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Development finance and regional industrialisation finance

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1. Introduction

Building on previous CCRED research on development finance institutions (DFIs) and regional development, this policy brief provides a broad scoping of the development finance landscape on the continent, presents a snapshot of sectoral patterns of financing by several of the largest African DFIs, and sets out a number of issues requiring further research and policy attention.

Targeted financial interventions are an integral part of the industrial policy toolkit, especially for late industrialisers (Amsden, 1989; 2001).[1] Capital markets are inherently imperfect, and the risks, learning costs, and gap between large initial outlays and eventual returns associated with investment in new firms and new industrial capabilities tend to make these unattractive to profit-driven private interests (Nayyar, 2016). Targeted developmental finance is also important because raising rates of investment in a general, market-driven sense is not sufficient to drive structural transformation, and the shift toward higher value-adding activities and higher incomes associated with it. From an industrial development perspective therefore, the nature and potential for dynamic growth of the sectors and industries receiving targeted investments matters a great deal (Cramer et al., 2020).

There is therefore a critical role for government institutions and policies in channelling "patient" capital to strategic industries that can drive growth, employment, exports and enhancement of existing industrial capabilities (Goga et al., 2019a; Robb and Vilakazi, 2021). Development banks, sector-specific financing programmes, state procurement policy and export finance services can play a critical role in directing credit where it is most developmentally impactful (Andreoni and Tregenna, 2021). Socialising risk through lowering borrowing costs, supporting firms to absorb learning costs and achieve scale economies, and disciplining capital in ways that support national and regional goals have been central to industrialisation worldwide (Cramer et al., 2020; Zalk, 2021a).

From a regional perspective, a range of studies have highlighted challenges related to financing as barriers to industrialisation, the formation of cross-border linkages, and effective competition across borders in the context of small, concentrated domestic markets. Issues of access, scale and costs of financing have been identified across a range of sectors: "value chain studies across sectors point to the fact that financing for large investments is not readily available even through development finance institutions, particularly financing of a sufficient long-term and risk-taking nature to support meaningful long-term investments." (Burke et al., 2017). These sector studies include steel and cement (Nsomba and Vilakazi, 2021); soaps and detergents (Bosiu et al., 2019); poultry, milling and dairy (Ncube et al., 2016); mining equipment (Fessehaie, 2015) and suppliers to supermarkets (das Nair and Chisoro, 2017).

In this last case, the modernisation of procurement systems and imposition of stringent quality standards by supermarkets has put suppliers in the region are under a great deal of pressure to make "significant investment in capital, technological, managerial, organizational, and financial upgrades to meet cost and quality requirements" (das Nair and

[1] However, institutions not unlike modern DFIs also played an important part in driving European industrialisation from the 19th century onward (Xu et al., 2021).

Chisoro, 2017: 3). In this context, financial support from both state and private sector has been inadequate:

> *"[Suppliers'] most requested support was financial support. Small suppliers encounter significant challenges with accessing finance and maintaining cash flow and working capital. Lack of access to finance means that suppliers cannot make the necessary investments in their plant, product, and brand. Existing government funding and support available to small suppliers involves complicated and extensive paperwork. Accessing government funds is associated by suppliers interviewed with administrative inefficiencies and bureaucracy making it difficult for local entrepreneurs to benefit from them. It involves considerable red tape and bottlenecks forcing suppliers to use consultants, at their own expense, to try to access such pockets of funding."*
>
> (das Nair and Chisoro, 2017: 28).

In this environment, firms' possibilities for scaling up production and operating at a regional level are highly constrained. Nsomba and Vilakazi's (2021) analysis indicates that the few firms that have managed to succeed in this regard tend to have relied on internal resources drawn from subsidiaries already established in other markets to fund expansion. These firms' successful navigation of the external finance constraint is thus "more likely to be an exception that proves the rule (Nsomba and Vilakazi, 2021: 10).

We may conclude from these studies that financial constraints are a major barrier to industrialisation within and between countries in the region. There are undoubtedly a number of other critical barriers to regional integration and increased intra-African commerce in general (see Geda and Seid, 2015 for a helpful discussion). However, both the historical role of industrial finance in late industrialisation, and the acute mitigation and adaptation challenges associated with climate change, suggest that scaling up development finance on the continent is a policy goal well worth pursuing (Zalk, 2021b; Bell et al., 2022). In the next section, we start by conducting a broad scoping of DFIs in Africa.

2. Scoping African DFIs: Size, regional distribution and mandate

This section draws on invaluable work by Xu et al. (2021) that set out to construct a global database of DFIs and Public Development Banks (PDBs). Their database enables us to extract a snapshot of the development finance landscape at global, continental, regional and national levels as of October 2021.

In Table 1, we begin by showing the distribution of DFIs and PDBs (referred to collectively as DFIs going forward) between continents, as well as their distribution among Xu et al.'s (2021) size categories and the total assets under management in the DFIs of each continent. Xu et al. (2021) use total assets as a criterion to classify PDBs and DFIs into five size categories: mega (more than $500 billion), large (between $100 billion and $500 billion [included]), medium (between $20 billion and $100 billion [included]), small (from $500 million to $20 billion [included]), and micro (less than and equal to $500 million).

The two most striking elements of Table 1 are that while Africa is home to a significant number of DFIs as of 2021 – almost as many as Asia and the Americas – the total assets under management by African DFIs is extremely small relative to other continents. In fact, African DFIs' assets of $193 billion constitutes just over 1% of the global total.

Table 1: Continental distribution of DFIs by size category and total assets (2021)

	Micro	Small	Medium	Large	Mega	No info	Total	Total assets (USD million)
Africa	40	30	2	0	0	34	**106**	**193 597**
America	36	46	7	4	2	20	**115**	**7 023 207**
Asia	55	65	17	9	3	15	**164**	**6 799 291**
Europe	23	60	20	4	4	7	**118**	**4 067 566**
Oceania	12	4	0	0	0	3	**19**	**12 669**
Worldwide	0	3	1	1	0	0	**5**	**594 482**
Total	**166**	**208**	**47**	**18**	**9**	**79**	**527**	**18 690 812**

Source: Author's construction based on Xu et al. (2021)

As a subset of African DFIs, Attridge et al.'s (2021) analysis of 33 national development banks (NDBs) in 21 countries provides several valuable insights. First, while the number of African NDBs have grown substantially in the last decade, and almost all of these have expanded their balance sheets and lending books, Attridge et al. argue that this expansion has been driven by increased debt rather than equity capitalisation: "[O]verall low levels of capitalisation… means that banks have limited ability to leverage their balance sheets and support economic transformation goals." (2021: 9). Second, while the profitability of some African NDBs is comparable to European counterparts, around half of the sampled banks have non-performing loan (NPL) ratios greater than 15%, with eight NDBs showing NPL ratios above 25% (Attridge et al., 2021). Third, Attridge et al. (2021) find a negative relationship between politically-influenced governance structures and board appointments, and financial performance.

Naturally, state institutions housing large pools of scarce financial resources can be vulnerable to capture by power elites and entrenched economic interests (Bhorat et al., 2017; Goga et al., 2021b). Effective developmental management of these resources is therefore a major challenge. While matters of institutional design and transparency undoubtedly have an important role to play in improving outcomes (see policy recommendations in Attridge et al., 2021), the influence of power and politics cannot be designed away. Informal networks and institutions often result in politically negotiated access to state resources for some entrepreneurs.

It is however important to note that these factors do not constitute a case against industrial policy in particular, and state involvement in economic development in general. Indeed, these dynamics need not even be growth-constraining. Successful late industrialising economies such as South Korea have been able to achieve structural transformation alongside significant corruption and contestation over state resources; the critical factor is that "the combination of formal and informal institutions creates an appropriate combination of opportunities and compulsions for [politically-connected entrepreneurs] to not only set up in production, but also to put in the effort to become competitive" (Khan, 2010: 72). Building developmental coalitions sufficiently powerful and industrialisation-oriented to manage development finance resources effectively is a major challenge, requiring sophisticated technical and political capabilities simultaneously.

Table 2: African DFIs (2021)

(a) Regional distribution and total assets[2]

Region	No. of PDB/DFIs	Total assets (USD million)
Continental	1	46 809
Eastern Africa	31	14 611
Central Africa	9	4 667
Northern Africa	12	86 387
Southern Africa	24	22 851
Western Africa	29	18 272
Total	**106**	**193 597**

(b) Top 10 African countries by DFI assets[3]

Country	Total assets (USD million)
1. Morocco	32 794
2. South Africa	20 953
3. Egypt	20 305
4. Algeria	15 896
5. Nigeria	4 498
6. Tunisia	2 952
7. Sierra Leone	2 920
8. Ethiopia	2 606
9. Zimbabwe	2 356
10. Cameroon	2 004
Total	**107 284**

Source: Author's construction based on Xu et al. (2021)

Next, Table 2 above shows (a) the regional distribution of African DFIs alongside their total assets under management and (b) the top 10 African countries. Table 2(a) shows that Northern Africa is host to by far the largest pool of assets managed by DFIs in the continent. This is reflected in table 2(b), which lists three North African countries in a "big 4" which together account for 84% of total DFI assets in the continent. However, and despite relatively diversified exports among some members, intra-regional trade in the Arab Maghreb Union (UMA) has remained particularly low according to Geda and Seid (2015: 23): "In 2005, Western Europe accounted for two thirds of total UMA exports: not only that most of the fuel exports (mainly from Algeria and Libya) went to that market, but also 80% of the manufactures exported by Morocco and Tunisia followed suit".

Complementarity of exports is already an obstacle to raising intra-African trade, but cases where African neighbours with relatively distinct export baskets still opt to trade primarily with Europe and other Global North partners instead, this may suggest a broader challenge for regional integration in parts of the Global South. If, for example, African countries' export orientation is motivated primarily by a need for hard currencies, both to import

[2] Note: Data on total assets missing for 7 out of 31 in Eastern Africa, 4/9 in Middle Africa, 3/12 in Northern Africa, 7/24 in Southern Africa and 13/29 in Western Africa.

[3] Note: The multinational category has been excluded from the table; the total assets managed by multinational PDB/DFIs total $75 661 million. These PDBs/DFIs are the following: African Development Bank, African Export and Import Bank, Trade and Development Bank, West African Development Bank, Ecowas Bank for Investment and Development, Development Bank of Central African States, East African Development Bank, The Company for Habitat and Housing in Africa, African Guarantee and Economic Cooperation Fund, Development Bank of the Great Lakes States, Maghreb Bank of Investment and Foreign Trade. Of the $75 661 million in total assets, the African Development Bank controls $46 809 million.

capital equipment and as a buffer against global financial volatility, this may prove an extremely complex barrier to regional integration.

In Table 3 below, we present a summary of the official mandates of the 106 African DFIs covered by Xu et al. (2021). While the largest proportion have flexible mandates, and further research is required to establish the sectoral composition of their financing activities, there are a few noteworthy details with respect to African DFIs. First, it is potentially significant that so many DFIs are mandated with SMME promotion (28) and rural development (10), while only five are dedicated to export-import promotion. The lack of an industrial financing category is in itself telling, and may go some way to explaining why the value chain studies referenced in the introduction found lack of adequate financing such a consistent theme in the region.

Table 3: African PDB/DFIs by official mandate (2021)

Official mandate	No. of DFIs
Flexible	45
SMME promotion	28
Rural and agricultural development	10
Social Housing	8
Infrastructure	6
Export-Import	5
International financing of private investment	3
Local government	1
Total	**106**

Source: Author's construction based on Xu et al. (2021)

Next, Table 4 below lists the top 10 DFIs in the continent by total assets, ownership and official mandate. These account for 78,5% of total assets under management by DFIs on the continent. The largest by some distance is the African Development Bank (AfDB), with three other multinational DFIs also making the top 10.

While South Africa is the country with the largest number of institutions in the top 10, the scale of the North African DFIs is made clear in Table 4 – Morocco's Caisse de Dépôts et de Gestion du Maroc alone is significantly larger than the South African DFIs combined. An analysis of whether the scale of these institutions translates into improved outcomes would be a worthwhile exercise, allowing us to explore Zalk's (2021b) suggestion that consolidation of African development banks would improve the quality of DFIs' governance and developmental impact.

Table 4: Top 10 PDB/DFIs by total assets, ownership level and official mandate (2021)

PDB/DFI	Total assets (USD million)	Ownership	Official mandate
African Development Bank	46 809	Multinational	Flexible
Caisse de Dépôts et de Gestion du Maroc	29 253	Morocco	Flexible
National Investment Fund	15 896	Algeria	SMME promotion
National Investment Bank of Egypt	14 839	Egypt	Flexible
African Export and Import Bank	14 440	Multinational	Export-Import
Industrial Development Corporation	7 843	South Africa	Flexible
Development Bank of Southern Africa	7 187	South Africa	Flexible
Trade and Development Bank	6 691	Multinational	International financing of private investment
West African Development Bank	5 324	Multinational	Flexible
Land and Agricultural Development Bank of South Africa	3 746	South Africa	Rural and agricultural development
Total	**152 028**		

Source: Author's construction based on Xu et al. (2021)

In light of the concentration of African DFI assets among the top 10, we have selected a two of these institutions for a brief further scoping, with the aim of conducting in-depth research on them in the future. The first is the AfDB, the largest African DFI by a long distance, and the second is the African Export-Import Bank (Afreximbank), another large multinational DFI and the only top 10 institution with an export promotion mandate.

Table 5: African Development Bank region and financing instrument composition (2020)

(a) AfDB portfolio by region

Region	Amount (USD million)	%
West Africa	10 998	25,9
East Africa	9 806	23,1
Southern Africa	9 405	22,1
North Africa	6 603	15,5
Central Africa	4 341	10,2
Multiregional	135	3,2
Total	**42 502**	

(b) AfDB approvals by financing instrument

Instrument	Amount (USD million)	%
Loans	2 619	62,8
Grants	940	22,5
Equity participation	17	0,4
Guarantee	355	8,5
Total	**4 171**	

Source: AfDB annual reports.

Table 5 lays out the regional distribution of the AfDB's portfolio in (a), as well as the composition of its approvals for 2020 in terms of financing instruments in (b). The former shows that North and Central Africa are underserved relative to other regions. Further exploration is required to establish the reasons for this. Table 5(b) clearly reflects Attridge et al.'s (2021) observations regarding African DFIs tendency to favour debt financing above other instruments – equity participation is the AfDB's least utilised instrument at just 0,4% of approvals. Again, a deeper exploration of the AfDB and other DFIs' funding and financing strategies is required to draw firm conclusions. However, reducing the proportion of debt instruments in the AfDB's portfolio and exploring innovative, equity-based arrangements may be one way to relieve the pressure of repayments on firms while also mitigating against risks associated with a volatile global financial outlook.

The AfDB's approvals according to its "High 5" priorities and the distribution of its portfolio by sector raise more interesting questions worth pursuing. The Bank's High 5 priorities and their underlying goals are briefly summarised as follows:

- Light Up and Power Africa: "The central vision… is to achieve universal access to electricity" (AfDB, 2020: 10);
- Feed Africa: "…supports the transformation of African agriculture and rural areas to eliminate hunger and malnutrition and move Africa to the top of export-oriented global value chains consistent with its comparative advantage" (AfDB, 2020: 13);
- Industrialize Africa: "…is about Africa's economic diversification to reduce Africa's reliance on mineral-based exports and to create jobs in a more diversified economy led by private entrepreneurs and businesses" (AfDB, 2020: 15);
- Integrate Africa: "…deeper integration through enhanced regional development and cooperation, and thus largely overcome the constraints of market size" (AfDB, 2020: 16);
- Improve the Quality of Life for the People of Africa: "improving quality of life for Africans and creating jobs can be regarded as the overarching objective of the High 5 agenda" – listed areas under this priority are Health; Water and sanitation; and Human capital, youth and skills development (AfDB, 2020: 18).

Table 6: African Development Bank sector and thematic composition (2020)

(a) AfDB approvals by “High 5” priority

"High 5" priority	Amount (USD million)	%
Light Up and Power Africa	463	11,1
Feed Africa	127	3,0
Industrialize Africa	199	4,8
Integrate Africa	184	4,4
Improve the Quality of Life for the People of Africa	3 199	76,7
Total	**4 171**	
Within “Industrialize Africa” priority		
Enterprises Development	83	41,8
Regional Environment Improvement	77	38,6
Financial Sector and Capital Markets Development	38	19,2
Industrial Business Environment	1	0,4
Total	**199**	

(b) AfDB portfolio by sector

	%
Transport	24,3
Power	22,8
Finance	17,0
Multisector	10,6
Agriculture	9,6
Water supply/sanitation	8,3
Social	4,0
Industry/mining/quarrying	2,1
Communications	0,9
Environment	0,4

Source: AfDB annual reports.

It is immediately clear from Table 6(a) that the extremely broad priority area, “Improve the Quality of Life for the People of Africa”, is by far the largest channel for AfDB approvals in 2020. The lack of specificity and focus in this priority area is a concern given its size; it may suggest that funding in this category is assigned on a relatively ad hoc basis and/or without sufficiently clear long-term objectives in mind.

While all 5 priorities are of potential value for regional industrialisation, the “Industrialize Africa” programme has been of particular interest due to the direct relevance and relative clarity of its goals. A breakdown of approvals under this priority is shown in the bottom half of Table 6(a); taken together with the sectoral breakdown of the entire AfDB portfolio in Table 6(b), it is clear that the financial sector in particular receives a surprising amount of support from the Bank. Since the role that the financial sector is supposed to play in facilitating the AfDB’s priorities is not explained in any significant detail in publically available documents, understanding of the motivation for the sizeable portfolio allocation to the financial sector will be important for future research.

Table 7: African Export-Import Bank sector and financing instrument composition (2020)

(a) Afreximbank gross loans by sector

Sector	2019	2020	2021 (9 months)
Financial Services	45,2%	54,7%	53,3%
Oil and Gas	22,8%	14,4%	15,3%
Manufacturing	6,2%	7,6%	7,1%
Construction	1,7%	5,0%	5,2%
Power	7,3%	5,4%	4,5%
Telecoms	4,9%	3,2%	3,2%
Health services	-	1,4%	2,8%
Government	4,5%	2,1%	2,3%
Transportation	2,3%	1,3%	1,7%
Other	5,1%	4,9%	4,7%

(b) Afreximbank approvals by instrument

Instrument[4]	2019	2020	2021 (9 months)
Lines of credit	41%	48,9%	44,4%
Direct finance	34%	29,9%	35,4%
Asset-backed	6%	5,6%	6,8%
Project finance	5%	4,8%	4,8%
Notes purchase	-	3,0%	2,6%
Receivables purchase	-	3,8%	1,2%
Other	12%	4,0%	4,7%

Source: Afreximbank results presentations.

Table 7(a) above also appears to confirm Attridge et al.'s (2021) observations regarding DFIs' preference for credit-based financing. More strikingly though, 7(b) further illustrates the need to better understand the relationship between African DFIs and the financial services sector. As shown below, Afreximbank has allocated an extremely large proportion of its loans to the sector – the onset of the pandemic appears to have prompted initially rapid growth in this proportion, jumping from 45,2% in 2019 to 54,7% in 2020.

3. Conclusion

Our scoping of African DFIs, based on a combination of the database developed by Xu et al. (2021) and our own snapshot analysis of two large DFIs publicly available reports, has raised a number of areas for future research and policy attention.

First, establishing whether relatively large North African DFIs do indeed enjoy scale and scope advantages relative to smaller institutions will help to establish whether consolidation is a viable and desirable policy choice in countries and regions where assets under management are currently dispersed between different DFIs.

Second, there is a need to conduct more detailed case studies of key DFIs on the continent; understanding the regional and sectoral allocation decisions of multinational DFI will assist in establishing the areas and sectors where financing deficits are most acute, and in-depth

[4] Lines of credit: "Export and import line of credit, pre- and post-export financing, Letters of Credit Confirmation and Correspondent Banking services."
Direct finance: "Direct lending to entities with a balance sheet of at least US$ 2m and annual revenue of more than US$10m. Pre- and post-export financing up to a max 80% value."
Asset-backed: "African content promotion in Africa's oil, gas and other mining sectors, maritime transport, railways and airline industries, and taking collateral in the form of the assets."
Project finance: "Limited recourse financing in support of export projects (e.g. mining, manufacturing & related projects), and infrastructure projects that facilitate exports or generate trade infrastructure services (e.g. power, ports and telecom)."
Notes purchase: "Purchase of promissory notes or similar instruments providing financing to corporates; recourse to issuer and acceptor."
Receivables purchase: "Purchase of specific receivables of goods and services sold to foreign or domestic buyers (forfaiting, factoring, invoice/bills discounting, etc.)."

research on funding costs and financing strategies will enable policymakers to understand the nature of constraints on expanding DFIs' scale and scope.

Third, there is a clear need to understand the rationale underlying AfDB and Afreximbank's significant relative levels of support for the financial services sector. Establishing which firms in which countries are the main beneficiaries of this support; what they do with the resources they receive and whether there is rent extraction or what amounts to arbitrage taking place; whether these large DFIs are eroding their own capabilities by outsourcing credit allocation to the private sector; and what the outcomes of this course of action has been, could result in valuable insights for policymakers and researchers on the continent.

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