



THE WORLD BANK

**Improving Access to Finance for Ghanaian SMEs:
Is there a Role for a New Development Finance
Institution?**

June 27, 2019

Purpose of the report

This report provides an historical overview of development finance in Ghana, as well as the circumstances and features required for a new development finance institution that can help reduce financing gaps faced by SMEs in key economic sectors. The report aims to inform World Bank operations in the country and was prepared by Carlos Vicente, Ajai Nair, Alexander Berg, and Ivor Istuk (World Bank) and Ruben Barreto and Alessandro Bozzo (consultants), with guidance from Douglas Pearce (Practice Manager). The report benefited from insights and recommendations made by Nadeem Karmali, Murat Sultanov and Haocong Ren (World Bank).

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List of Acronyms and Abbreviations

ADB	Agricultural Development Bank
AQR	Asset Quality Review
BDC	Business Development Bank of Canada
BOG	Bank of Ghana
CEO	Chief Executive Officer
DBG	Development Bank of Ghana
DFI	Development Finance Institution
ECA	Export Credit Agency
EDAIF	Export Development & Agriculture Investment Fund
EGC	Exim Guaranty Company
EXIM Bank	Export Import Bank
FIRA	<i>Fideicomisos Instituidos en Relación con la Agricultura (Mexico)</i>
FIT	Financial Investment Trust
GDP	Gross Domestic Product
GIRSAL	Ghana Incentive-based Risk Sharing System for Agriculture Lending
GNI	Gross National Income
ICT	Information and Communication Technologies
IFC	International Finance Corporation
MSME	Micro, Small, and Medium-Sized Enterprise
NIB	National Investment Bank
NPL	Non-Performing Loan
OECD	Organisation for Economic Cooperation and Development
PCG	Partial Credit Guarantee
PEVC	Private Equity and Venture Capital
PFI	Participating Financial Institution
SDI	Specialized Deposit-Taking Institution
SME	Small and Medium-Sized Enterprise
SOE	State-Owned Enterprise
SSNIT	Social Security and National Insurance Trust
USAID	United States Agency for International Development
USD	United States Dollar
WBG	World Bank Group
WGV	Wangara Green Ventures

Executive Summary

The Government of Ghana has announced its intention to establish a new national development finance institution (DFI) to help accelerate the structural transformation of the Ghanaian economy. This report discusses the financial sector context in Ghana, the major financing gaps in the country, the global experience with DFIs, and identifies key aspects associated with the proposed DFI's design and operations that need the Government's careful consideration to ensure that the proposed DFI is effective and sustainable.

Credit to the private sector in Ghana has been consistently lower than expected from Ghana's structural characteristics. This situation has deteriorated in recent years due to several factors, including banks' reduced risk appetite arising from the economic slowdown and strong deterioration in asset quality, closure of problem banks, and high levels of public sector borrowing that make investment in government securities highly profitable. Real lending rates remain very high, reflecting high opportunity cost and structural issues such as the absence of robust credit risk mitigation tools and contract enforcement framework that can mitigate the risks of strategic defaults by borrowers, or of a well-functioning credit information system that reduces the risk of selecting poor projects. High cost of credit reduces the effective demand for credit and the capacity of many otherwise creditworthy borrowers to repay their debt.

Banks and non-bank lenders in Ghana often provide financing to firms with maturities that are shorter than what a firm's business would require to break-even and grow. Predominance of short-term maturities in bank credit and institutional investments reveals lenders' concerns with private sector risk and a preference to finance businesses that have frequent cash-flows and a short-term nature in order to reduce credit and interest rate risks. Short loan maturities also reflect limited access to long-term funding by financial institutions.

Small and medium-sized enterprises (SMEs) in Ghana face higher credit constraints as banks lend to a limited number of firms, prioritizing large borrowers. Many small firms are not profitable enough to be able to repay loans at the current market rates and tenors. They also have difficulties securing working capital given the late payment practices of private and public sector buyers. The MSME financing gap in Ghana is estimated at 13 percent of GDP (about US\$6.1 billion in 2017). The shares of credit from the banking sector to agriculture and manufacturing suggest that both sectors face significant financing gaps, particularly the agriculture sector.

Ghana should continue to improve the macroeconomic environment. The government should continue to reduce macroeconomic imbalances, particularly reducing fiscal deficits and associated domestic borrowing which has crowded out the private sector and pressured market interest rates. It should also maintain low inflation and improve international competitiveness of Ghanaian industries. Financial sector institutions, including the new DFI, will face significant obstacles if these reforms are not implemented.

Competitive, diversified, and sound private sector-led financial systems are better positioned to sustainably increase access to financial services in an economy. Hence, it is critical that the Government should continue implementing legal, regulatory and policy reforms aimed at improving payments and credit infrastructure, enhancing contract enforcement, and developing capital markets.

The importance of SMEs for job creation justify specific public policy interventions to address market failures and reduce the financing gap they face. These include both measures to increase competitiveness of firms and measures to increase supply of financial services such as credit and insurance. The former includes measures such as improving technical and management skills, providing incentives for innovation and adoption of new technologies, and facilitating improved access to markets. The latter includes measures such as strengthening credit infrastructure and the establishment of DFIs.

A well-governed and well-managed DFI in Ghana could play a role in addressing some failures in the credit markets for key client segments such as SMEs that have potential to accelerate Ghana's structural transformation. To do this most effectively, the DFI would need to play a catalytic role by providing longer tenor funding at competitive costs and risk-sharing arrangements that would encourage private financial institutions to explore these key segments and finance activities that would otherwise remain unfunded or underfunded. This may also need to be complemented by technical assistance to financial institutions that are willing to partner with the DFI to build up their operational systems and staff skills.

A new sound DFI can bring together the government and strategic development partners willing to take a catalytic role in increasing private financing for SMEs. Existing DFIs in Ghana do not have the corporate governance arrangements, the business model, or the expertise required to play this catalytic role. Without jeopardizing its sustainability, this new DFI can operate closer to the risk frontier and offer specific instruments to address this financing gap. For example, by extending long-term Cedis-denominated credit lines to financial institutions, the DFI could help increase the maturity of loans to firms that have a longer investment cycle; by offering partial credit guarantees, it could incentivize financial institutions with excess liquidity to provide more loans to firms that cannot offer traditional real estate as collateral but are nonetheless creditworthy; by providing a platform for invoice discounting, it could facilitate increased working capital financing and help improve overall payment performance in the economy.

While a new DFI in Ghana offers an opportunity to reduce the financing constraints faced by businesses, it also entails limitations and risks. Global experience shows that DFIs with weak governance and multiple and competing mandates are easy targets of political interference which compromise their sustainability and impose high costs on taxpayers. This has indeed been the case in Ghana in the past, where several DFIs have suffered over time from a lack of financial sustainability and have either relied on budget allocations and donors to survive or drifted into a more profit-oriented objective that partly limits their development mandate.

Good corporate governance is a critical component for the success of the proposed DFI. Success requires balancing commercial and non-commercial objectives, building a strong board of directors that can insulate the institution from the political process, and introducing a high level of transparency. This report puts forward key aspects related to the mandate, ownership, corporate governance, management, regulation and supervision of the new DFI, as well as to their key business rules, processes, resource management, and skills. A well-governed new DFI can provide a blueprint for the reform of existing state-owned financial institutions in Ghana.

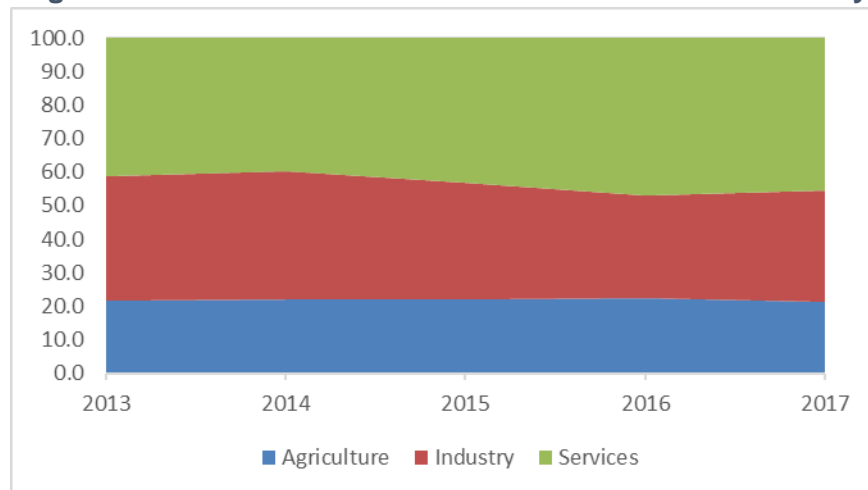
That said, even the establishment of a well-governed and successfully operating DFI can only partially address financing gaps in the Ghanaian economy and therefore Ghana should continue deepening financial sector reforms. DFIs cannot fix all the above-mentioned constraints limiting access to finance.

I. Introduction

1. **The Government of Ghana has announced its intention to establish a new national development finance institution (DFI)** that will “provide long-term financing for the rapid industrialization and development of the agriculture sector, among others, in Ghana using a private sector model”.¹ The Task Force created to establish the new DFI further elaborated that the DFI would promote “economic transformation”.

2. **Structural (economic) transformation refers to the reallocation of economic activity (employment and output) across the broad sectors of agriculture, manufacturing, and services that accompanies increases in income per capita.** Ghana’s economy remains undiversified with about 40 percent of the labor force in non-wage agriculture and most urban workers in low-productivity informal jobs. Over the last five years, the share of agriculture in the economy has been stable at about 20 percent, signaling the challenges in transforming the economy into more value-added activities (Figure 1). There are several cross-cutting binding constraints to economic transformation in Ghana, such as macroeconomic instability, poor infrastructure (energy and transport), and limited pool of managerial and entrepreneurial skills.²

Figure 1. Structural transformation in the Ghanaian economy



Source: Ghana Statistical Service.

3. **Public policy has been used across the world to promote economic transformation.** Public policy can influence structural change by (i) facilitating stakeholder coordination and information sharing,

¹ This report uses the terms “development finance institution” and “development bank” somewhat interchangeably. It follows Scott (2007) and defines the more general term—development financial institution—to be a not-for-profit maximizing institution with an explicit public policy mandate that is mainly financed by non-deposit resources such as loans from the state, long term loans from multilateral institutions, and bonds issued in local and international capital markets.

² World Bank Group. 2016. *Creating Markets in Ghana. Country Private Sector Diagnostic*. Washington DC. The report also identifies economic sectors that have high development impact and high feasibility (energy, agribusiness, and finance), as well as other priority sectors with high linkages: education, information and communication technologies (ICT), transport, and health.

thereby smoothing the transformation; (ii) making precompetitive investments in infrastructure and skills for the future; and (iii) helping align structural change with broader societal objectives, such as environmental sustainability or job creation.³

4. **DFIs are a key tool for economic transformation in countries where inadequate supply of long-term financing undermines the ability of firms to invest in projects with long gestation, limiting economic growth and job creation.** Limited long-term financing is usually related with the lack of long-term funding sources by financial institutions, but also arises from their preference for businesses that have frequent cash-flows and a short-term nature in order to reduce risk. Research shows that weak institutions, poor contract enforcement, and macroeconomic instability lead to shorter maturities on financial instruments.⁴ Well-governed and well-managed DFIs can provide patient financing, including by leveraging private domestic resources, providing long-term financing, sharing credit-risks, establishing platforms that can facilitate private financing, and supporting coordination among economic agents.

5. **This report discusses the financial sector context in Ghana, the major financing gaps in the country, the global experience with DFIs, and identifies key aspects associated with the proposed DFI's design and operations that need the Government's careful consideration to ensure that the proposed DFI is effective and sustainable.** The focus of this report is on finance for enterprises, particularly small and medium-sized enterprises (SMEs), rather than for public infrastructure or housing.⁵

6. **While a new DFI in Ghana offers an opportunity to reduce the financing constraints faced by businesses, there are limitations and risks associated with such new institution.** First, DFIs cannot fix by themselves all the constraints limiting access to finance, which arise from an interaction of multiple factors including high levels of public sector borrowing, poor business environment, lack of information infrastructure, and limited technical and managerial skills among borrowers. Second, international experience shows that DFIs are often targets of political interference which compromise their effectiveness and sustainability. When DFIs fail, they tend to impose high costs on taxpayers as governments step-in to pay their liabilities.

7. **Good corporate governance is a critical component for the success of the new DFI.** Governance of a DFI is more challenging than the governance of a private financial intermediary. Success requires balancing commercial and non-commercial objectives, building a strong board of directors that can insulate the institution from the political process, and introducing a high level of transparency.

8. **This report discusses five key aspects that require the Government's careful consideration.** These relate to the ownership, corporate governance, regulatory and supervision of the new DFI, key business processes and rules, and financial instruments. The discussion draws on international evidence

³ T. Altenburg, M. Kleinz, and W. Lutkenhorst. 2016. Directing Structural Change: From Tools to Policy. *German Development Institute Discussion Paper Series*. No. 24/2016. Bonn: German Development Institute.

⁴ World Bank Group. 2015. *Global Development Finance Report*. Washington DC.

⁵ Long-term finance is defined in this report as any financial instrument with maturity exceeding one year, as well as public and private equity instruments. The one-year cut-off maturity corresponds to the definition of fixed investment in national accounts. By comparison, the G20 uses a maturity of five years or more, which is more adapted to the context of investment horizons in developed financial markets. G-20 (Group of 20). 2013. *"Long-Term Investment Financing for Growth and Development: Umbrella Paper."*

and WBG experience with corporate governance reforms and reform DFIs and state-owned enterprises (SOEs) more generally. The discussion also draws on a recent WBG survey of development banks.⁶

9. **The report is structured as follows.** Chapter II provides an overview of the financial system in Ghana and of its recent dynamics, focusing on the challenges to overall financial development. Chapter III discusses the difficulties faced by SMEs in general and particularly those in agriculture and manufacturing sectors in accessing finance in Ghana. Chapter IV provides an overview of the role that DFIs have played across the world in addressing financing gaps as well as the challenges they have faced, including in Ghana, and the rationale for the establishment of a new DFI in Ghana, considering the current institutional context and challenges. The final chapter discusses key design features and potential financial instruments that the proposed DFI in Ghana could offer to ensure that it can successfully fulfil its mandate.

⁶ World Bank Group. 2018. *Survey of National Development Banks 2017*. Washington DC.

II. Overview of Financial Sector in Ghana

11. **Financial intermediation in Ghana grew fast between 2010 and 2017, reflecting licensing of new institutions (both banks and non-banks) and the growth of the fund management and pension subsectors.**⁷ The size of the financial sector (by assets) expanded from 37 percent of GDP in 2010 to about 59 percent of GDP (or about US\$ 34 billion) in 2017. The sector is more diversified than peers, although most assets (59 percent of total) are still held by commercial banks. The fund management subsector has 15 percent of assets, pension funds have 12 percent, specialized deposit-taking institutions (SDIs) 11 percent, and insurance companies 3 percent. Conversely, the stock market capitalization has been decreasing and reached an estimated 20 percent of GDP in 2018 (from 33 percent of GDP in 2010 and 58 percent of GDP in 2011), reflecting lower investor confidence and limited new issuances. Government domestic debt represents a significant part of financial assets (18 percent of GDP in December 2018) in the capital markets. Overall Ghana's financial sector is deeper than those of Cameroon, Sudan, and Zambia, but is lagging behind Cote D'Ivoire, Kenya, and lower middle income and regional countries averages (Table 1).

Table 1. Financial depth in Ghana: Cross-Country Comparison (2017)

	GNI per capita	Broad Money	Banking assets	Domestic Credit	Credit to private sector
	(USD, Atlas m.)	(% of GDP)	(% of GDP)	(% of GDP)	(% of GDP)
Ghana	1,880	26.1	33.2	24.5	13.9
Cameroon	1,370	20.5	23.8	16.6	14.5
Cote D'Ivoire	1,580	38.7	47.2	37.4	26.5
Kenya	1,460	36.7	49.3	40.3	29.3
Nigeria	2,100	20.4*	24.5	23.3	14.2
South Africa	5,430	72.2	102.9	180.5	147.7
Sudan	2,380	24.7	21.4	23.3	8.8
Zambia	1,290	22.0	29.4	21.8	11.2
Income group average	2,118	67.7	n.a.	64.4	43.7
Regional average	1,487	36.5*	n.a.	63.4	48.3

GDP = gross domestic product; GNI = gross national income; USD = United States Dollar. * 2016.

Source: World Development Indicators (accessed on February 14, 2019); International Monetary Fund, Monetary and Financial Statistics; calculations by World Bank staff. Calculations do not use the rebased GDP figures disclosed by the Ghana Statistical Service in October 2018.

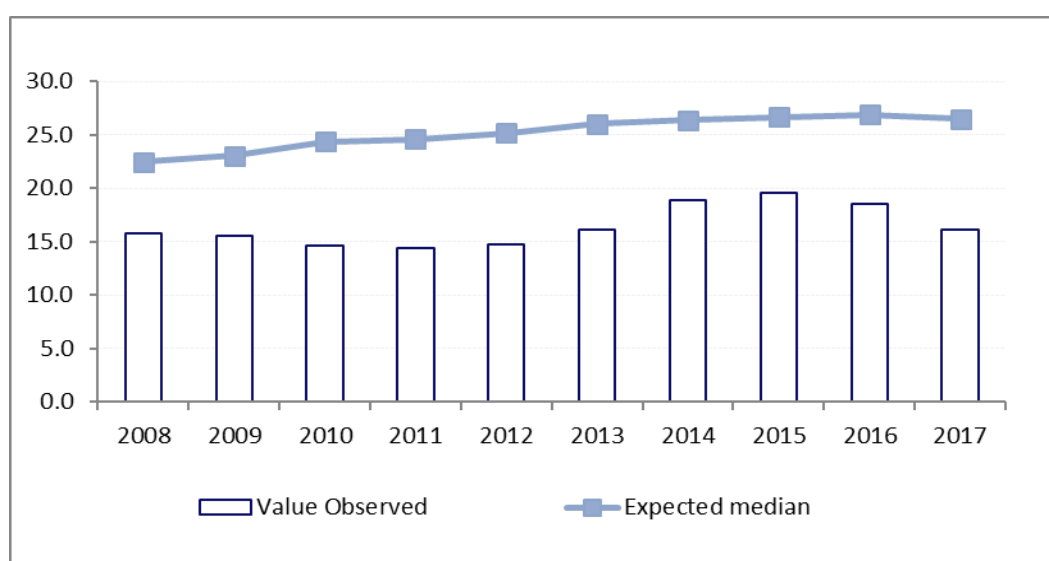
12. **The banking sector in Ghana experienced significant consolidation in the last few years, but is still less concentrated than peers.** In 2017, the three largest banks owned approximately 40 percent of the total banking assets, up from 31 percent in 2015, lower than the expected income group median of 61 percent. However, the structure of the banking sector changed recently following the transfer of assets and liabilities of two small indigenous banks to a state-owned bank through a purchase and assumption transaction, as well as the establishment of a bridge bank (capitalized by the state) which assumed the

⁷ In 2000, there were 16 banks with 304 branches, which grew to 34 banks with approximately 1,500 branches in 2017.

assets and liability of other seven indigenous banks. As a result, the share of banking sector assets owned by the state has increased significantly. As of March 2019, there were 23 banks, mostly foreign-controlled.

13. **Bank credit to the private sector has substantially decreased over the last few years.** This is due to banks’ reduced risk appetite arising from economic slowdown and strong deterioration in asset quality, as well as the transfer of bad assets from defunct banks to receiverships, in a scenario where investment in government securities remains highly profitable. As of December 2018, credit to the private sector was estimated at 13 percent of GDP (down from a peak of 16 percent of GDP in 2015). Credit to private sector in Ghana has been consistently lower than expected from Ghana’s structural characteristics (Figure 2). Loans to private sector accounted for only 35 percent of bank assets (down from an average of 40 percent between 2013 and 2017), while claims on government and public corporations accounted for 29 percent (up from an average 23 percent between 2013 and 2017), and cash reserves accounted for 11 percent. Funding is primarily based on deposits (63 percent of assets), followed by borrowings (17 percent), and shareholders’ funds (13 percent). In 2018, investment in three-month treasury bills yielded an annual real return of 3.7 percent, revealing bank’s high opportunity cost to lending to the private sector.

Figure 2. Private credit in Ghana: International comparison

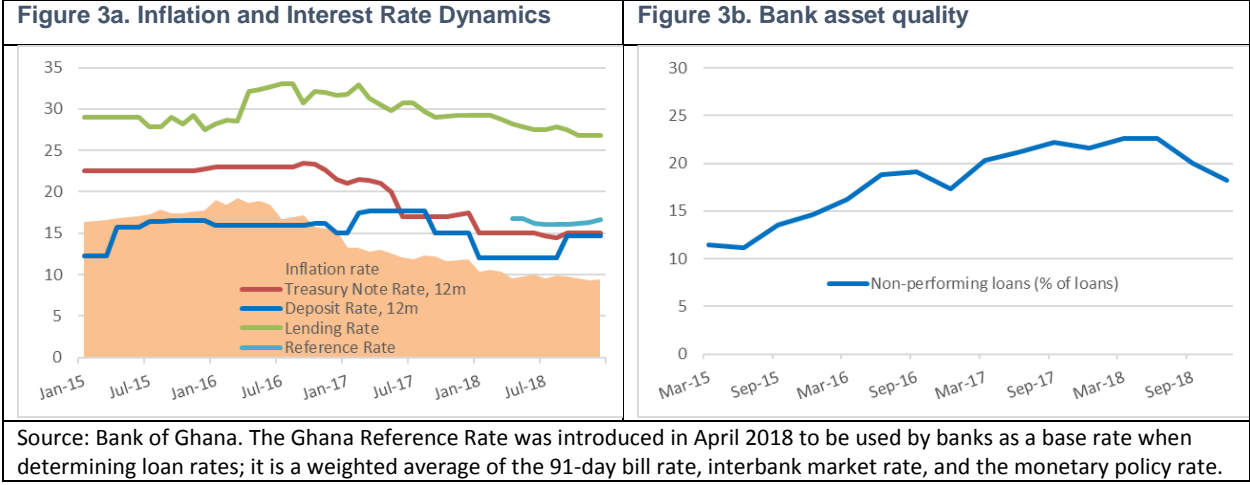


Note: The Expected median is a statistical benchmark for Ghana based on its structural characteristics, such as the level of economic development. For details, see T. Beck, E. Feyen, A. Ize, and F. Moizeszowicz, *Benchmarking Financial Development*, World Bank Policy Research Working Paper 4638 (Washington, DC: World Bank, 2006). Calculations do not use the rebased GDP figures disclosed by the Ghana Statistical Service in October 2018.

14. **Real lending rates have further increased in 2018 due to declining inflation at a faster rate than declining nominal lending rates.** Real lending rates remain very high at 17 percent (average of 14 percent during 2013–2017), reflecting high credit risk and funding costs (Figure 3a).⁸ The high credit risk reflects some cyclical factors but mainly structural issues such as the absence of credit risk mitigation tools (e.g., a reliable secured transactions framework) and contract enforcement framework that can mitigate the

⁸ With nominal lending rates at an average of 27 percent (2018) and 3-month treasury-bills paying an annual rate of about 15 percent, the lending rates imply a high-risk premium on lending. The average interest rate spread is also high at 15 percent (2018).

risks of strategic defaults by borrowers (moral hazard), or a well-functioning credit information system that reduces the risk of selecting poor projects (adverse selection). This leads to the predominance of a bank lending model based on immovable collateral. High cost of credit reduces the capacity of many otherwise creditworthy borrowers to repay their debt.



15. **Non-performing loans (NPLs) remain high, albeit declining.** The average gross NPL ratio declined from 21.6 percent in December 2017 to 18.2 percent in December 2018, in part due to the closure of problem banks, write-offs of NPLs following a more stringent application of the Bank of Ghana’s policy, and settlement by the Government of the debt of energy sector SOEs. Excluding the fully-provisioned loan-loss category, the NPL ratio stood at 10.2 percent in December 2018. NPL ratios vary significantly among banks. The private sector, being the largest recipient of outstanding credit balances, accounted for the greater proportion of banks’ NPLs, only slightly decreasing from the December 2018 levels of 97.1 percent to 96.9 percent in February 2019. The proportion of banks’ NPLs attributable to the public sector declined from 7.3 percent in December 2017 to 2.9 percent in December 2018 but has slightly increased to 3.1 percent attributed to increases related to public enterprises. Most private sector non-performing loans were debts of indigenous enterprises accounting for 75.4 percent of total NPLs in February 2019. The commerce and finance sectors account for the largest share of industry NPLs, although the proportion of loans to agriculture, forestry and fishing sectors that are impaired is higher (36 percent in April 2019). Economic slowdown during the 2014–2016 period and high NPLs further contributed to slow real credit growth (Figure 4).

Figure 4. Real Private Sector Credit in Ghana (% , year-on-year)



Source: Bank of Ghana.

16. **While average bank capitalization levels appear adequate, there are some vulnerabilities.** The average capital adequacy ratio increased to 22 percent in December 2018. This is well above the regulatory minimum of 10 percent and BOG’s recommended level of 13 percent. However, high NPLs continue to pose a major risk to banks, which also continue to be exposed to foreign currency risks –26 percent of the value of outstanding loans is denominated in foreign currency as of September 2018. To beef up the capital position of banks, BoG significantly increased the minimum paid-in capital to GH¢400 million (about US\$ 80 million) starting in December 31, 2018. This in part led to three mergers, a voluntary winding up, and a downgrading of one bank to a Saving and Loans Company.

17. **Banking sector liquidity remains high and slightly above the median of countries with the same income level.** Increased capital levels and restrictive credit policies have led to an increase in broad liquidity indicators, with the sector Liquid Asset Ratio reaching in 2018 the highest level in a decade (62 percent). In 2017, liquid assets represented 44.5 percent of deposits and short-term funding, higher than the income group median of 36.7 percent and of an expected median of 33.8 percent.

18. **Despite increased capital levels, banks continue to be profitable due to high interest margins.** After-tax average profitability of the banking system – as measured by return on equity – stood at 19 percent in December 2018, lower than the average 24 percent between 2013 and 2017, but still higher than the median for countries in the region and similar income group. Return on assets stood at 3.4 percent, lower than the average 5 percent between 2013 and 2017, but also higher than the median for countries in the region and similar income group. Profitability tends to increase with bank size, largely because of economies of scale. Banking operational costs are moderate, with a cost-to-income ratio of 54 percent in June 2018.

Table 2. Ghanaian Banking Sector: Soundness and Stability Indicators

	2014	2015	2016	2017	2018
Capital (% of total assets)	14.3	14.5	13.2	13.1	13.0 ^a
Regulatory capital (% of RWA)	17.9	17.8	17.8	15.6	21.9
Domestic credit growth, real at year end (%)	17.3	-3.9	-0.5	-2.8	-0.6
NPLs (% of gross loans)	11.3	14.7	17.3	21.6	18.2
Non-provisioned NPLs / bank capital (%)	11.2	14.7	15.8	14.9	15.4 ^a
Foreign currency-denominated loans, % of loans	29.9	29.2	24.8	22.8	26.0 ^a
Deposits-to-loan ratio (%)	134.6	137.4	146.4	153.4	192.9 ^a
Return on assets (%)	6.4	4.6	3.8	4.3	3.4
Cost-to-income ratio (%)	43.3	46.6	44.7	43.4	46.9 ^a

NPL = non-performing loan; RWA = risk-weighted assets; ^a As of September.

Source: BOG; International Monetary Fund, *Financial Soundness Indicators*.

19. **Capital markets have been developing in recent years, but remain small, concentrated, and not a viable source of funding for the majority of firms.** In December 2018, the Ghana Stock Exchange had stocks of only 40 companies listed, while having 129 debt securities listed (two thirds were government securities and the rest were corporate securities). Stock market capitalization was equivalent to 20 percent of GDP. The five largest companies accounted for 65 percent of market capitalization. The stock market is also illiquid with a 0.3 percent turnover ratio (2018).

20. **Specialized Deposit-taking Institutions (SDIs) play a key role in Ghana's financial sector.** Since 2011, their number rapidly expanded and in 2017 they accounted for 11 percent of systems' assets. There are hundreds of SDIs of several types, which are regulated by BOG, including microfinance institutions, rural and community banks, savings and loan companies, finance houses, and credit unions. Like the banking sector, many of these institutions have come under stress. However, they have also played a key role in expanding financial inclusion in Ghana.

21. **Macroeconomic imbalances constrain financing in Ghana.** BoG has largely maintained a tight monetary policy⁹ to safeguard price stability, leading to high market interest rates. Despite its recent decline driven by cuts in the policy rate, the average nominal lending rate stood at 26.9 percent in December 2018. Moreover, increasing government's financing needs and attractive risk-adjusted returns

⁹ The policy rate was at 16 percent in March 2019, down from a peak of 26 percent between September 2015 and September 2016.

in government securities have led banks and investors to shift resources to these instruments.¹⁰ Ghana's risks of external and overall debt distress continue to be assessed as high. Public debt interrupted its downward trend in 2018 (59.6 percent of GDP in December 2018) due to the realization of contingent liabilities in the banking sectors through resolution of failed banks.

22. Uncertainty surrounding government commercial arrears are also a critical weakness, undermining trust in economic relations and imposing unfair burden on SMEs, which have limited negotiating power in the commercial relationships with the government. Anecdotal evidence from banks suggest that a significant share of bank NPLs emanate, directly or indirectly, from government arrears. The International Monetary Fund estimated that the stock of outstanding arrears was GHc 3.9 billion (1.5 percent of GDP) at the end of 2017.¹¹ Possible measures to improve payment behavior include strengthening the management of public financing and introducing regulations on contractual payment terms both for public and private sector, with accompanied statutory interests in case of breach of those terms.

23. Access to finance is also constrained by structural weaknesses in credit infrastructure. As stated above, high credit risk is in part due to the absence of risk mitigation tools, such as a reliable secured transactions framework, and a functioning contract enforcement framework that can mitigate the risks of strategic defaults by borrowers.¹² Ghana has one of the most advance collateral registries in Sub-Saharan African, with over 150 thousand collateral registrations, representing GHc 150 billion (US\$35 billion) in financing backed by collateral, with 73 percent of the financing going to SMEs. But banks complain that registering their interest on an asset at the collateral registry does not yet provide legal certainty as the sale of the asset can be blocked if the borrower submits the case to the courts. Insolvency legislation in Ghana is fragmented across several pieces of legislation and does not adequately protect creditors. For instance, the current legislative focus is on liquidation, and no modern reorganization framework is in place. Consequently, businesses that are still viable but financially distressed cannot be easily rescued.

24. Moreover, the credit information system is plagued by the absence of a well-functioning national identification system for individuals and enterprises that could facilitate credit appraisal and the provision of other financial services. This does not help lenders in appraising the risk of projects. Banks do not seem to trust the credit information provided by credit bureaus, since they believe that not all banks are sharing good quality credit reports to the bureaus.¹³ Therefore, banks predominant lending model is based on collateral (immovable property), rather than cash flow-based lending or start-up financing models. In Ghana, the value of required collateral was estimated at an average of 240 percent of the loan amount, which is higher than the Sub-Saharan Africa average.¹⁴

¹⁰ Moreover, exposure to government counterparts receives a zero risk weight for purposes of calculation of banks' capital adequacy.

¹¹ International Monetary Fund. 2018. *Country Report No. 18/113*.

¹² The draft securities transaction bill under discussion in Parliament may solve this issue by safeguarding the right to execution. Court cases typically last between 1 and 3 years, depending on their complexity.

¹³ BOG's attempts to remedy this issue have not yet been effective. Banks and other institutions also reported difficulties in securing information from the land registry.

¹⁴ Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank.

25. **Invoice / receivable finance products like factoring and supply chain finance are known but not widely offered by banks in Ghana.** Stated reasons are the lack of legal clarity and certainty when assigning invoices and the lack of potential clients due to the small manufacturing base. Lack of business experience, financial records and electronic invoicing were also mentioned as obstacles for development of factoring finance.

III. Financing Constraints of Ghanaian Small and Medium Enterprises

27. **This chapter discusses the challenges faced by SMEs in Ghana when attempting to secure financing for investment.** While Chapter II already flagged that credit to the private sector as a whole is much lower than expected from Ghana's structural characteristics, in this chapter uses the concept of financing gap to analyze the reasons why credit from financial institutions to SMEs is provided in amounts and terms that are shorter than what could potentially be provided.¹⁵ The SME segment is likely to face market failures and therefore is a candidate to benefit from public policy interventions, for example in the form of specific financing instruments provided by a DFI.

III.1. MSME financing gap

28. **In Ghana, micro, small and medium-sized enterprises (MSMEs) are defined both in terms of number of employees and turnover.** According to the Ghana Statistical Service, a business entity that employs between 1 and 5 workers is a micro enterprise; one employing between 6 to 30 workers is a small enterprise; a firm employing between 31-100 workers is a medium enterprise and a firm employing more than 100 workers is a large enterprise. In contrast, the National Board for Small Scale Industries in Ghana defines SMEs using both fixed assets and number of employees: SME is a firm with not more than 9 workers, and that has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million Ghanaian edis. The banking sector in Ghana typically uses a definition based on the value of the exposure and most banks seem to define SME loans as those under US\$ 5 million.

29. **MSMEs in Ghana are largely informal and are less profitable than large firms.** In 2015, there were about 640 thousand business establishments in Ghana, of which 98 percent were micro or small.¹⁶ About one-tenth of establishments are formal, with the remaining 90 percent being informal. The survey found that MSMEs account for 83 percent of persons engaged in businesses. MSMEs collected 71 percent of business revenues in the country, but only 66 percent of profits, signaling that businesses generally benefit from larger scale. Many MSMEs have limited income-generating potential arising from their small scale, poor managerial skills and business models, and lack of innovation.

¹⁵ This report defines a financing gap (in a specific market segment) as the difference between the current levels of financing supply and the demand that can potentially be addressed by financial institutions.

¹⁶ Ghana Statistical Service. 2018. *Integrated Business Establishment Survey Phase II*. <http://www.statsghana.gov.gh/gssmain/fileUpload/pressrelease/IBES%20II%20Summary%20%20Report.pdf> (accessed on March 15, 2019).

Table 3. Overview of Businesses in Ghana by Size of Establishment (%), 2015

	Revenues	Profits	Fixed asset investments	Number of establishments	Number of persons engaged
Large	29.0	33.9	32.0	0.4	16.6
Medium-sized	21.3	21.0	55.5	1.5	12.0
Small	32.1	27.2	6.8	18.4	39.3
Micro	17.7	17.9	5.8	79.8	32.1
TOTAL	100.0	100.0	100.0	100.0	100.0

Source: Ghana Statistical Service.

30. **SMEs in Ghana seem to have relatively less access to financing than similar firms in Sub-Saharan Africa.** According to the 2013 Enterprise Survey, access to finance was ranked as the most important obstacle by the largest proportion of surveyed enterprises (50 percent).¹⁷ The survey found that 72 percent of small and 52 percent of medium-sized firms cite access to finance as a major constraint to their growth, much higher than small and medium-sized firms in Sub-Saharan Africa (42 and 34 percent respectively). Only 20 percent of small firms and 23 percent of medium-sized firms reported having a bank loan or line of credit, compared with 16 percent and 26 percent respectively in Sub-Saharan Africa. In contrast, Ghana has a larger proportion of enterprises reporting the use of supplier/customer credit to finance working capital (37 percent) compared to Sub-Saharan Africa and global average (25 percent and 26 percent respectively). A Ghana Statistical Service Survey showed that micro and small enterprises represented only 13 percent of investments in fixed assets, although they represent 50 percent of revenues and 45 percent of profits (Table 3).

Table 4. Access to credit by firms in Ghana

	Percent of firms with a bank loan/line of credit	Proportion of loans requiring collateral (%)	Value of collateral needed for a loan (% of the loan amount)
Small	19.9	70.6	244.8
Medium	22.9	87.9	198.6
Large	50.8	95.3	222.8

Source: The World Bank, Ghana Enterprise Survey (2013);

<http://www.enterprisesurveys.org/data/exploreconomies/2013/ghana#finance--size> (accessed on May 20, 2019)

31. **Banks in Ghana provide credit to a limited number of firms, prioritizing large borrowers, which in part reflects limited profitability of many small firms.** On one hand, many small firms are not profitable enough to be able to repay external loans at the current market rates. This is reflected in high historical

¹⁷ Access to electricity was considered the most important obstacle by 19 percent of business owners and managers, ranking second as the most important obstacle.

default rates. But this disparity in access to bank credit also reflects the fact that many banks in Ghana do not have specialized departments nor credit appraisal and monitoring processes focused on MSMEs, and therefore apply the same methods for all sizes of business loans. This leads loan officers to focus on the larger loans. Large firms have access to finance from parent companies, from domestic banks interested in large corporate customers, or from foreign banks that usually serve multinational firms outside their home countries. SDIs have limited capital that prevent them from having a larger presence in the MSME credit market.

32. Small businesses in Ghana also have difficulties securing working capital, particularly given the late payment practices of private and public sector buyers. A few financial institutions have already tried or are considering factoring products for domestic transactions. They believe that the market has potential, but they also cite systemic bottlenecks, including lack of clear and efficient rules regulating assignment of receivables (this would be corrected with the full implementation of the proposed secured transactions system), lack of enforceability of contractually-based late payment interest, buyers' unwillingness to cooperate or accept assignment of invoices, and limited quality of the credit reporting system (needed to properly ascertain the risk of buyers' default).

33. The International Finance Corporation (IFC) estimates that the MSME financing gap in Ghana is equivalent to 13 percent of GDP (about US\$6.1 billion in 2017), lower than the Sub-Saharan Africa average (22 percent of GDP). In addition, the IFC estimates the informal MSME demand for credit at around the same amount. The size of the formal MSME credit market is estimated at about 7 percent of GDP (or about \$3.4 billion in 2017). The number of formal MSMEs is estimated at 26,000, 23 percent of which are estimated to be women-owned. Seventy-four percent of these MSMEs are estimated to be partially or fully credit-constrained.¹⁸

34. Select banks interviewed during the preparation of this report reported significant exposures to the SME sector. These include Fidelity Bank, Ecobank, and Societe Generale. Fidelity Bank reports around 30 percent of its portfolio in loans to SMEs, including through partnerships with the United States Agency for International Development (USAID), SNV, and Medical Credit Fund to finance SMEs. Fidelity also reports financing receivables. Ecobank reports having around 10 percent of their credit portfolio with SMEs and also uses USAID guarantees. Societe Generale reports less than 10 percent of its credit portfolio with SMEs but claims to be the only bank in Ghana that provides factoring services and one of the two providing leasing services.

35. The private equity and venture capital (PEVC) industry is another source of finance for SMEs in Ghana.¹⁹ The experience of the PEVC industry in Ghana, whereby many successful funds have provided both equity and debt, also demonstrates that there is a paucity of longer tenor debt in the market. Some PEVC funds (e.g., GroFin and Injaro) focus on the agribusiness sector.

¹⁸ IFC. MSME Finance Gap 2017. <https://www.smefinanceforum.org/data-sites/msme-finance-gap> (accessed on January 24, 2019)

¹⁹ Information on the PEVC industry is based on McGuiness, Patrick. 2019. *Ghana PEVC market: Potential Role for VCTF Trust*. Unpublished report.

36. **Data shared by select investment firms confirms existence of a large SME financing gap and the need for advisory services to help bridge this gap.** Three firms providing equity and quasi-equity that were interviewed during the preparation of this report reported being able to invest in only less than 10 percent of enterprises in their pipeline, but that these ratios can go up with good advisory services. The potential flow of PEVC financing to the SME sector is estimated at around \$25 million per year, a very small proportion of the estimated SME finance gap.

37. **The problems of adverse selection and moral hazard are particularly prominent in MSME financing.** MSMEs usually cannot provide the type of collateral required by financial institutions (i.e., real estate assets) and the absence of credit risk mitigation tools (e.g., a movable collateral framework or a risk-sharing facility) and of a good contract enforcement framework reduces the appetite from financial institutions. This type of collateral-based lending is inefficient and perpetuates inequality. Moreover, even if financial institutions were more open to cash-flow based lending, MSMEs do not typically prepare standard financial reports which are required to assess their creditworthiness, given the limitation of Ghanaian credit information systems about MSMEs.

III.2. Agriculture and Manufacturing sector financing gap

38. **Demand side information on financing gaps and constraints in the agriculture-sector is limited.** Since the level of commercialization in the agricultural production is low, financing for the sector relates primarily to access to credit for households engaged in the agriculture sector and that for small and medium size agribusinesses. Demand-side information for access to credit for agricultural households typically comes from household surveys or dedicated financial inclusions surveys such as Finscope. The only Finscope survey in Ghana was undertaken in 2010 and hence the data is too old to provide useful information on access to credit for agricultural households. The more recent Financial Inclusion Insights surveys do not seem to include detailed information on access to credit and source of primary income, two factors necessary to identify level of access and adequacy of credit available to agricultural households.

39. **However, supply side information suggests that there is a significant financing gap in agricultural production.** Even after taking into account the low levels of commercialization in the sector, which means that some portion of the agricultural GDP is not bankable, it seems likely that there is substantial financing gap in the sector. The share of bank loans that goes to agricultural production is just 3.7 percent (September 2018), much smaller than the sector's contribution to Ghana's GDP (20 percent for agriculture in 2017). While aggregate data on financing provided by rural banks, microfinance institutions and other SDIs to the sector is not available, given their relatively small share in financial sector assets, their volume of financing to the sector is likely to be much lower than that of the banks. Hence, the level of formal financing for agricultural production is likely to be still much smaller than the bankable portion of the agricultural GDP and hence the likelihood of substantial financing gaps in the sector.

40. **There is partial availability of data on financing constraints in the agribusiness sector.** The Enterprise Survey 2013 identifies the food sub-segment under manufacturing but does not do this under the Services segment—which would include retail (agricultural input dealers, commodity buyers, etc.) and wholesale businesses (agricultural commodity traders) focusing on the agricultural sector. The survey data

shows that enterprises in the food sub-sector (within the manufacturing segment) are the most constrained. A much smaller proportion of enterprises in the food sub-segment reported having a loan or credit line from a bank compared to the average for all firms in the manufacturing sector (15 percent and 25 percent respectively). The proportion of enterprises in the food sub-segment that reported loan applications being rejected is nearly double that for the average for all manufacturing firms (19 percent and 11 percent respectively).

41. **In the 2013 Enterprise Survey, the proportion of manufacturing sector firms in Ghana reporting access to financing as a major constraint is substantially larger compared to the average for Sub-Saharan Africa but smaller than service sector enterprises in Ghana.** The proportions are 58 percent, 40 percent and 66 percent respectively. However, the differences in the proportions of enterprises reporting having a loan or credit line from a bank are less marked (22 percent, 23 percent, and 25 percent respectively).

42. **Supply-side data suggests that the manufacturing sectors also receives a smaller share of bank lending compared to its contribution to the GDP.** The share of bank loans that finances manufacturing was nearly 10 percent in September 2018. This is smaller than the sector's contribution to Ghana's GDP, which was 12 percent for manufacturing in 2017. As can be seen, the gap in manufacturing sector is much smaller than that in the agricultural sector.

III.3. Tenor of enterprise financing in Ghana

43. **Banks in Ghana often provide loans to firms with tenors that are shorter than what the firm's business cycle would require.** For example, in 2017, only 44 percent of loans and advances were provided for more than one year, still an improvement from previous years (Table 5). The experience of the PEVC industry in Ghana, where many successful funds have provided debt in addition to equity, also demonstrates that there is a paucity of longer tenor debt in the market. The Task Force created to establish the new DFI reported that the share of bank loans longer than five years has been increasing, reaching 23 percent in 2017 (from 4 percent in 2013). However, a substantial portion of this is likely due to restructuring of NPLs, particularly those from energy sector borrowers. Nevertheless, this is still below potential, limiting overall efficiency in allocation of resources and thereby economic growth and job creation.

Table 5. Maturity of Bank Credit in Ghana (% of total)

	2013	2014	2015	2016	2017
0-3 months	74	68	30	36	35
3-12 months			37	22	21
More than 1 year and up to 5 years	22	23	25	29	21
More than 5 years	4	9	8	13	23
TOTAL	100	100	100	100	100

Source: World Bank staff's calculations based on financial statements of 12 of the largest banks in Ghana and on Bank of Ghana's consolidated data as reported by the Ministry of Finance's Task Force to establish the new DFI.

44. **The corporate bond market provides debt financing with slightly longer maturities than bank credit, but only for large corporates, since SMEs are not able to tap into this market.** In the first eight months of 2018, there were only a few corporate bond issuances in Ghana for three- and five-year maturities. Moreover, in recent years, Ghanaian corporates have not had success in issuing bonds in international markets (as of March 2019, there was only one outstanding international bond issued by a Ghanaian financial institution that had been issued in 2014 for a 12-year maturity). However, Ghanaian corporates have had some success in accessing international syndicated loans: between 2013 and 2017, there were 22 deals for \$15.8 billion with an average maturity of just under five years.

45. **Mutual funds also tend to invest in short-term assets, reflecting the same risk aversion to long-term instruments.** In 2017, mutual funds had 62 percent of their portfolios in short-term money market instruments, still an improvement from the average 75 percent between 2014 and 2016 (Table 6). The funds management sector has been growing over the last few years—in 2018, the sector size was estimated to be about 9 percent of GDP (4 percent of GDP in 2013)—and could potentially become an important source of funding for the economy.

Table 6. Mutual funds' investments by asset class (% of total)

	2014	2015	2016	2017
Capital markets	17.6	14.2	20.4	32.4
Money markets	73.6	75.2	71.6	61.7
Other	8.8	10.6	8.0	5.9
TOTAL	100.0	100.0	100.0	100.0

Source: Ghana Securities and Exchange Commission.

46. **Predominance of short-term maturities in bank credit and institutional investments reveals banks and non-bank lenders' concerns with private sector risk and a preference to finance businesses that have frequent cash-flows and a short-term nature in order to reduce credit and interest rate risks.**²⁰

Concerns with private sector credit risk would explain why the Government has been able to secure financing with longer maturities than the private sector. Maturities of government securities go up to 15 years in local currency, with an average maturity of about 7 years, and are financed by banks, pension funds, and mutual funds. In September 2018, the average maturity of banks' holdings of government securities was 2.7 years, revealing banks' preference for longer-term investments in government securities rather than in private credit. In recent years, the Government has also successfully secured the sale of US Dollar-denominated Eurobonds in international markets with maturities between six and nine years. Moreover, prices in Ghana are prone to significant swings, making it more difficult for lenders to forecast the value of money in the future and therefore leading them to limit the offer of long-term loans.

47. **Short loan maturities also reflect limited access to long-term funding by financial institutions.** Banks' funding is mostly comprised of short-term deposits, followed by short-term borrowings. Long-term borrowings comprise only 5 percent of assets while shareholders' funds were equivalent to 13 percent of assets (October 2018). A linear regression shows that the share of long-term assets (more than one year) in bank's total assets is positively associated with the share of long-term borrowings (the association is significant at a 90 percent confidence level).²¹

48. **Because of the long-term nature of its funding, the pensions sector in Ghana could provide a substantial share of long-term finance to the economy.** The total size of the pension funds in Ghana grew from 5 percent of GDP in 2013 to about 8 percent of GDP in 2017. The sector is dominated by a defined-benefit scheme for public and private sectors managed by the Social Security and National Insurance Trust (SSNIT). SSNIT accounts for about half of total pension assets, making it the largest institutional investor in Ghana. In 2017, fixed income was estimated to represent about a third of SSNIT's investment portfolio, while equity investments were estimated to represent between a quarter and a third of the portfolio, and real estate about a fifth of the assets.²² However, investment advisors and life insurance companies continue to allocate the bulk of their assets to money market instruments and term deposits.

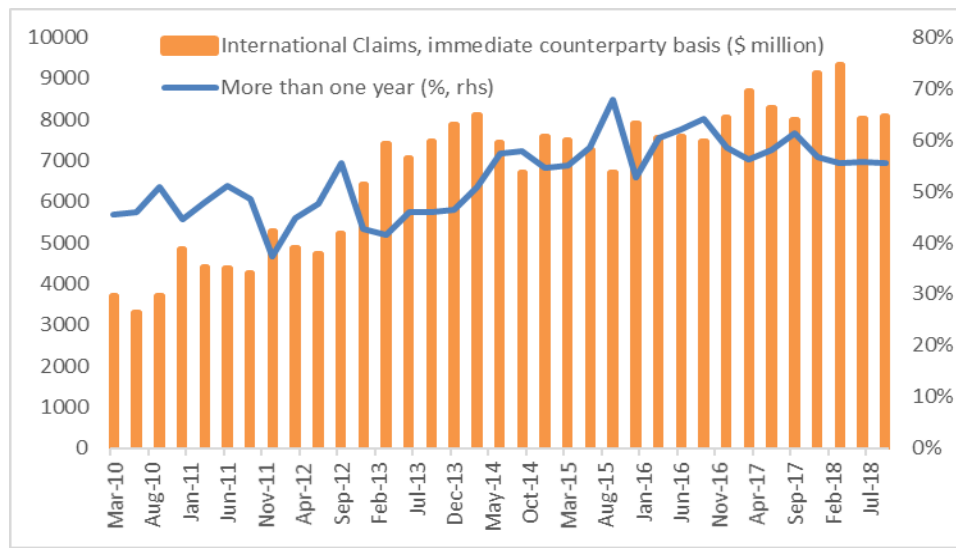
49. **Maturity of overall foreign borrowings has expanded slightly in the last few years and is longer than for domestic borrowings, although still limited.** As of September 2018, about 56 percent of international claims on Ghana counterparts had maturity longer than one year (Figure 5).

²⁰ While businesses with short-term cycles dominate the Ghanaian economy, it is not clear whether the predominance of short-term financing in the economy reflects this fact or is instead a contributing cause.

²¹ Calculations based on financial statements of 11 of the largest banks in Ghana for the years 2015 to 2017.

²² Source: World Bank staff's calculations based on SSNIT's Investment Series publication. The latest financial statements published by SSNIT on its website is for 2015.

Figure 5. International claims on Ghana



Source: Bank for International Settlements.

IV. Role of DFIs and Rationale for a new DFI

50. **This chapter discusses the role that DFIs have played in addressing financing constraints, both globally and in Ghana, and the potential roles a new DFI can play.** The existence of market failures in financial markets provides a rationale for public intervention and has led several governments to establish DFIs to provide financing for strategic sectors. However, most DFIs across the world have failed to meet their objectives. In Ghana, several governments have used DFIs as a policy tool, but their impact has also not been transformational.

IV.1. Global experience in Development Finance

Rationale for establishing development banks

51. **The role of DFIs (including development banks) in promoting access to financial services and economic development has oscillated in line with views about the role of the state in the economy.** De la Torre, Gozzi, and Schmukler (2017) identify three views – the interventionist view, *the laissez-faire* view, and the pro-market view – that have shaped the policy debate and influenced the timing of the establishment of development banks around the world.²³

52. **The interventionist view dominated policy thinking from the 1950s to late 1970s and stemmed from the view that widespread gaps in access to finance were the result of market failures that market forces alone could not address.** Thus, the state should play an active role in mobilizing and allocating resources, either directly through the ownership of DFIs or indirectly by directing private banks to allocate

²³ For a comprehensive literature see de la Torre, Augusto; Gozzi, Juan Carlos; Schmukler, Sergio L.. 2017. *Innovative Experiences in Access to Finance: Market Friendly Roles for the Visible Hand?*. Latin American Development Forum;. Washington, DC: World Bank.

credit to specific borrowers typically at below market interest rates. The main goal was to drive capital accumulation and technological adoption, particularly in strategic sectors such as agriculture and industry.²⁴ Not surprisingly, many development banks established during this period had an agricultural or industrial focus (e.g., Ghana Agricultural Development Bank [1965] and Ghana National Investment Bank [1963]).

53. **Dismal outcomes associated with direct state intervention in the economy led to the emergence of the *laissez-faire* view in the 1990s.** It called for the withdrawal of the state from direct intervention in the economy and financial markets and instead focus on the creation of the enabling environment necessary for the private sector to flourish. This led to the liberalization of the financial sector in many countries and privatization of state-owned financial institutions. It also led to credit infrastructure reforms, including the establishment of credit information systems (credit bureaus and credit registries), secured transactions reforms (e.g., broadening of acceptable collateral and creation of online registries for movable collateral), and reforms of insolvency laws. These reforms largely succeeded in restoring financial stability and increasing financial depth, but often missed expectations with regard to financial intermediation, particularly the availability of term financing for investment access and SME finance more broadly.

54. **The pro-market view is emerging as a middle-ground between the two opposing views discussed above.** Initially motivated by limited financial intermediation after years of reforms and further galvanized by the imperfection of private financial markets exposed by the global financial crisis, the pro-market view recognizes the centerstage role of markets in promoting financial intermediation and access to finance, but also the complementary role of state intervention. According to de la Torre, Gozzi, and Schmukler (2017), the pro-market view postulates that “state interventions should be designed to complement (rather than displace) market-based financial contracting and facilitate the development of financial markets through the adequate choice of instruments (for example, subsidies, loans, guarantees) and institutions (for example, private financial intermediaries, state-owned banks).”

55. **Development banks are present in both developing and developed countries, and the design of the latest set of banks aligns to the pro-market view.** While their total number is unknown, there are development banks in developed countries, such as the KfW in Germany and the Business Development Bank of Canada (BDC), and in developing countries, such as the Development Bank of Rwanda and the Agriculture Bank of Sudan. Data from the World Bank 2017 global survey of development banks show that of the 64 respondent development banks, 17 were in high-income countries while 47 were in developing countries.²⁵ The same data also shows that 16 percent of the development banks were established before 1945, 37 percent between 1945 to 1979 period, 22 percent between 1980 to 1999, and the remaining 25 percent from 2000 to 2015. The Development Bank of Nigeria, Tanzania Agricultural

²⁴ For example, sectors that could drive long-term growth, create employment, supply raw materials, or substitute imports.

²⁵ For fiscal year 2019, the World Bank considers high income countries those with a gross national income per capita higher than US\$12,055 (Atlas method).

Development Bank, Société de Financement Local²⁶ (France, 2013), and British Business Bank²⁷ (UK, 2014) were established during this last period, and their design features are closely aligned with the pro-market view.

56. **Countries have established development banks to address various market failures, including limited availability of long-term finance, as well as agricultural and SME finance.** The 2017 Global Survey shows that the mandates of the development banks in the sample include support to agriculture, SMEs, international trade, housing, infrastructure, and local governments. Eighty-seven percent of development banks target SMEs, 90 percent offer long-term loans (the top product offering), and 83 percent lend to agribusiness. Others support new product launches (64 percent) and start up activities (58 percent), demonstrating a commitment to support entrepreneurship and innovation. Beyond the provision of credit, development banks also provide guarantees, savings (by taking deposits), platforms to facilitate supply chain financing, and business development services. While profitability is necessary for their sustainability, development banks seek to maximize development impact and not profits.

57. **More recently, DFIs have also played a countercyclical role, compensating for the reduction of private sector credit during economic downturns.** Results of the 2012 Global Survey showed that, between 2007 and 2009, sampled DFIs increased their lending by an average of 36 percent, compared to 10 percent increase in private bank credit for the countries surveyed during the same period.²⁸ This was the case in all regions. Moreover, 50 percent of the development banks indicated that they increased their lending and/or credit guarantees during the global financial crisis to compensate for the reduction in lending by private sector financial institutions (World Bank 2017). Other studies confirm the countercyclical role of state-owned financial institutions (including development banks).²⁹

58. **DFIs have various sizes and different funding and lending models.** For instance, 38 percent of the development banks that responded to the 2017 survey had less than \$1 billion in total assets in 2015, 35 percent had between \$1 – \$9.9 billion, 21 percent between \$10 – \$99 billion, and 2 percent above \$100 billion. Examples of large development banks include the Brazilian BNDES (approx. \$210 billion in assets as of September 2018) and China Development Bank (\$2.4 trillion in 2017). It is worth noting that

²⁶ Société de Financement Local (SFIL) is a state-owned development bank established in 2013. It has three shareholders: French Government (75%), Caisse des Dépôts et Consignations (20%), and La Banque Postale (5%). SFIL fully owns Caisse Française de Financement Local (Caffil), a covered bond issuer through which it refinances long-term loans granted by La Banque Postale to hospitals and local governments. It also refinances large export credits insured by Bpifrance Assurance Export. SFIL is regulated and supervised by the French Prudential Supervision and Resolution Authority.

²⁷ The British Business Bank is a development bank wholly owned by HM Government that aims to make finance markets work better for small businesses in the United Kingdom at all stages of their development. None of the British Business Bank group of companies takes deposits or offers banking services.

²⁸ Luna-Martinez and Vicente (2012). Sample of 90 development banks from 61 countries.

²⁹ For instance, Bertay, Demirguc-Kunt, and Huizinga (2015) show that lending by state banks is less procyclical than lending by private banks, especially in countries with good governance, and in high-income countries is even countercyclical. They also show that state banks can play an important role in stabilizing credit throughout the business cycle and during periods of financial instability. Choi, Gutierrez, and Martinez Peria (2016) found that government-owned banks played a countercyclical role during the financial crisis in all regions, having experienced a faster increase in their loan portfolios than private institutions. Finally, Ferrari, Mare, and Skamnelos (2017) show that all state-owned financial institutions in Europe and Central Asia expanded their loan portfolios faster than did the overall banking sector after the global financial crisis. Commercial state-owned financial institutions expanded their loan portfolios faster than development banks and after 2011 seem to have turned to investment instruments such as government bonds.

the value of development banks does not come from their size, but from their ability to target certain segments and leverage private financing. Also, according to the survey, most development banks do not take deposits (67 percent), as they rely on other sources of funding such as borrowings in the domestic and international markets and own capital. In addition, development banks can operate as first-tier only (40 percent), second-tier only (10 percent), and both first-tier and second-tier (50 percent).³⁰ First-tier development banks offer credit directly to end borrowers while second-tier ones lend to other financial institutions that on-lend to end borrowers. Because second-tier development banks are mostly exposed to other financial institutions, their NPLs and other financial performance indicators tend to be better than those operating as first-tier.

Challenges associated with development banks

59. **International experiences show that on average state-owned financial institutions have performed badly.** State-owned banks are associated with lower quality of financial intermediation, misallocation of resources, lower levels of financial development, inefficiency and high NPLs.³¹ They are also associated with high fiscal risks. For example, the recapitalization of state-owned banks prior to privatization reached more than 10 percent of GDP in Albania, Czech Republic, and Turkey between 1991 and 2002 (Sherif, 2004). Poor performance of DFIs is particularly related to the lack of a clear mandate and to weak governance structures which allow political intervention (Rudolph, 2009). As a result, DFIs are unable to balance financial sustainability with the delivery of their development mandate, often drifting away from their policy mandates, competing with the private sector, and distorting the credit culture by failing to enforce loan agreements. Inter-American Development Bank (2011) also summarizes the shortcomings of public development banks.

60. **Various factors have contributed to the poor track record of DFIs.** Among them are: (i) multiple and competing mandates, goals and objectives; (ii) poor corporate governance, particularly weak and poorly organized government owners, politicized boards and management, and low levels of transparency and deficient monitoring and evaluation practices; and (iii) inadequate supervision and prudential guidelines. To function effectively, DFIs also need a stable macroeconomic environment that supports private sector activity.

Multiple and competing mandates and goals

61. **DFIs exist to pursue social goals, which are often multiple and competing.** This complicates the task of defining their mandate in terms of a specific target sector or market segment. In addition, most DFIs also have a basic goal of financial self-sufficiency and sustainability, which may conflict with other goals such as providing subsidized financing to farmers. The absence of clear goals or a mechanism to balance multiple goals makes it difficult to assess managerial performance, reduces incentives to maximize efficiency, and leads to potential capture of the DFI and its resources by elite clients or management. Governments may also exploit broadly defined mandates to justify meddling in DFIs' affairs for political gain. Moreover, broadly defined mandates give the DFI the latitude to overreach, directly competing with (and not complementing) the private sector.

³⁰ The 2012 Global Survey showed the following distribution: first-tier only (36 percent), second-tier only (12 percent), and both first-tier and second-tier (52 percent)³⁰.

³¹ See Bertay, Demirgüç-Kunt, and Huizinga (2015) for complete literature review.

62. **World Bank (2017) indicates that development banks have been established with a wide range of policy or developmental mandates.** Surveyed development banks were divided into two groups: (i) institutions with a narrow and specific mandate which explicitly refers to target sector(s), customers or activities, and (ii) institutions with broad mandates that are formulated in general terms without reference to a particular sector or activity. Examples of a broader mandate is "...to promote the country's economic development" or "to promote the development of key growth sectors." Fifty-one percent of the surveyed development banks have a broad mandate. The remaining forty-nine percent have narrow policy mandates,³² including institutions that were specifically established to support SMEs (15 percent), infrastructure projects (13 percent), agriculture (10 percent), export and import activities (8 percent), local governments (5 percent), and housing (2 percent).

63. **There are advantages of adopting narrow, but flexible, development mandates.**³³ An institution with a narrow mandate can focus its business activities on specific market gaps and specialize in its target market. Monitoring and assessing the performance and success of this type of institution is feasible because market gaps can be measured and tracked over time. Some DFIs, such as the *Fideicomiso Instituidos en Relación con la Agricultura* (FIRA) of Mexico, quantify the financing gaps in the markets in which they operate and are able to track their progress over time. The data that FIRA collects and analyses can show the percentage of SMEs, farmers, and other types of borrowers that are unable to obtain financing per year and to what extent the FIRA is helping fill that gap. However, the mandate should also be flexible to allow the DFI to adjust to changing market circumstances. Periodic reviews of the mandate offer an opportunity for the identification of changes requiring adjustment in the DFI mandate or focus.

64. **Financial sustainability is often ignored in the discussion about mandates.** In the long-term, mandates can only be effectively delivered by DFIs that are financially sustainable. Otherwise, DFIs will fail to replenish or build their capital and therefore the government will frequently be required to step in to make new capital injections or to subsidize the bank, with resulting high fiscal risk for the government, reduced autonomy and independence for the DFI, and increased political interference (through the budget process). The 2017 survey showed that thirty-two percent of development banks surveyed indicated that they had been recapitalized over the past four years using government funds, subsidies, or transfers to cover losses or support balance sheet expansion. To avoid this, some development banks are required to earn a minimum medium-term rate of return (e.g., not lower than government's long-term borrowing cost for BDC).

Poor corporate governance

65. **The literature generally argues that poor corporate governance is the root cause of DFIs' poor performance.**³⁴ Many of the problems that commonly afflict DFIs, such as weak performance, financial

³²Examples include the Credit Guarantee Corporation of Malaysia, Hungarian Export-Import Bank, and Banobras of Mexico (which specializes in large infrastructure projects).

³³ Broadly defined, too narrow mandates (e.g., support to agriculture) can limit the ability of the DFI to maximize impact (e.g., through support to value chains) and to diversify risks.

³⁴ Corporate governance refers to the structures and processes for the direction and control of companies. It specifies the distribution of rights and responsibilities among the company's stakeholders (including shareholders, directors, and managers) and articulates the rules and procedures for making decisions on corporate affairs. Corporate governance therefore provides the structure for defining, implementing, and monitoring a company's goals and objectives and for ensuring accountability to appropriate stakeholders. See World Bank. 2014. *Corporate Governance of State-Owned Enterprises: A Toolkit*. Washington DC.

problems, diffuse mandates, unfair competition with the private sector, and capture by interest groups, are linked with weaknesses in corporate governance.

66. **Good practice in corporate governance is set by a variety of international standards, depending on the type of institution.** This includes the Organization for Economic Cooperation and Development (OECD) Principles of Corporate Governance (2004), the OECD Guidelines on Corporate Governance of State-owned Enterprises (2005), and the Basel Committee on Banking Supervision's Guidelines for Corporate Governance of Banks (2015). The World Bank's State Owned Enterprise Governance Toolkit describes many of these reforms in detail (footnote 34). The IFC's Corporate Governance Development Framework is also relevant, as it provides an approach to evaluate and improve the corporate governance of an organization.³⁵

67. **Compared with purely commercially-oriented financial institutions, DFIs face distinct governance problems that directly affect their performance.** The challenge of goal setting in private sector financial institutions is relatively straightforward: the principal goal of owners is to achieve the best financial performance while managing an acceptable level of risk. But DFIs face distinct governance challenges, including weak and poorly organized government owners, politicized boards and management, and low levels of transparency.

Weak and poorly organized government owners

68. **Most governments around the world do not do a good job of executing their responsibilities as owners of DFIs.** Strong, commercially-minded government owners impose accountability on DFI management, while minimizing political interference in their operations.

69. **For most DFIs, ownership rights are exercised by the Ministry of Finance.** However, there are decentralized ownership models where line ministries are responsible both for defining sector policy and providing the product or service (through their ownership of an SOE). Such arrangements not only involve an inherent conflict, but also lead to inefficiency: activities are not subject to competition; bureaucrats exercise direct control over strategic and operational decision making, giving priority to the state's policy goals at the cost of efficiency; and in many cases create unlevel playing fields or unequal competition. The decentralized model also creates heightened risks for the use of assets for political purposes.

70. **Ministries often lack sufficient capacity to effectively exercise ownership rights, particularly staff with the required commercial and financial experience.** The existence of multiple state-owned entities also leads to the dispersion of scarce skills and capacity to exercise ownership rights effectively. Qualified staff are often busy with many different tasks, and lack focus on exercising the "ownership" role.

71. **Good practice shows a trend towards a centralized approach that concentrates SOE ownership authority in a single ownership entity rather than dispersed to several different line ministries.** Experiences from several countries show that reforming the state's ownership arrangements can improve SOE accountability while giving SOE boards and management greater autonomy in operational decision making. Ownership reforms aim to clarify the state's role as owner, reduce fragmentation of ownership responsibilities across multiple institutions, reduce political and administrative interference in commercial

³⁵ International Finance Corporation. DFI Toolkit on Corporate Governance. https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/cg+development+framework/dfi+toolkit+on+corporate+governance (accessed on March 26, 2019)

decision making, and enhance accountability for results. A key aspect is separating the state's ownership functions from its policy-making and regulatory functions to enhance the focus on ownership issues and minimize conflicts of interest that may arise when the roles are combined. The objectives of such a model are to: separate the state's ownership function from its policy-making and regulatory functions to reduce conflicts of interest; minimize the scope for interference and bring greater professionalism to the state's ownership role; and promote greater coherence and consistency in exercising the state's ownership role.

72. An alternative approach is to maintain the decentralized approach while building capacity in the Ministry of Finance as an owner. Since centralized ownership units are still rare around the world, most reform efforts aim to build capacity within the line Ministries, including Ministries of Finance. This includes assigning responsibility for the ownership function within the Ministry, developing ownership policies, and building staff capacity. The 2017 survey showed that in 54 percent of respondents, it is the Ministry of Finance or the Treasury that represents the national government as a shareholder of the development bank, while in 15 percent of the respondents it is the Ministry of Finance along with other relevant ministries (e.g., economy, foreign affairs).

Politicized boards and management

73. DFIs often lack professional boards of directors with adequate competencies to play a modern corporate governance role. For most organizations, the board of directors is the primary entity responsible for the organization's governance, setting strategy and overseeing management. However, boards of many DFIs often act as a "parliament" representing different stakeholders—including elected officials, civil servants, and employee representatives—all of whom may have agendas that conflict with the interest of the company. Conversely, boards may act purely as a "rubber stamp," exercising no oversight of managers, who in practice report directly to the government. Moreover, board members are often appointed for political reasons rather than based on technical and financial expertise. Independent directors are usually underrepresented on the board, and where they do serve on boards their independence is often called into question. Decision making is influenced by the government. Board functions often fall short of the classic functions of a board, such as key decision making, appointing management, overseeing strategy, overseeing internal audit and controls, and monitoring top executives.

74. Data from the 2017 Survey of Development Banks indicates that many boards are structurally weak and are not able to effectively play their oversight role. Among the surveyed development banks, the average board consists of nine members. Boards usually have a mix of government representatives from various ministries and other government entities, as well as independent members. Forty-nine percent of surveyed development banks indicated that most of their board members were "independent," 43 percent reported that independent board members were a minority, and the remaining eight percent did not have any independent board members.

75. Having a significant number of government representatives to boards is not considered good practice, as it weakens board autonomy, accountability, and access to relevant banking and industry skills. Where it is common practice, there is a consensus that their numbers should be limited, they should meet the necessary qualifications, and they should have the same obligations and roles as any other board member.

76. In most countries responding to the 2017 survey, the board does not appoint the chief executive officer (CEO). Fifty-four percent of the banks indicated that the relevant minister or the president of the

country appoints their director general or CEO. This weakens the accountability of the CEO to the board and reduces its effectiveness. In the rest, the board of directors appoints the CEO.

Low levels of transparency and deficient monitoring and evaluation practices

77. **Although “publicly owned,” many DFIs are not particularly transparent.** Experience shows that many DFIs have weak internal controls and processes, with inadequate accounting and auditing practices, low levels of transparency and disclosure, and with no requirements for publicly reporting their accounts and other information. Lack of transparency and disclosure undermines performance monitoring, limits accountability at all levels, and creates conditions under which corruption can flourish.

78. **Still, many development banks have formal elements of transparency, including the requirement to undergo external auditing.** According to the 2017 Survey, 93 percent of surveyed development banks indicated that they publish an annual report and make it available to the public on their website. However, for some non-listed DFIs, the publication of the reports can lag for more than a year. In addition, 96 percent of surveyed development banks are required to undergo audits by a professional external auditor.

79. **However, it remains difficult to understand DFIs’ performance and whether they are achieving their mandate.** The key issue is establishing a performance monitoring system in which strategy and goals can be accurately measured by performance indicators. Many key details are now difficult to obtain from public sources—only 80 percent of institutions disclose off-balance-sheet information, 85 percent disclose their governance and risk management framework, and 79 percent disclose their regulatory capital and capital adequacy ratio. However, few report on additionality and impact: only 49 percent of DFIs reported that they conduct economic impact evaluations of their products and services, and 37 percent indicated that they use third parties to conduct such evaluations on their behalf. In addition, only 49 percent of DFIs monitor the increase in productivity of their clients and only 40 percent consistently monitor the survival rate of SMEs and clients they serve.

Inadequate regulation and prudential supervision

80. **Prudential supervision is an important check on the activities of financial institutions, aiming to ensure the safety and soundness of the financial sector, and overall financial stability.** Governments regulate financial institutions through regulatory requirements (e.g. capital, liquidity, or governance requirements) and actively supervise institutions to ensure that regulatory requirements are met (through licensing procedures and on-site and off-site supervision).

81. **Many DFIs do not fall under the prudential supervision of a financial sector supervisor.** Instead, prudential supervision is sometimes provided by the ministry providing the strategic direction. This raises multiple problems. First, the ministry or agency exercising the supervisory function usually does not have the same expertise to monitor and assess the risks associated with the business of the DFI under their umbrella as a bank supervisory agency. Second, due to inherent conflicts of interest, the supervising institution can delay prompt corrective action or even the simple recognition and disclosure of problems. In some cases, though rare, the central bank also exercises ownership rights thereby creating a similar conflict of interest as that of ministries.

82. **The 2017 Survey indicated that 22 percent of respondent institutions are not required to comply with the same standards of prudential supervision (e.g., minimum capital, minimum capital adequacy requirements, loan classification and provisioning) as private financial institutions.** These DFIs are subjected to other standards, usually more lenient than the standards applicable to private banks. In many cases, when such standards do apply to state financial institutions, they may not be as rigorously enforced.

Limitations of DFIs

83. **Finally, development banks are not a panacea – the causes of market failures in the financial sector are complex and often require other policy interventions.** Lack of finance for agriculture and SMEs is a result of many factors beyond the control of development banks. As discussed in Chapter III, lending to agriculture in Ghana is constrained by the high probability of crop failure due to lack of agricultural infrastructure; internal constraints faced by SMEs, including limited scale and poor managerial skills and business models; and difficulties faced by borrowers in establishing their track record in the absence of credit information infrastructure. Moreover, the overall business environment in Ghana is still challenging as demonstrated by Ghana's position in the Doing Business ranking. The physical infrastructure is deficient, contract and collateral enforcement is poor, and the quality of accounting information is substandard. A DFI cannot solve all these problems; on the contrary, these problems could affect the DFI's performance.

84. **The establishment of development banks should be accompanied by the deepening of financial sector reforms.** Competitive, diversified, and sound private sector-led financial systems are better positioned to sustainably increase access to finance. In this context, the establishment of DFIs should not be a reason not to continue improving credit infrastructure, enhancing contract enforcement, and developing capital markets to become an alternative source of long-term funding for firms.

IV.2. Development Finance in Ghana – past and present

85. **Since independence, Ghana has established DFIs to increase financing for key sectors of the economy such as SMEs, exports, industry, and agriculture.** Overall, these DFIs have suffered over time from a lack of financial sustainability and have relied on budget allocations and donors to survive. This section discusses the experience with some of the most emblematic DFIs that have operated or are operating in Ghana.³⁶

The National Investment Bank

86. **The National Investment Bank (NIB) was the first Ghanaian DFI, established in 1963 by an Act of Parliament to handle rising public investments in industry.** In 1975, and after several years of limited performance and weaknesses in investment appraisal, supervision, and loan recovery, the NIB was transformed into a commercial bank.³⁷ The government and NIB expected that the commercial bank

³⁶ More information on the context and history of development finance in Ghana can be found in World Bank Group. 2016. *Ghana's Development Finance Institutions: Review of Current Status and Principles for Reform*.

³⁷ As of December 31, 1974, eighty percent of NIB's loan portfolio was in arrears of more than three months. Transformation into a commercial bank proceeded in steps and initially NIB was only allowed to open deposit

license would allow NIB to secure more stable financing in the form of deposits (rather than through state subsidies), but also to mitigate credit risk by ensuring that the bank could control borrowers' cash that would flow through transaction accounts with the bank.

87. **NIB is currently a small lender in Ghana (estimated market share is less than 3 percent) that is focused on the manufacturing, building and construction, and agro-processing sectors.** About 70 percent of its loan portfolio is allocated to the private sector. Retail and SME credit represent less than 20 percent of the loan portfolio. NIB has more than 50 branches across the country and uses a retail lending model.

88. **NIB's official mandate is still to serve as a DFI but, as a regulated commercial bank, it needs to prioritize commercial banking activities to ensure financial sustainability and safeguarding of deposits.** This dual mandate reduces clarity and limits proper oversight. NIB loan portfolio quality has suffered in recent years from high exposure to government-financed construction projects. As of March 2019, NIB had yet to receive additional capital to meet the BOG's new capital requirements.

The Agricultural Development Bank

89. **The Agricultural Development Bank (ADB) was established in 1965 by an Act of Parliament as a fully government-owned institution to provide credit to agriculture.** ADB was created through the transformation of NIB's agricultural department into a separate entity. Since its creation, ADB has also gone through several rounds of restructuring, particularly in 1988 when it required a substantial capital injection from the government.

90. **The agricultural share in ADB loan portfolio fell after it became a universal bank in 2004 and stood at about 30 percent in mid-2018.** ADB share of the Ghanaian credit market is small and estimated at not more than 4 percent. It operates through a network of almost 80 branches across the country, using a retail lending model.

91. **ADB has also suffered from the lack of clarity created by a dual mandate.** The bank has been affected by high NPLs and credit has been declining as the bank tries to meet capital adequacy requirements. After an attempt in 2016 to divest government entities' shares through an initial public offering in the stock exchange, the government reassumed control in 2018 following BOG's decision to annul the acquisition of shares by some private investors that did not pass BOG's fit and proper standards. As of March 2019, ADB had also not been able to receive the additional capital needed to meet the BOG's new capital requirements.

The Export Finance Company (EFC) and the Eximguaranty Company

92. **Following a period of financial liberalization in the 1980s, government efforts to channel more finance to priority sectors shifted towards establishment of new institutions to support export-oriented activities.** These included the Export Finance Company (EFC) in 1989 and the Eximguaranty Company (EGC) in 1994.

accounts for its borrowers. NIB implemented a restructuring program that paved the way for a series of World Bank loans, the first of which was approved in 1975.

93. **The EFC was a special purpose vehicle that provided financial and other support to non-traditional export sectors in Ghana.** EFC's financial products included working capital, pre- and post-shipment credit, and project finance. Initially, EFC secured funds through BOG-funded export bills. But the mismatch between short-term borrowing and long-term lending and problems with repayment from borrowers led to financial difficulties and BOG stopped providing funds. In 2016, EFC was eventually absorbed by the new Export Import (EXIM) Bank after several years without the capacity to raise new funds or to adequately cover costs.

94. **The EGC was established to provide credit guarantees and financial risk management solutions to SMEs, both exporters and importers.** EGC provided financial institutions with coverage of up to 75 percent of their credit, mostly through individual guarantees. The amount per guarantee was capped to ensure that it reached smaller firms. It conducted its own due diligence of SMEs although the main client relationship remained with the partner financial institution that provided the credit to the SME. Pricing was based on the product type and total fees ranged between 1 and 4.5 percent of the guarantee amount. Overall, the risk sharing provided by EGC was in demand by financial institutions although its outreach was limited. In the years before the absorption by the EXIM Bank (in 2016), EGC often reached a portfolio of 150 guarantees with an average duration of one year. But due to its small size, high operational costs, and substantial payments arising from its high-risk portfolio, EGC financial sustainability was weak, limiting its outreach. As of end 2018, the legacy EGC fund had a capital of GHS 8 million and a portfolio of GHS 16 million in guarantees.

The Export Development & Agriculture Investment Fund (EDAIF)

95. **EDAIF (originally EDIF) was established in 2000 by an Act of Parliament to provide financial support to export-oriented activities.** In 2011, EDAIF's mandate was expanded to support the development and promotion of agro-processing and related agricultural activities, and in 2013 to industrial development. EDAIF was financed by public funds, including 10 percent of the net proceeds obtained from divestitures carried out by the Divestiture Implementation Committee and 0.5 percent of a levy on the dutiable value of non-petroleum imports. EDAIF was often an instrument to implement President's Special Initiatives as well as to finance overall infrastructure for export promotion.

96. **EDAIF provided both credit on concessionary terms and grant financing.** Its lending model required applicants (firms) to secure funding from designated financial institutions, which typically requested collateral as they incurred the full credit risk. However, EDAIF rules still required firms to apply directly to EDAIF, and therefore each operation required approval by EDAIF's Management or Board (depending on the loan amount). Grants were used for capacity-building, research, infrastructure, common use facilities, and agri-business-oriented activities.

97. **For its credit operations, EDAIF determined an interest rate cap of 12.5 percent on loans provided with its funding, well below market rates.** The substantially below-market rates meant that the loans were potentially prone to rent-seeking and possibly one reason for the long delays in vetting applications. Participating financial institutions paid only 2.5 percent for accessing EDAIF funds, thus ensuring a margin of 10 percentage points. This margin seems to have been interesting enough for many banks that participated in the scheme (EDAIF worked with more than 20 different designated financial

institutions), although it is possible that banks used EDAIF funds to finance their best clients (who would have received loans anyway) given that margins in the SME credit market tend to be higher. NIB was the leading partner financial institution, with an estimated 25 percent of the number of projects under the export credit facility, while Ecobank was the leading partner in terms of the overall value of financing.

98. **In 2016, EDAIF was also absorbed by the new EXIM Bank with a portfolio of about GHS300 million (or about \$60 million) in wholesale lending to several banks.** From inception until its absorption by EXIM Bank, EDAIF is estimated to have supported through its export credit facility close to 400 beneficiaries, about half of which in agriculture and just over a quarter in manufacturing. NPLs were high, particularly in the portfolio of state-owned financial institutions (e.g., NIB and ADB), but since participating financial institutions were bearing the credit risk, EDAIF tended to get repaid, albeit sometimes with significant delays.

The Export Import (EXIM) Bank

99. **Overlapping mandates and weak performance led the government to consolidate EDAIF, EFC, and EGC into the new EXIM Bank, approved by an Act of Parliament in 2016, to improve Ghana's export competitiveness, foreign exchange earnings, and balance of trade.** The EXIM Bank has a statutory capital of only GHS 50 million (about \$10 million) but is entitled to 0.7 percent of the annual revenues from a levy on the dutiable value of non-petroleum imports (estimated at about \$50 million per year). Its Board is dominated by government appointees. The EXIM Bank is not supervised by the BoG.

100. **EXIM Bank has also adopted a retail lending model, with offices in a few regions, and until end of 2018 had disbursed loans of more than GHS 700 million (about \$140 million).** EXIM Bank provides loans of up to seven years. Its integration of EGC's credit guarantee portfolio had not yet been finalized but EXIM Bank expects to continue offering this product. Its strategy and operations are significantly influenced by the government 10-points agenda and other Presidential initiatives such as the One-District-One-Factory initiative and the Planting for Food and Jobs Programs, and currently focus on 10 product value chains that are expected to be internationally competitive and have potential for export or import substitution. EXIM Bank also acts as the de-facto export credit agency (ECA) for Ghana, although it is not yet recognized internationally as the official ECA in Ghana.

101. **Having been established with a structure similar to previous DFIs, and without restructuring of the several schemes that it absorbed, the EXIM Bank is unlikely to address past challenges that reduced the impact of previous Ghanaian DFIs.** The institution seems to have a higher-risk tolerance than other DFIs that operate as commercial banks. The new loan portfolio already has a share of NPLs of about 10 percent, despite being relatively new.

Ghana Incentive-based Risk Sharing System for Agriculture Lending (GIRSAL)

102. **GIRSAL is a risk-sharing scheme initially proposed by the BOG that aims to double the share of bank lending to agriculture.** GIRSAL was established as a non-bank financial institution in 2018 that will be supervised by BOG. An interim board has been selected to help operationalize the institution.

103. **GIRSAL is expected to provide partial credit-guarantees to participating financial institutions to finance agriculture and agro-processing activities.** The Ministry of Finance is expected to provide an initial capital of GHS 400 million (about \$80 million), which by itself (without leverage) would already cover about 25 percent of the estimated bank credit market for agriculture. GIRSAL is partnering with the African Development Bank, which will provide financing for the scheme’s capital as well as technical assistance to de-risk farmers. GIRSAL aims also to improve the enabling environment for agri-insurance.

Lessons Learned

104. **Many DFIs in Ghana started out as non-deposit taking DFIs but have been converted to universal banks to help them secure funding through deposits.** The state-owned universal banks purport to have relatively sophisticated governance frameworks as they are required to follow the BoG’s Guidelines on Corporate Governance for the banking sector (which cover the elements of international good corporate governance practice for banks, including fiduciary duties of directors, board responsibilities, board composition and independence, establishment of board committees, the risk management function, and requirements for board training). They are also covered by the BoG’s prudential regulation and oversight.

105. **However, DFIs in Ghana have traditionally been subject to significant political intervention and interference.** Interviews and past research suggest that the government has often formally and informally directed existing DFIs on to whom to lend, on what terms to lend, and when to forgive indebtedness. Loans of some institutions are not treated as “loans” that are required to be paid back. Interviews suggest that these pressures continue.

106. **DFIs in Ghana seem to suffer from many of the same ownership problems as DFIs in other countries.** A recent World Bank report highlighted problems with current corporate governance practices, including:³⁸

- The ownership model is decentralized and revolves around the line Ministry, leading to potential conflicts in policy-making and ownership roles. In the case of the banking sector, BoG-controlled Financial Investment Trust (FIT) owns shares in some banks.³⁹ FIT was designed as a separate legal entity from the BoG to avoid conflicts of interest but how BoG maintains that separation is unclear to the market.
- The ownership role is fragmented. The line Ministry is the key player, votes the shares, and nominates some directors. The Presidency is directly involved in appointing members of the Board and the Managing Director (CEO).
- Line ministries tend to be involved in operational matters that (under good practice) should be left to the Board and management.
- Policy towards DFIs is somewhat unclear. The role of the Ministry is not specifically identified in any policy document and there is no clear delineation of the responsibilities of either the Minister or the Ministry.
- Political interference, including wholesale replacement of boards after changes in government and poor financial performance (high NPLs in case of DFIs).

³⁸ World Bank Group. 2017. *Enhancing the Corporate Governance of SOEs in Ghana*. Unpublished.

³⁹ FIT was created to own shares that the BoG acquired in past recapitalizations of banks and in part is also a legacy of past DFI restructuring.

107. **Contrary to good practice, the government's ownership objectives and core ownership rights do not seem defined in any law or policy documents.** In the absence of a clear delineation of the objectives and ownership rights, there are multiple and competing objectives as well as confusion and obfuscation of the respective roles of the state as shareholder, the board of director, and management. As a result, problems arise in the way in which the state exercises its ownership rights in the DFIs.

108. **The government plans to create a new "single entity" to oversee SOEs.** A new law has been recently published in the official gazette that will establish a new framework for the ownership of SOEs, in line with international good practice.

IV.3. Is there a role for a new DFI in Ghana?

109. **The establishment of a new development bank will not per se eliminate existing financing gaps in the Ghanaian economy and so Ghana should continue deepening financial sector reforms and developing a competitive, diversified, and sound private sector-led financial system.** In this context, the Government should continue improving credit infrastructure, enhancing contract enforcement, and developing capital markets to become an alternative source of long-term funding for firms.

110. **Ghana also needs more reforms to increase competitiveness of firms.** This includes measures to improve technical and management skills, provide incentives for innovation and adoption of new technologies, and facilitate improved access to markets, among others.

111. **Moreover, financial development requires macroeconomy stability, without which any DFI will struggle to operate.** The government should continue to introduce measures to reduce macroeconomic imbalances, such as fiscal discipline and improved international competitiveness of Ghanaian industries. Financial sector players, including DFIs, will face significant obstacles in their operations if reforms are not implemented.

112. **But considering the current failures of some credit markets and that macroeconomic and other reforms require time, a new DFI could play a role in addressing some of these failures in the credit markets for key segments such as SMEs that have potential to accelerate Ghana's structural transformation.** For this, a DFI would need to play a catalytic role in providing term funding and risk-sharing arrangements that would encourage private financial institutions to explore these segments and finance activities that would otherwise remain unfunded or underfunded. By providing term funding to other financial institutions, the DFI would reduce the maturity mismatches identified above as one of the constraints to term financing. Similarly, risk sharing arrangement would mitigate financial institutions risk, likely increasing their appetite to move to risky segments such as agribusinesses and SMEs. This may also need to be complemented by technical assistance to financial institutions that are willing to partner with the DFI to build up their operational systems and staff skills.

113. **Existing DFIs in Ghana do not have the corporate governance arrangements, the business model, or the expertise required to play this catalytic role.** State-owned commercial banks that rely on deposits for funding of activities are required by regulation to prioritize financial sustainability to safeguard deposits. On the other hand, the non-deposit taking DFIs in Ghana (e.g., EXIM Bank) operate

with a first-tier lending model and are therefore subject to higher risk of political interference. Moreover, they have a legal structure that foresees the Government as the single shareholder and makes it unlikely to allow strategic shareholders that could provide knowledge and appropriate checks and balances. It is also unclear that these strategic partners would be interested in buying equity in existing DFIs in Ghana.

114. **In 2017–2018, the Government considered merging and transforming ADB and NIB into a new DFI.** However, this option was not preferred for various reasons: (i) the Government does not fully own ADB and would have to buyout the other shareholders; (ii) dealing with labor issues and legacy systems and business models (including unnecessary staff, branches, and deposit-taking business) would be expensive and delay full functioning of the new DFI; (iii) considerable due diligence, negotiations, and decisive and strong managerial processes would be required to achieve a successful transformation of the two entities; and (iv) it would be difficult to change the legacy of both institutions, including their corporate governance culture.

115. **A greenfield option offers the opportunity to design a fundamentally different type of DFI, one that complements the private sector and is designed in line with international best practice (Table 7).** A greenfield option also has the potential to attract private and foreign capital, so that the new DFI could start at scale and become impactful in a reasonably short time.

Table 7. Good Practices for New Development Bank

Challenges faced by existing DFIs	Good practices for new development bank
<p>Weak corporate governance may allow political interference</p> <ul style="list-style-type: none"> - Weak and poorly organized government owners - Politicized boards and management - Low levels of transparency - Deficient monitoring and evaluation 	<ul style="list-style-type: none"> - International standards (OECD Principles of Corporate Governance, OECD Guidelines on Corporate Governance of State-owned Enterprises, Basel Committee on Banking Supervision’s Guidelines for Corporate Governance of Banks, World Bank State Owned Enterprise Governance Toolkit) - Separate the state’s ownership function from its policy-making and regulatory functions - Appoint board members based on qualifications rather than solely on shareholder representation - Board should select the CEO among a pool of candidates identified by professional search experts - Timely publication of audited financial statements and external auditor’s opinion
<p>Multiple and competing mandates, goals and objectives</p> <ul style="list-style-type: none"> - Absence of clear goals or mechanism to balance multiple goals makes it difficult to assess managerial performance, reduces incentives to maximize efficiency, and leads to potential capture by management - Governments may exploit broadly defined mandates to justify meddling in DFIs’ affairs for political gain - Broadly defined mandates give the DFI the latitude to overreach, directly competing with the private sector 	<ul style="list-style-type: none"> - Adopt specific, but flexible, development mandates - Financial sustainability should be a primary focus - Conduct periodic reviews of the mandate to ensure its continued relevance <p>Examples:</p> <ul style="list-style-type: none"> - Credit Guarantee Corporation of Malaysia - FIRA (Mexico) - Business Development Bank of Canada
<p>Inadequate supervision and prudential guidelines</p>	<ul style="list-style-type: none"> - Subject new development bank to specialized and independent supervision by Bank of Ghana - Define a specific regulatory framework for development finance operations

<ul style="list-style-type: none"> - DFIs supervised by a non-specialized ministry or agency (which also provides the strategic direction) rather than by a financial sector supervisor - Potential conflicts of interest if supervising institution delays prompt corrective action or disclosure of problems 	<p>Examples:</p> <ul style="list-style-type: none"> - Bank Negara Malaysia - Central Bank of Nigeria
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116. **While a new DFI in Ghana offers an opportunity to reduce the financing constraints faced by businesses, it also entails limitations and risks.** Global experience shows that DFIs with weak governance and multiple and competing mandates are easy targets of political interference which compromise their sustainability and impose high costs on taxpayers. This has indeed been the case in Ghana in the past, where several DFIs have suffered over time from a lack of financial sustainability and have either relied on budget allocations and donors to survive or drifted into a more profit-oriented objective that partly limits their development mandate. The next chapter discusses some key aspects relating to the DFI's design and business model that requires the Government's close consideration to ensure that the new DFI does not suffer from the weaknesses of the existing ones and can play an impactful role in addressing the financing gaps to the targeted sectors and client segments.

V. Establishing the Development Bank of Ghana

117. **This chapter describes key design elements required for establishing a new development bank in Ghana in a sound manner.** While many of these key elements are applied universally, some proposed features specifically consider the historical and institutional context and political economy of Ghana. The new Development Bank of Ghana (DBG) has the potential to become a key institution that can help accelerate Ghana's structural transformation. However, to do so the DBG needs to be well designed to avoid the problems that have affected previous DFIs in Ghana and builds on the lessons learned from the global and national experience with DFIs.

118. **This chapter also discusses key financial instruments that the DBG can use to incentivize private financial institutions to expand their lending to underserved segments.** These products include local currency financing with longer tenors, a universal partial credit guarantee (PCG) scheme, and a digital platform for supply chain financing to SMEs.

V.1. Key design elements

Ownership

119. **The government should retain controlling interest in the new DBG but should consider a possible participation of strategic shareholders (particularly international DFIs and development agencies).** Public control of development banks ensures focus on development objectives. As the 2017 World Bank global survey of development banks shows, most development banks (85 percent) are fully owned by their domestic governments. The remaining 15 percent are partially owned by foreign governments, international development agencies, or private sector. This partial ownership would enhance corporate governance and facilitate technology transfer, ultimately bringing value to the DBG. This is particularly the case if these shareholders are selected strategically and share the same goals as the government.

Legal Form

120. **The development bank should consider establishing the proposed DFI as a limited liability company under the banking and corporate legislation.** Although most development banks in the world have been established under a special law or decree, the Government should consider establishing the proposed DFI as a limited liability company licensed by BoG. This would also have the advantage to allow partial ownership by strategic shareholders and strengthen its ability to be shielded from political interference. This would also incentivize the BoG to develop a regulatory framework appropriate for a development bank that currently does not exist in Ghana. Moreover, it would force the DBG to comply with transparency and disclosure requirements prescribed by the Companies Act.

Prudential Regulation and Supervision

121. **Being licensed and supervised by BoG will require DBG to be subject to similar prudential standards applying to commercial banks.** This would improve efficiency and sustainability by ensuring that the DBG adheres to good practices on loan underwriting, classification, and provisioning; risk management; anti-money laundering; management of related party exposures; among others. The management of the DBG can invoke the need to comply with prudential requirements as a reason not to engage in politically-driven lending activities. Supervision oversight would also increase investor confidence and therefore allow the DBG to access funding at a lower cost.

Corporate Governance

122. **The success of the DBG requires a strong commitment to sound corporate governance arrangements and rules.** The DBG should serve the public interest defined in its mandate and operate independently from political motivations and specific interest groups. Otherwise, recent history in Ghana suggests that the country and its taxpayers might be better off without a new development bank.

123. **The Articles of Association establishing the DBG should provide the foundation for good governance by stipulating key provisions that would ensure a high degree of independence, including the ability to resist undue political interference.** It should prescribe a governance structure, including the roles and responsibilities of the shareholders, board of directors, management, regulators, auditors, and others. These elements would act as the statutory protection against political intervention.

124. **Clearly identifying a representative of the Government as shareholder would reduce the likelihood of political interference in DBG operations.** The Minister of Finance should act as the representative on behalf of the Government and could delegate his/her ownership responsibilities and rights to a specific department or entity. The government shareholder representative should provide policy guidance to the DBG, ensure that it operates according to its mandate, conduct periodic reviews of the DBG's policy mandate, appoint or ensure the appointment of the bank's statutory boards, monitor performance, and ensure coordination between state-owned DFIs. The government shareholder representative should be direct or indirectly accountable to the parliament which is the ultimate representative of the taxpayers.

125. **The Board of Directors should act in the best interest of the DBG and its owners and be composed by a majority of independent, non-executive, and professional directors.** The directors should be selected through open competition based on the value they bring to the board as demonstrated by their skills and experience in the DBG's key business processes. Board members (and senior managers) should be subject to fit and proper tests by the BoG. Appointment of senior government officials and staff of the government representative shareholder should be avoided because those appointees are often viewed as direct representatives of the shareholder in the board. Boards are accountable to the shareholders for achieving corporate objectives, and this accountability breaks down if the same people who should hold the board accountable are part of that same board. Moreover, government officials often lack the required skills and experience to be effective board members of a DFI.

126. **The board should have a good mix of skills to allow it to be fully competent in its stewardship responsibilities.** This includes (i) approving the strategic direction of the DBG and its corporate plan; (ii) ensuring the adequacy of the bank's systems to identify, measure, and manage risk; (iii) approving

management's succession planning and the appointment of top managers; (iv) monitoring performance; and (v) ensuring the integrity of the information systems and the information generated. The board should include members with extensive banking and management experience, for instance in risk management, investments, accounting, human resources, and public policy formulation. Current board members should play a role in the appointment of new board members, for example by identifying skills gaps in the board and making recommendations to the shareholders.

127. **The top management team must be composed of competent and experienced professionals that are accountable to the board of directors for the management and performance of the DBG.** The DBG should be managed to attain its policy goals in a sustainable manner with due regard to efficiency and economic profitability. The board of directors should play an active role in the selection of the CEO, leading the appointment process including the identification, shortlisting, and recommendation of candidates for final appointment by the shareholders meeting. Ideally, the board of directors should have the authority to hire and fire the CEO. Management should be free to make operational decisions within the scope of the DBG's mandate and board oversight. In particular, it should have autonomy to decide to whom to lend and under what conditions, as well as to enforce the terms of the loan.

128. **A performance contract/shareholder compact which includes targets and indicators should be signed between the shareholders and the board of directors.** This contract would form the basis for evaluating board performance. In addition, procedures should also be put in place to individually evaluate the performance of the chairperson, board members, and the CEO.

129. **The chairperson should be the only interlocutor between management and the shareholders.** Government officials and shareholder representative should not have direct contact with the management of the DBG.

Mandate

130. **The DBG should operate under a clear and specific mandate.** Such mandate should describe the DBG's value proposition (e.g., to encourage more private financing to key market segments), positioning or cooperation with the private sector, and the requirements for self-sustainability. The DBG should undergo a periodic review of its mandate, since market gaps are dynamic and its mandate should adapt accordingly. The mandate should also clarify how the DBG will be made accountable for its performance. Ideally, these specifications and requirements should be spelled out in the articles of association establishing the DBG.

131. **The DBG should aim to serve sectors and market segments that private banks are currently less willing or unable to serve.** It should complement private financial institutions rather than compete with or replace them. The DBG should be required by its articles of association to report annually on its complementary role. A wholesale lending model would support this objective.

132. **The DBG should offer services that can address the market failures covered by its mandate.** Long-term lending denominated in local currency could increase debt maturity for firms and allow financing of investments that require a longer gestation period. Partial credit guarantees could help expand access to credit by creditworthy firms that do not possess collateral and help improve banks' risk

perception of SMEs as they become more familiar with this segment. A supply chain financing platform can facilitate factoring services by helping aggregate public and private sector receivables of Ghanaian SMEs.⁴⁰

133. **Technical assistance, both for PFIs and for enterprises receiving financing, is likely to be a critical component for DBG's success.** The experience of the PEVC industry is illustrative: PEVC firms often spend substantial time and resources developing their pipelines and providing post-investment technical assistance. However, the DBG should avoid providing direct advisory services to firms, except to partner financial institutions that are willing to expand their lending to the DBG's market segment. Ghana already has credible advisory firms that work with firms, for example to help them raise capital from early stage financing providers. Ghana also has a network of approximately 30 accelerators and incubators who play a key role in the early-stage financing eco-system.⁴¹

Lending Model and Key Business Rules and Processes

134. **The DBG should operate as a second tier DFI that would provide eligible financial institutions with specific services to encourage them to expand financing to creditworthy firms in key sectors.**⁴² This would allow it to have a lean organization and reduce political pressure to lend to certain groups since credit allocation decisions and enforcement of loan contracts would be left in the hands of private financial institutions. Wholesale development banks tend to perform better than their retail counterparts because they only take the financial intermediary credit risk – the end borrower's credit risk is borne by the partner financial institutions. Eligibility criteria for participating financial institutions (PFIs) should be clear and applied objectively, and be based on financial performance, business practices (including environmental and social safeguards), operational capacity, and governance structure. The DBG should become proficient in assessing financial institutions' credit appraisal and risk management practices.

135. **Pricing will be a key business decision for the DBG management and should ensure that the DBG is sustainable over time.** DBG should set its pricing policies in a manner that ensures that its capital would not decline in real terms. This would require a medium-term rate of return not lower than the inflation rate or the government's long-term borrowing cost. This requirement should not be mistaken with profit maximization. Moreover, DBG should allow its partner financial institutions to set prices on their on-lending on a commercial basis to avoid market distortions; this means that its lending rates should recover its cost of funding, operational costs, and credit risk. If many financial institutions are eligible for accessing DBG funds, the DBG could consider testing competitive auctions for allocation of its funds. Distorted

⁴⁰ Reverse factoring is particularly efficient and accessible to SMEs when offered through online platforms interconnecting buyers, financiers and SME suppliers. These platforms can be privately owned and operated or specifically developed by a DFI. Irrespective of the model, with enough business volume, private participation in reverse factoring programs would become attractive.

⁴¹ Robust data on their effectiveness is not available but anecdotal evidence indicates that some of them have been successful in supporting early-stage companies in raising external funds. A good example is Stanford Seed (Stanford Institute for Innovation in Developing Economies), launched in 2013 to provide hands-on coaching to approximately 60 companies a year, of which roughly 40 percent are focused on Ghana.

⁴² The second-tier model has some disadvantages: (i) by not dealing directly with borrowers, the DFI has no direct control on credit allocation; and (ii) the DFI does not learn about the needs of the target sector from the source, limiting its ability to provide feedback to the government and influence policy and strategies.

interest rates can lead to misallocation of resources, create opportunities for corruption, and contribute to disintermediation and capital flight.⁴³

136. **Any provision of subsidies should be properly justified, temporary, and transparent.** A robust analysis should be undertaken for any provision of subsidies to certain groups or sectors through proper cost benefit analysis (at the program level), including the quantification of gains and internalization of the opportunity costs of public funds. Subsidies should also be provided for a limited period and criteria for lifting them should be set up front. The cost of such subsidies should be included and discussed in DBG's budget. Cross-subsidization, if any, should also be made transparent through proper disclosure in the DBG's reports.

Key required resources and skills

137. **Although development banks can have multiple funding sources, the DBG should have a strong capitalization—from both government and strategic investors—to allow it to reach a reasonable scale in the Ghanaian financial system.**⁴⁴ This can be achieved on a gradual basis, as the DBG demonstrates good performance. The DBG would also need to secure a stable and diversified stream of long-term funding, including from international DFIs and through the capital markets. The DBG should not seek a license to take deposits from the public.

138. **To operate close to the risk frontier, the DBG would need sophisticated risk management capacities to ensure that it not taking excessive risk and exposing itself to unsustainable losses.** The DBG will need to build skills in appraisal and risk rating of financial institutions and their systems. This includes specific knowledge about legal remedies in case of insolvency and resolution of financial institutions.

139. **The DBG should have market research capabilities to allow the assessment of products and industries where Ghana can have a competitive advantage and that will drive Ghana's future growth.** This is likely to require some basic understanding of recent technological developments and economic trends. As technology and market dynamics shift, Ghana's competitive advantages will vary and therefore the DBG mandate should be flexible enough and avoid commitment to any particular economic subsector.

140. **To be able to intermediate funds from international development institutions, the DBG will need skills in environmental and social safeguards.** The DBG should be able to monitor and manage the environmental and social risks and impacts of their portfolio and PFI subprojects. This would require an environment and social management system that provides effective environmental and social procedures

⁴³ The DBG may still be able to lend at below average interest rates if it secures its funding at below market rates or if the shareholders implicitly accept a lower rate of return. Lending at below market rates should not be the result of risk underpricing or non-recovery of operational costs as this would render the operations unsustainable.

⁴⁴ The size of national DFIs vary significantly: at the end of 2015, 38 percent of the DFIs that answered a World Bank survey reported having assets of less than \$US 1 billion, 35 percent reported having assets between \$US 1 billion and \$9.9 billion, 21 percent reported having assets between \$US 10 billion and \$US 99 billion, and 2 percent reported having assets of more than \$100 billion. Of the DFIs that answered the survey, 47 percent have far less than 10 percent of the financial system assets in their countries.

and capacity for assessing, managing, and monitoring risks and impacts of subprojects, as well as managing overall portfolio risk in a responsible manner.

141. **The DBG should set up partnerships with strategic partners to access external resources and skills.** Key partnerships include those with PFIs that already have strong systems for enterprise credit appraisal, delivery, and monitoring. The DBG may also benefit from partnering with credit reference bureaus for basic automatic screening of subprojects proposed by PFIs.

Transparency and Disclosure

142. **The DBG should meet high standards of transparency and disclosure.** Its accounting and auditing standards should follow international good practice. Its board should have a qualified and independent audit committee served by a strong internal audit function. The DBG should be audited by a reputable external auditor approved by the shareholders and the supervisor (as applicable). It should publish its management report and audited financial statements with all explanatory notes; the report should disclose the board structure (including names and qualifications of board members and their current employment) and management structure. Procedures to prevent and handle conflicts of interest should be in place including those regarding related party transactions. Publicizing its investment strategies and particular investments could help reduce concerns over improper use of public funds.

Monitoring, Evaluation and Learning

143. **The DBG should have in place a monitoring, evaluation and learning system that captures its additionality and sustainability, and it has systems in place to allow internal learning.** If possible, the DBG should also evaluate the development impact of its wholesale financing. Reporting financial performance, although important, is not enough for a DFI. It also needs to set measurable policy targets, monitor and report on performance (e.g., in its annual report). Given the difficulty of directly measuring development impact, DFIs have relied on proxy indicators to approximate their catalytic role and development impact. Such indicators include number of target clients served (e.g., SMEs), number of first borrowers, average loan maturity, number of jobs generated by firms in the portfolio, and increase in sales. Inter-American Development Bank (2011) offers a possible tool.

144. **More recently, there has been more emphasis on rigorous impact evaluation of instruments and programs.** Impact evaluation techniques such as propensity-score matching or regression discontinuity design using a score threshold are amenable whenever funds are allocated based on competitive selection. On the other hand, allocation of funds in programs or instruments based on rounds and oversubscription is amenable to randomized evaluations.

V.2. Local currency financing

145. **The DBG could provide local currency term financing to help expand the maturity of borrowings by local businesses, enabling them to better exploit job-creating investment opportunities.** In Ghana, banks provide little long-term lending, with the bulk of loans having maturities of less than three years. As discussed in Chapter II, this reflects the lack of long-term funding sources by banks, but also their

preference for businesses that have frequent cash-flows and a short-term nature in order to reduce credit risk. SDIs have similar, if not more binding, funding constraints. Discussions with financial institutions revealed their demand for competitively-priced, local currency term funding.

146. **Lines of Cedis-denominated term credit could be provided to eligible PFIs that meet predetermined criteria such as financial performance, business practices, operational capacity, regulatory compliance, and good governance.** In particular, preference should be given to financial institutions that have lending technologies that are more appropriate to underserved segments. All types of financial intermediaries (e.g., banks, SDIs) could join the scheme as long as they meet the eligibility criteria. The applicable interest rates to PFIs should not distort the interbank and wholesale credit market for financial institutions, nor reduce incentives for PFIs to attract deposits, and ensure the sustainability of the DBG.

147. **Sub-loans should target eligible and creditworthy enterprises in the DBG's target segments, i.e., those that are facing higher financing gaps.** PFIs would bear the sub-loans' full credit risk. Both working capital and investment sub-projects should be eligible. Interest rates charged to end borrowers should not distort credit markets. Any subsidy should be transparent, targeted, time-limited, and capped; funded explicitly through the government budget or other sources subject to effective control and regular review; fiscally sustainable; set up not to give an unfair advantage to some PFIs as compared to other qualified and directly competing institutions; and economically justified, or shown to be the least-cost way of achieving development objectives.

148. **To avoid currency mismatches in the DBG's balance sheet, wholesale borrowing from international development partners in foreign currency should be limited or channeled through the Government.** The Ministry of Finance could then pass the loan proceeds in local currency to the DBG, which could on-lend them to the eligible PFIs in local currency.

V.3. Partial credit guarantees⁴⁵

149. **A professionally-managed DFI such as the DBG could be in charge of managing a universal public scheme of PCGs that would target underserved businesses in Ghana such as SMEs.** By reducing collateral requirements and bank's losses in case of default, well-managed PCG schemes help convince liquid banks to lend to creditworthy borrowers that cannot offer traditional real estate as collateral. PCGs can also help financial institutions better understand the risk profile of SMEs as they become more familiar with this segment. In most jurisdictions, the regulatory framework allows banks to have lower capital requirements for loans guaranteed by public PCGs (when compared to traditional loans), thus providing an additional incentive.⁴⁶

⁴⁵ This section is based on separate Technical Note on the potential of PCGs in Ghana, prepared by Alessandro Bozzo.

⁴⁶ However, the guarantee usually needs to meet the regulator's minimum legal requirements in seniority, revocability, and effectiveness. The World Bank and FIRST Initiative. 2015. *Principles for Public Credit Guarantee Schemes for SMEs*. Washington, DC: World Bank.

150. **Bankers interviewed in Ghana expressed interest in a universal and permanent PCG scheme, which could complement existing schemes that target specific economic sectors (e.g., agriculture, health) or are temporary in nature.** A permanent scheme would give greater confidence to financial institutions and businesses to invest in the relationship with the scheme, as has been observed in many countries. This is particularly the case when liquidity levels in the banking sector are high. However, the government should avoid having more than one institution managing PCG schemes to avoid unnecessary costs, and possible competition between schemes in pursuing the same customers.

151. **In the long term, the universal PCG scheme should aim to cover a meaningful share of the MSME credit market in Ghana.** For example, a scheme with \$US 50 million in capital would be able to reach almost ten percent of the MSME credit market, considering a leverage ratio of four and an average guarantee coverage of two thirds of the loan. Capitalization of the PCG scheme should be done gradually and conditional on a demonstrated impact on underserved segments.

152. **The PCG scheme should be operated through a wholesale model through which the PCG manager would provide guarantees through PFIs.** PFIs will be responsible for credit risk management and therefore the DBG would not have contact with customers nor would evaluate them. This reduces the costs required to reach thousands of MSMEs that require credit in small amounts.⁴⁷ As with credit lines, the DBG could offer PCGs to all types of financial intermediaries (e.g., banks, SDIs) as long as they meet the eligibility criteria. Coverage should be flexible and tailored to the risk of the target market segment and sector, covering all types of credit exposures. Pricing should be based on the risk of each PFI and adequate to ensure the scheme's sustainability and additionality (through PFIs' participation).⁴⁸

153. **To strengthen its credibility towards the financial system, the PCG scheme should be established under a clear legal framework.** The capital to finance the scheme could be placed in a trust fund, as is the case in many countries (e.g., Argentina, Canada, Colombia, Ecuador, Mexico, Peru, Paraguay). Alternatively, the PCG could be established as a subsidiary of the DBG. Ideally, the fund's assets should be exclusively dedicated to supporting the credit risk and no other kind of cost. The DBG would have fiduciary responsibility over the trust fund. The provision of PCGs under this scheme would be subject to regulation and supervision of the BoG and DBG's strong corporate governance framework would be extended to the PCG scheme. Thus, financial institutions would then be confident that they will receive payments of the guarantees, as long as they observe the conditions agreed in the contracts.

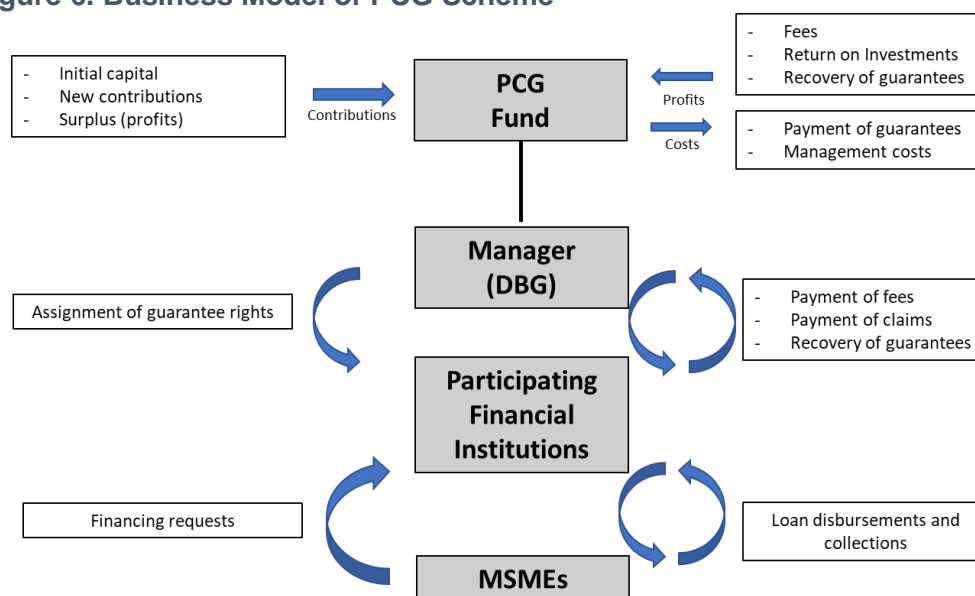
154. **The DBG should establish a dedicated unit to manage the new PCG scheme.** The unit should be small, lean, and rely extensively on technology to issue a large volume of guarantees.⁴⁹

⁴⁷ The scheme should target financially constrained MSMEs, while offering some flexibility to financial institutions. Some of the potential criteria for MSMEs include the number of employees in the enterprise, turnover, and loan amount.

⁴⁸ As PCG schemes mature and collect more loan performance data, managers of PCGs can eventually start applying risk-based pricing to each individual loan. To reduce costs, risk-based pricing could be based on automatic (or near automatic) credit scoring models.

⁴⁹ For example, FOGAPE—a PCG scheme in Chile that in 2017 provided more than 42 thousand PCGs for a total of about US\$750 million—had only six employees.

Figure 6. Business Model of PCG Scheme



155. Eventually, the DBG could also manage tailored guarantee schemes (trust funds) targeting specific sectors (e.g., agriculture, exporters, renewable energy) or have specific purposes (e.g., disaster recovery). Each scheme would be ring-fenced and have their own rules and funding sources. The DBG would provide shared back-end services—such as management information systems, staff, and treasury functions.

V.4. Digital platform for MSME financing⁵⁰

156. Cloud-based technologies decrease the costs of deployment and usage of finance-related services, such as accounting, e-commerce payments, and e-invoicing, making them more accessible to MSMEs. Cloud-based accounting services also increase the reliability of MSME books to be used for credit risk assessment. Direct access to users through a platform also provides an opportunity to offer scalable financial capability / business acumen training to MSMEs during the so-called “teachable moments” (when recipients pay the most attention to the information / knowledge provided).

157. Fintech companies across the world have started to offer specialized web (cloud)-based business services to MSMEs, but that is not the case in Ghana so far. Private developers quote the lack of sufficient demand in Ghana that can help them meet their expected returns when investing in a developing market. Obstacles also include lack of financing opportunities, low business acumen, unreliable local institutions, and underdeveloped financial infrastructure.

158. A credible DFI could become a sponsor for a digital platform for MSME financing that would offer non-existing or hard-to-reach services to MSMEs in Ghana. The platform could offer

⁵⁰ This section is based on separate Technical Note on “Fintech Platform for MSME Finance” in Ghana, prepared by Ivor Istuk.

complementary financial and associated services. While the exact design of such platform needs to be gauged through a detailed feasibility study, services that can potentially be provided in a first phase of development include: (i) accounts receivable finance; (ii) electronic invoicing; and (iii) cloud-based accounting; In future stages, the platform could be used to offer or link to other non-financial but related services to MSMEs, therefore contributing to their improved bankability. Both internet and smartphone penetration have increased considerably in Ghana in recent years, increasing the potential viability of such platform. Overall, the platform could help create new markets and new financial products, decrease risk of MSME financing, improve the credit process, and positively influence business acumen and growth of Ghanaian financial and MSME sectors.

159. **In addition to the required deployment of a technology platform, this initiative would have to be supported by an appropriate regulatory framework and market-building efforts.** The regulatory framework should provide clarity on (i) licensing requirements for operation of digital platforms for financial services, (ii) recognition of e-invoicing for tax reporting purposes, (iii) definition of factoring, and (iv) rules that apply to late payments.

160. **Offering public sector payables to MSMEs for discounting through the platform would help increase the volumes and the platform's sustainability.** This would attract financiers willing to discount such receivables and thus provide working capital finance for MSMEs, ultimately improving payments liquidity on the market. Credit guarantees could also induce financial institutions to join the platform. Outreach to MSMEs could also help increase demand for the services offered through the platform.

161. **To ensure financial sustainability of the platform, users and service providers should be expected to pay fees for the use of the platform.** The fee income should at least cover the costs of operating the platform, but consideration should be given also for it to cover the capital investment. Several options exist for pricing, including fees per transaction, fees for access/availability to the platform, and success fees (e.g., a percentage of interest paid by borrowers). Different services are likely to have different pricing models. The business and pricing models should be part of a detailed feasibility study that should also discuss the governance and responsibilities for designing, implementing, and operating the platform. Development (i.e., investment) costs could be reduced by allowing the developer to become the future platform manager and collect platform revenues up to a certain period.

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