluation are important concepts that are key to the operations of development banks. Development banks use M&E to assess the financing interventions they make in specific areas. While some development banks may have M&E department with dedicated officers responsible for specific tasks, others may not. The role of the development banks also includes ensuring sustainable development practices by mainstreaming and funding their impact evaluation projects, programs or policies. Thus, the decision to deploy resources to complement these efforts remain, therefore, crucial for achieving sustainable development goals.

The continent's development banking sector has, however, struggled with a lack of qualified management to handle the variety of difficulties development banks would have to contend with Development banks in Africa lack the implementing strategies for the operation of impact evaluation. The main challenges for impact evaluation of development banks in Africa are technical (examples, framework flaws, and design application problems) and managerial challenges (examples, insufficient stakeholder engagement, problems in collaborating with partners, and mechanism and management transitions). These challenges can arise at different points in development banks' planning and implementation of an impact evaluation, or after the project, program, or policy is completed. When planning and implementing an impact evaluation of more than half the planned duration of development banks' projects, the team conducts a review to assess the progress of each project. However, delays before the mid-term review are common. This means that projects may not be built or declared as planned. Delays in project implementation as planned can result in rushed disbursements later in the project lifecycle, which can have a mitigating impact on project outcomes and damage the development banks' reputation.

Macro-fundamental Challenges

The severity and frequency of numerous compounding and cascading crises, including climate change, COVID-19 pandemics, geopolitical conflicts, financing of trade, and infrastructure constraints have an impact on countries' ability to pursue development priorities and prepare for future shocks. As a result, African governments are experiencing significant setbacks in the achievement of the SDGs and Africa's 2063 Agenda. Given the emerging trends of the importance of development banks to SMEs and economic development, some development banks in Africa face a variety of difficulties such as limited financial resources; political and economic unpredictability; difficulty determining project viability and bankability; inadequate infrastructure maintenance and operations;

changes in regulatory and policy framework; skill and capacity limitations; and difficulty ensuring environmental and social considerations. Other macroeconomic challenges facing Africa's development banks, especially NDBs are currency depreciation, high inflation, high interest rates, and issues of loans defaults (credit risks). These developments have had a strong impact on development banks in the regions.

19.6 Lessons from Development Banks' Experiences in Africa

It is obvious that the development banks' contribution to Africa's growth and development is crucial. Development banks' flexibility allows them to respond to the needs of African nations—whether those needs relate to funding for infrastructure, energy, agriculture, or any other sector that needs support on different scales throughout the continent. The establishment of alternative DFIs to provide direct capital in the market is another important aspect of development finance that contributes to increasing the amount of capital available to finance economic growth and development. Despite the various difficulties development banks encounter, they have significantly impacted many areas of the economy in developing and emerging countries and have been key levers in the transformation of national economies. Some of the lessons from development banks' experiences in Africa are reflected in the areas of sustainable development, project funding, climate funding, impact evaluation, intra-Africa trade, governance, political embeddedness, and risk management.

Sustainable Development

The COVID-19 pandemic and the beginning of the SDGs "Decade of Action" have coincided, generating serious concerns about the likelihood of accomplishing this ambitious goal. Africa's Agenda 2063 and the 2030 Agenda for Sustainable Development have both been advanced by several development banks in Africa and other MDBs. To help their members address urgent development concerns, development banks have been steadfast partners in assisting the efforts of the countries of Africa to attain these goals. They have done this by providing funding, technical assistance, and information.

Development banks play a critical role in supporting countries' efforts to achieve these goals by directly financing and supporting projects and programs in the public and private sectors and helping to mobilize public and private resources for investments in line with the SDGs and to catalyze. The development banks also work to complement one another's initiatives and to address the national goals of their operating nations. Even while each development bank has its unique reporting procedures, all have tried to show how their activities support both the advancement of each objective and sustainable economic development.

It is clear that the lessons learned from the cases indicate that development banks and private sector assistance are essential for the sustainable development of Africa's priority sectors. For instance, apart from countries like South Africa, Egypt, Tunisia, and Zimbabwe, many African nations lack appropriate national strategy and institutions to drive the growth of infrastructure, as well as the growth and development of trade and export.

In Africa, development banks are acknowledged as important players in financing local development projects. Development banks, typically, help industries like agriculture, foreign trade, infrastructure, tourism, housing, and SMEs in addition to providing long-term finance. For instance, the Regional Member Countries (RMCs) of the African Development Bank (ADB) and other regional development banks receive assistance from them to achieve structural transformation that will end poverty on the continent and promote sustainable economic development. Development banks prioritize building infrastructure in order to increase Africa's productive capacity. ADB has recently launched a New Deal for Energy, which will support Africa's development and hasten the goal of ensuring that everyone has access to energy by 2025. Development banks also prioritize the industrialization and integration of Africa by promoting private sector growth. The ultimate objective of development banks in Africa is to improve the standard of living of Africans by facilitating their equal access to decent jobs and adequate food.

Project Funding

The funding experience of development banking in Africa throws up immense lessons. For instance, the establishments of major DFIs or development banks in Africa, such as AfDB, Afreximbank, EBID, DBSA, IDBZ, and others, highlight the importance of collaboration between the public and private sectors in Africa, and between Africa and its non-African development partners. They are also indicative of the enormous capacity of African nations to solve their common problems through cooperative effort. The joint efforts of DFIs throughout the continent have produced excellent outcomes in terms of economic development and growth. For instance, the operations of the AfDB have had significant impact on the economies in Africa (AfDB, 2013, 2018, 2020). This is evident in the many critical projects across different sectors, which has either been supported or developed by the Bank.

Through the intervention of the AfDB, critical energy projects including Sao Tome Principe Mini Hydropower Projects Support Programme; the Egypt Electricity and Green Support Programme Phase 1; the Burundi support energy for cooking and restoration of the environment in four refugee camps; the Lesotho-Mafeteng Solar PV Project; the South Africa ESKOM II power project; the South Africa ESKOM II Loan; and the Togo-CIZO Pilot Project for off-grid rural electrification using solar kits have been developed in the region (Abor, 2023). However, significant effort is needed to reach the target of universal energy as stipulated in the UN SDG 7 goal. The Bank has water infrastructure projects including Comoros Road Network Rehabilitation Project; Nacala Rail and Port Projects; Rwanda-Kigali Bulk Water Supply Project; and Egypt—Sharm El-Sheikh Airport Development Project among others. The lesson from these experiences is that the movement of goods and services, intra- and inter-regional trade, water supply and access to water supply have not only been developed across those economies but have had positive impacts on those economies.

Climate Funding

The experience of the Development Bank of Mauritius (DBM) shows that it has contributed to the financing of more than 16,000 beneficiary enterprises including SMEs. It has engaged in green investment activities that ensure overall long-term sustainability of the society as a whole including the provision of electricity with the use of PV panels for industrial buildings and hospitals including the J Nehru Hospital. The lesson from this initiative is that the installation of PV panels offers a source of electricity to the education sector (secondary schools). This initiative has helped to promote cleaner source of energy and improve sustainability of the environment and the society as climate change challenges and issues are addressed. In addition, the domestic credit market and women entrepreneurs of Mauritius have been able to get access to DBM's loan at lower interest rates—leading to development in the domestic market and women empowerment. The Banque de Financement des Petites et Moyennes Entreprises (BFPME) has demonstrated a remarkable dedication to supporting SMEs and achieving economic development in Tunisia. For instance, in 2019, BFPME approved an amount of TND 21.9 million (US$ 7.1 million) for 42 projects, and allocated around a hundred participatory loans at no interest rate. This boosted projects that were on hold because the financing scheme was not completed.

Impact Evaluation

It has become increasingly important for development banks to network among monitoring and evaluation (M&E) and impact evaluation practitioners to share knowledge on M&E and impact evaluation related to the delivery and effective development outcomes. However, there are no practical experiences in terms of impact evaluation for some development banks in Africa. For instance, the Development Bank Ghana (DBG), as a new entity, has paid little attention so far to M&E and impact evaluation. Similarly, there are no practices in Côte d'Ivoire for measuring the impact of government initiatives or policies in favor of national development banks. Established development banks that have M&E units have not been active well in terms of carrying out impact evaluation of their funded projects. The private sector's participation in development banking initiatives aided in sharpening the mandate of development banks or DFIs in Africa. This enables the development banks' operations to be centered on sustainable economic development. As a result, development banks were able to establish structures and standards that pushed management to produce results and carry out policy, project, price, and product mandates in a way that suited the African market. Additionally, it gave the development banks a framework for evaluation procedures and helped them narrow their emphasis on the items that would assist them achieve the specific goals and the clear objectives they had set for the region.

Intra-African Trade

A documented experience from the cases reveals that a well-planned collaboration between the public and private sectors on an equal footing might go a long way toward permanently resolving the many issues that are currently hampering activity in the continent's trade sector. Experience has also shown that financing is not the only way to promote the export of manufactured goods. African businesses need the technical expertise, market awareness, and other qualities necessary for successful export production. From the cases, experiences of development banks highlight the fact that promoting intra-African commerce needs more than just capital to result in real growth and development. Furthermore, agencies for trade and export promotion, where they exist, seem to lack the financial and technical resources necessary to effectively support trade and export growth. The lessons from this experience are that African governments must do more to encourage commerce by streamlining processes to make it easier for commodities and services to move over the continent. Development banks need to work to implement market access opportunities outlined in several bilateral and multilateral agreements to enhance trade in Africa.

In addition, finding answers to the issues facing critical sectors of the economy is a crucial lesson for export development. For instance, the worldwide commodity markets are extremely volatile, which has a significant impact on Africa's commodity exports and revenues. The lesson from this challenge is that in order to restore predictability to the industry, the formation of suitable public–private partnerships must be strengthened. Furthermore, building solid correspondent banking relationships between African banks is necessary to promote the expansion of intra-African trade. Due to the limited correspondent banking relationships between African banks, African development banks and traders are currently hesitant to accept African payment risk. Therefore, if intra-African trade is to increase and aid in the development of the continent, a system to make African payment risk acceptable to African financiers and traders is needed. Before engaging in intra-African trade agreements for which bank assistance is necessary on both sides of the trade, one option is to help African bankers understand themselves and better recognize each other's risk. The only sustainable way for African countries to achieve the much-needed macroeconomic and political stability, which are both crucial elements for attracting foreign capital inflows, and trade financing flows in particular, is to deepen and speed up the pace of economic and political reforms.

Governance, Political Embeddedness, and Risk Management

It is clear that DFIs and for that matter development banks in Africa have benefited greatly from robust shareholder backing. Shareholder support provides the guarantee that development banks are adequately capitalized to carry out their duties. Unlike regional or international DFIs, NDBs have strong reliance on national governments and political meddling, and these cause multilateral, regional, and other bilateral DFIs not to participate in their activities. NDBs offer comparative benefits over multilateral or regional development banks because of their political embeddedness in Africa and other parts of the world (Abor, 2023; Abor et al., 2020; Attridge et al., 2021). It is interesting to note that after years of neglect, politicians and academic scholars are suddenly paying attention to NDBs. They are concentrating on comprehending the functions of these banks, their corporate governance frameworks, political involvement, their responsibilities in accomplishing a country's development goals, and how they interact with the private sector and governmental initiatives.

Development banks have successfully managed the numerous shocks that surfaced in the external environment, which presented enormous hazards. Relying on strategic plans was one of the factors that helped development banks in Africa to manage risks in their operational environment. For instance, Afreximbank's Strategic Planning process has aided the bank's management in solving a number of issues. The high rate of credit defaults in the area weakens the framework of development finance. This makes it challenging to spread risks throughout their client portfolio which makes it challenging to make unbankable deals bankable.

A valuable lesson for development banking is that it is riskier to finance non-African companies operating in Africa because these deals frequently go wrong. In addition to providing loan syndication, identifying, and creating positive collaborations with relevant local companies to assist their operations and activities, development banks have developed tight banking relationships. The recurring oversubscription of Syndicated Loans and Bond Issues by participating development banks demonstrates the high demand for risk in the global financial markets, leading to the overall reduction of loan commitment and the ability of arranging for development banks to fulfill their mandate.

19.7 Development Banking in Africa: The Way Forward

Development finance has emerged as one of the main avenues that economies believe they can utilize to support sustainable economic growth and ultimately make the world a better place as the world continues to liberalize and become a global village. As part of Africa's effort to also reap the many benefits that are claimed to result from development projects, many African economies have established NDBs, which lower the obstacles to corporate and public sector growth on the continent of Africa (Abor, 2023). However, it is evident that the advantages of development banking would not be shared equally among the participating nations. On the other hand, it is also obvious that development banks take advantage of internationalization and the benefits derived from regional development projects by creating new NDBs based on the cooperation of other development banking institutions among state governments.

A climate that removes obstacles to sustainable development goals will be of enormous importance to the African continent because, generally, the success of development banking among participating countries depends on the smooth entry of DFIs into Africa. Africa must possess the ability to absorb funding in addition to being attractive to international DFIs in order to realize the full potential for growth and development on the continent. Thus, a renewed interest in development banks in Africa and the growing commitment in the use of all policy tools to generate sustainable development and growth will go a long way to improve and promote Africa's 2063 Agenda.

In spite of the introduction of mechanisms to attract institutional investors to engage in development finance, including climate and infrastructural development, the results fell short of expectation. Yet, given the region's climate and infrastructure bottlenecks and investment needs, the majority of African nations are still having problems changing their development policies to support a rise in infrastructure demand. Governments, citizens, and multilateral development banks will need to coordinate policies in order to mobilize private sector banks and institutional investors and realize their financial potential. Development banks can support programs that improve the ability to help overcome obstacles to infrastructure development and climate funding. Thus, the need to enhance funds for climate and to promote private and public infrastructure investment, and development initiatives is great and urgent. In addition, investment effort needs to start with the development banking system. It must, however, take a different approach and place an emphasis on significant financial investments in issues that affect all nations, such as post-pandemic climate mitigation and adaptation. The increased focus on balancing domestic and international needs will take varied forms for borrowers of development banks and for development banks themselves. Some nations will need technical support and funds to design a low-carbon transition strategy to foster an investment-friendly environment, while many nations will need assistance to invest more in risk reduction, resilience building, and project preparation. In accordance with commitments made as part of the international reform agenda and good practice guidelines, development banks should use a combination of core and allocated funds and carefully consider the advantages and disadvantages of the various funding mechanisms at their disposal. This is due to the fact that the multilateral development system's performance and governance are greatly influenced by the quality of funding.

Trade and export promotion policies should be developed with input from all governments and the private sector to overcome these structural and policy deficiencies. Additionally, proper state institutions with adequate funding should be established to support efforts to develop commerce and export. To fill the void caused by the dissolution of the commodity boards, under-capitalized, inexperienced private sector firms that could hardly manage the commodity export industry successfully should be founded. African nations must create suitable financial instruments to reduce perceived risk associated with funding selected areas, and efforts should be made to ensure development bank partnership to provide a vehicle for risk mitigation and easy access to financing.

Experience has shown that development banks are most at risk of failing in their initial years of establishment, because their systems could be vulnerable and their understanding of the market could also be limited. Considering the immense contributions and experiences of development banks in the region, it seems entirely accurate to say that its future looks bright. Nevertheless, development banks continue to face several operating-environment issues, necessitating the need for them to be as adaptable as ever to efficiently carry out their development mandate. The continued economic uncertainty around the world, the erratic price of commodities, the implementation of Basel III and its effects on the operations of development banks and other international DFIs, and the pressing need to process African commodities by funding the expansion and modernization of export-related projects are a few of these difficulties. Therefore, it is vital to establish beneficial partnership to support development banks' operations and activities. Development banks can leverage on this to expand on their achievements in using beneficial relationships to enhance their operations and activities. For example, the partnerships created and reputation built in the foreign capital markets could be useful in assisting development banks' operations in the medium- to long-term.

The Basel III and International Capital Adequacy Review's recommendations, including the greater use of shareholder guarantees, should be implemented on a schedule agreed upon by development banks. Therefore, development banks will not have to worry about jeopardizing the stability of their long-term finances in order to increase lending. The development, approval, and oversight of the implementation strategy, which will rely on the technical know-how of specialist groups, must actively include shareholders. Development banks should also include guarantees designed to draw fresh investment for loans related to climate change and increase the scope and impact of their climate projects. Similarly, development banks should promote the restructuring of the disjointed financial intermediary system and make use of private capital mobilization. To encourage capital development and stability, this can be accomplished through efficient coordination between fiscal, monetary, and development policies.

Additionally, development banks need to promote and incentivize nations to use their financing in initiatives that address global issues. For instance, varying loan periods, adaptable guarantee programs, improved financial instruments, and providing competitive loan pricing will help build a resilient financial system. Effective prioritization of international operations will be essential to ensure the best use of the limited resources available in a situation of constrained resources, which is likely to rise in the wake of future crises. Efforts to assess and improve the selectivity of such funds should be built on a detailed analysis of how development bank financing complements other sources of development funding.

It is essential for development banks to tailor well-structured corporate governance frameworks to their unique characteristics and business operations in order to have efficient corporate governance systems. Instituting robust and efficient corporate governance systems for development banks is necessary to reduce potential risks, and mitigate any unfavorable influence from the government, and potentially other influential factors that could affect the results of development banks' projects, programs, and policies. Promoting good corporate governance among development banks should be a goal for policymakers and regulators. They need to formulate more consistent policies and reconsider the urgency in implementing a framework of strong corporate governance system to yield a desirable policy or program outcome.

An extensive and robust impact evaluation plan that offers a way to identify the pillars that will encourage environmental, social, and governance progress as well as the SDGs is crucial if the continent is to benefit from the development banks. To ensure that the mandate of African development banking is consistent with DFIs' guidelines, efforts at maintaining effective M&E and impact evaluation systems need to be strengthened. Instituting strong monitoring and evaluation as well as impact evaluation systems is an important step in ensuring that development banks fulfill their mandate and are consistent with the legislative instrument and international guidelines. In addition, various approaches to impact evaluation should be advocated. Policymakers should come up with the best way to decide what development banks hope to get out of an evaluation, and how it relates to the kinds of policies or initiatives they are involved with. This initiative is needed to better capture the results and lessons of policies, programs and projects of development banks in the region. DFIs or development banks in Africa should be committed to increase the use of evidence-based approach from impact evaluation in project design. Increased awareness of impact evaluation initiatives of development banks can help boost resource mobilization and the quality of development through transparency and accountability. To ensure that the banks' mandate is consistent with transparency, accountability, and legal framework for development, efforts for maintaining good governance practices, M&E and IE should not be overlooked. The role of development banks in supporting regional and national developments, particularly, in mainstreaming impact evaluation in their policy mandate and governance decision to deploy resources to complement these efforts remains, therefore, crucial.

In conclusion, development banks in Africa cannot be seen in isolation. Instead, policy coordination that supports macroeconomic conditions and initiatives is essential. This requires the African economies to shift their policies to mobilize domestic and foreign resources, and adopt an investment-oriented growth strategy by increasing capital injection of governments, national and multilateral development banks to support development and investment projects.

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Index

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C

D

F

G