



**AFRICAN DEVELOPMENT BANK GROUP**

**STRATEGY UPDATE  
FOR THE BANK'S  
PRIVATE SECTOR OPERATIONS**

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## **TABLE OF CONTENTS**

- Executive Summary**
- 1. INTRODUCTION**
  - 2. PRIVATE SECTOR DEVELOPMENT**
    - Conceptual Framework
    - Strategic Priorities
    - The Bank's Triple Role
    - Implementation Modalities
  - 3. PRIVATE SECTOR OPERATIONS**
    - Upstream – Projection Selection
    - Downstream – Portfolio Management
    - Efficiency and Productivity
  - 4. CONCLUSIONS AND RECOMMENDATIONS**

## **LIST OF FIGURES**

- Figure 1: PSD – Poverty Alleviation Puzzle  
Figure 2: Private Sector Development Triangle  
Figure 3: Project Selection Strategy  
Figure 4: Maximizing Strategic Fit

## LIST OF ABBREVIATIONS

AERC	African Economic Research Consortium
BOAD	Banque Ouest Africaine de Développement
DBSA	Development Bank of Southern Africa
DEG	German Bilateral Agency
DFI	Development Finance Institution
EADB	East African Development Bank
EBRD	European Bank for Reconstruction and Development
EPSA	Enhanced Private Sector Assistance for Africa Initiative
EVA	Economic Value Added
FMO	Dutch Bilateral Agency
HIPC	Heavily Indebted Poor Country
ICF	Investment Climate Facility for Africa
ICT	Information and Communications Technologies
IFC	International Finance Corporation
IFI	International Financial Institution
MDG	Millennium Development Goal
OPSM	Private Sector and Microfinance Department
PFI	Public Financing Initiative
PSD	Private Sector Development
PSO	Private Sector Operations
UNECA	United Nations Economic Commission for Africa

## EXECUTIVE SUMMARY

1. This paper builds on the Bank’s vision and strategy for private sector development (PSD) and sets out a new strategy for the Bank’s private sector operations (PSO).
2. The Bank’s vision for private sector development is founded on a conceptual framework that links entrepreneurship, investment, and economic growth with the Bank’s ultimate goal of poverty alleviation. Given the importance of PSD as the engine for poverty-reducing economic growth, the Bank’s strategy articulates five focal priorities for its interventions: (i) supporting private enterprises, (ii) strengthening financial systems, (iii) building competitive infrastructure, (iv) promoting trade, and (v) improving the investment climate.
3. Private sector development as a driver of growth is an institution-wide priority with shared responsibility for developing and implementing the AfDB’s strategy. The Bank’s PSD efforts are based on three interrelated activities: (i) *Diagnostics and Strategy Development* – the responsibility of the Chief Economist’s Office and Research Team in conjunction with the Bank’s Country and Regional Teams; (ii) *Enabling Environment Programs* – the responsibility of the Economic and Financial Governance and Reform Department and the other Public Sector Departments; and (iii) *Catalytic Transactions* – the responsibility of the Bank’s Private Sector and Treasury Departments, which take the lead in supporting private sector operations through a variety of instruments and capital market operations. For the Bank to play an efficient and effective role in PSD, all three legs of this PSD triangle must function in close coordination through constant communication and synchronization of activities internally as well as with external development partners.
4. Although the Bank has played a major role in assisting African governments to improve their investment climates for over 40 years, it is only since 1991 that the AfDB has assisted entrepreneurs by directly financing private sector operations and other transactions without the support of a sovereign guarantee from the host country (collectively referred to as PSO).<sup>1</sup> In undertaking private sector operations, the Bank recognizes that given the enormous financing needs of the continent, its primary objective should be to catalyze other private sector investors by selectively building a portfolio of high-performance projects with strong demonstration effects.
5. Building a high-performing portfolio requires a coherent and sustained effort at all stages in the “business chain.” Upstream, the Bank needs to ensure that it has a robust project selection process that enables it to identify, select, and commit to the “best projects.” To achieve this, under the new PSO strategy, the Bank’s project selection process focuses on operations that simultaneously maximize the potential impact and leverage the Bank’s sources of sustainable comparative advantage. Downstream, the Bank needs to have robust processes for managing its portfolio to ensure quick and effective implementation, to identify and rehabilitate projects going off track, and to secure and recover the Bank’s assets when rehabilitation is not feasible. Across the entire business chain the Bank needs to ensure that its processes are not only effective but also efficient. Achieving a high level of “productivity” will ensure that the Bank is able to maximize its development impact within a given resource base.
6. Given its more than 40 years of experience on the continent, its public-private organizational structure, its Pan-African cooperative governance structure, and its AAA credit

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<sup>1</sup> The Bank may finance majority publicly owned enterprises without a sovereign guarantee if the enterprise is both commercially operated and creditworthy.

rating, the AfDB is uniquely positioned to act as “honest broker” for private sector development on the continent. To fulfill its responsibilities as the apex Pan-African financial institution, the AfDB plays three important roles in private sector development: (i) advisor, (ii) financier, and (iii) partner. Increasingly, the Bank will shift from being a pure end investor in private sector operations to acting as a catalyst for true private investment. To accomplish this, the Bank will progressively deploy risk-sharing instruments that will enable it to leverage its risk capital base and strong project origination expertise.

## 1. INTRODUCTION

1.1 In recent years African economies have shown steady growth and the prospects for continued progress are promising. Increased political stability, improvements in governance, and the pursuit of sounder economic policies are frequently cited as contributing factors behind this encouraging trend. These positive developments notwithstanding, if Africa is to attain the growth rate of 7% per annum necessary to achieve the primary MDG of halving the number of population living in absolute poverty by 2015, its economic strategies must confer a more vibrant role to the private sector and to the facilitation of both foreign and domestic investments.

1.2 In recognition of the crucial role that the private sector plays in development dynamics, the AfDB formulated its first comprehensive strategy for private sector development in 2004.<sup>1</sup> This highlighted the importance of adopting a Bank-wide approach to private sector development and has served as the primary road map for Bank interventions in the private sector over the past few years. One visible result of this strategy has been a sevenfold increase in the Bank's non-sovereign lending operations from 2004 to 2007.<sup>2</sup>

1.3 This paper proposes some refinements to the Bank's broader private development strategy to reflect changes in the Bank's organizational structure following the most recent institutional reforms. These PSD and PSO strategies are fully consistent with the higher-level strategies being proposed for the Bank Group and therefore provide a coherent yet more detailed perspective on PSD as a cross-cutting development theme.

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<sup>1</sup> The Bank's Private Sector Development Strategy, ref – ADB/BD/WP/2004/71.

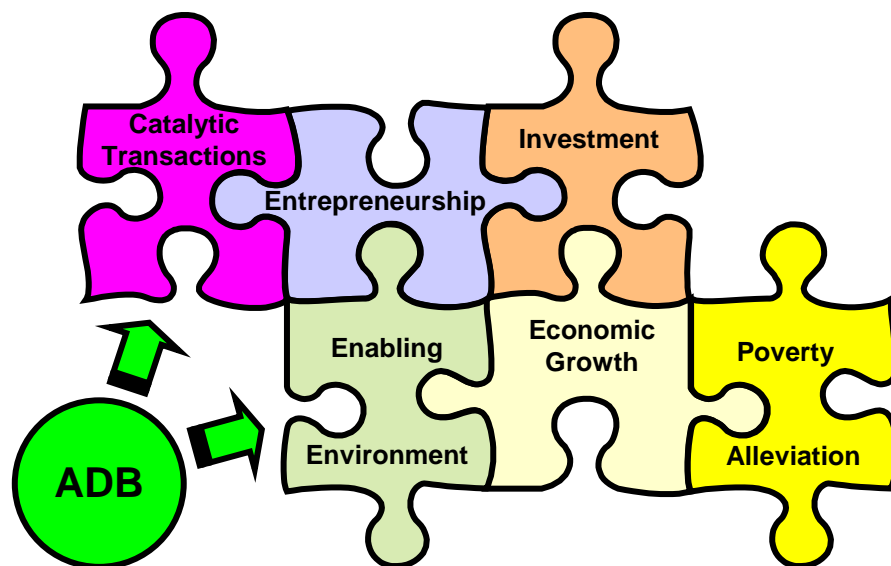
<sup>2</sup> Private sector financing operations in 2007 exceeded USD 1.4 billion compared to USD 200 million in 2004.

## 2. PRIVATE SECTOR DEVELOPMENT

### Conceptual Framework

2.1 As illustrated in Figure 1 below, the AfDB’s vision for private sector development is founded on a conceptual framework that links entrepreneurship to its overarching poverty alleviation mission. This framework recognizes that (i) entrepreneurs come in all shapes and sizes, from the micro-entrepreneur selling handicrafts to the mega-entrepreneur promoting an infrastructure project and (ii) they all play a contributing role in creating jobs and boosting economic growth. The private sector functions as a primary driver of poverty alleviation when local business conditions provide a fertile environment for entrepreneurs to invest in both productive and human capital.

Figure 1 The PSD-Poverty Alleviation “Puzzle”



2.2 While it is difficult to quantify the direct “cause and effect” of each business venture on poverty alleviation, there is a general consensus on the strong linkage between entrepreneurship, business development, job creation, economic growth, and poverty alleviation. Institutions such as the African Development Bank, which harness strengths in both the public and private sectors, can play a unique role by: (i) improving the business-enabling environment<sup>3</sup> to support commercial activities and (ii) promoting specific private sector transactions that catalyze other investors by demonstrating that investments in Africa can yield attractive returns while achieving development objectives.

### PSD Strategic Priorities

2.3 The Bank’s PSD strategy is one element of a broader array of interrelated institutional priorities including infrastructure development, regional integration, good governance,

<sup>3</sup> For the purposes of this paper, the term “enabling environment” is used in broad sense to describe all of the factors required to support business development. It includes factors related to the investment climate such as the regulatory framework, as well as basic public infrastructure such as power, water, transportation, and telecommunications.

knowledge management, partnerships and harmonization. The PSD strategy articulates five focal priorities: (i) *supporting private enterprises*, (ii) *strengthening financial systems*, (iii) *building competitive infrastructure*, (iv) *promoting regional integration and trade*, and (v) *improving the investment climate*. All these areas were identified as pivotal when the first Private Sector Development Strategy was drawn up, and they remain equally valid today.

- ***Supporting Private Enterprises*** – The Bank strives to support private enterprises across the full business spectrum from micro-enterprises to mega-enterprises and across the broadest range of countries from middle income to low income. Given the diversity and huge numbers of micro, small, and medium-scale enterprises (MSMEs), the Bank generally channels its support to these businesses through financial intermediaries, using lines of credit or guarantee facilities combined with grant resources for technical assistance and capacity building. The Bank also supports MSMEs by assisting business associations and other business development services. For the larger-scale enterprises, the AfDB is usually able to provide direct financial support in partnership with other financial institutions.
- ***Strengthening Financial Systems*** – A sound financial system and a vibrant banking sector are essential ingredients for private sector development in both urban and rural areas. Given the diversity of financial intermediaries and the requirements for capital market development, the Bank adapts its assistance to local requirements. Where effective potential partnerships with commercial, cooperative, and microfinance banks can be identified, the Bank seeks to provide longer-term financing through lines of credit or guarantees, subordinated debt, equity, and/or technical assistance. For regional development finance institutions (DFIs), the Bank seeks opportunities to build synergies through closer partnerships as well as through its regular financial instruments. The Bank also aims to promote other non-bank financial institutions, including leasing and insurance companies, and seeks opportunities to strengthen the local capital markets through instruments such as private equity funds, local currency financing, and facilitation of remittance flows.
- ***Building Competitive Infrastructure*** – The participation of the private sector in infrastructure through public-private partnerships (PPPs) has opened up wide opportunities for improving the supply and quality of basic services in areas such as power, transportation, telecommunications, and water. This not only improves daily living conditions for the general population but also builds a more attractive business environment for foreign and domestic corporations and sponsors. The Bank is uniquely positioned to address the infrastructure needs of regional member countries by combining resources from both public and private windows (including concessional resources) as well as providing technical assistance and capacity building in support of PPPs. The Bank encourages projects in the extractive sector that also enhance public goods in infrastructure, such as power and transportation. A new generation of PPPs based on a model successfully developed by the UK's Public Financing Initiative (PFI) also opens up new opportunities for private financing in social infrastructure service sectors such as health and education.
- ***Promoting Regional Integration and Trade*** – To assist African countries to become more competitive in the global marketplace, the Bank advocates trade liberalization policies, finances programs to support inter- and intra-regional trade, helps local banks to establish relationships with foreign banks, and strengthens the financial capacity of local trade financing institutions. Trade promotion is one of the primary ways the Bank can support the development of indigenous private sector companies and the African agricultural sector. Through the private sector, the Bank seeks to reinforce regional

integration by promoting the creation of regional development corridors. Private sector operations in the extractive industries can act as the wealth-creating springboard for the expansion of regional development corridors: these can lead to the development of public infrastructure, the creation of upstream local supply-chain businesses, the creation of downstream value-adding industries, and the longer-term diversification of Africa's largely resource-based economies.

- ***Improving the Investment Climate*** – The Bank aims to improve the investment climate and so catalyze domestic and foreign companies to support economic and social development. It does this by assisting governments to reform their legal and regulatory frameworks; to strengthen economic and corporate governance; to promote fiscal responsibility, transparency and accountability; to consolidate property rights; to mitigate risks for domestic and foreign investors; to support commercial law reform; and to improve security for goods and transactions. The Bank works with existing development partners such as the World Bank Group to gain scale by applying lessons learned across countries and regions. The Bank also supports the creation of new organizations that focus on improving the enabling environment, such as the Investment Climate Facility for Africa (ICF), which is an independent trust endorsed by NEPAD which seeks to mobilize resources to support Africa's development and to remove barriers to growth.<sup>4</sup>

### **The Bank's Triple Role in PSD**

2.4 Given its more than 40 years of experience on the continent, its public-private organizational structure, its Pan-African cooperative governance structure, and its AAA credit rating, the AfDB is uniquely positioned to serve as "honest broker" for private sector development on the continent. As the apex Pan-African financial institution, the AfDB fulfills three important roles in private sector development: (i) *advisor*, (ii) *financier*, and (iii) *partner*.

- ***Advisor*** – The Bank is acknowledged as an important source of expertise for its RMCs. This expertise is shared through official publications, training programs, conferences and seminars, advisory services, and direct contact with project sponsors.
- ***Financier*** – The Bank finances reform programs with RMCs and specific transactions with private sector entrepreneurs. However, the Bank's financing operations are not designed as a substitute for private financing, but rather to act as a catalyst in mobilizing capital for deserving projects that will add to productive capacity and increase economic growth.
- ***Partner*** – The Bank also acts as a development partner to the three main stakeholder groups in private sector operations: (i) African entrepreneurs and foreign investors, (ii) RMCs and local communities, and (iii) the international community. From the entrepreneur's perspective, the Bank ensures that investors' interests are adequately protected from political interference and that governments respect their contractual obligations. From the country perspective, the Bank ensures that governments and local communities understand the financial and economic implications of new investments and that they derive their "fair share" of the benefits from projects. For the international community, the Bank plays a crucial role to ensure that international standards for environmental sustainability, legal compliance, and governance are upheld.

### **Implementation Modalities**

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<sup>4</sup> See <http://www.investmentclimatefacility.org>.

2.5 The Bank's PSD efforts are an institution-wide priority based on three interrelated activities: (i) *diagnostics and strategy development*, (ii) *enabling environment programs*, and (iii) *catalytic transactions*.

- ***Diagnostics and Strategy Development*** – The starting point for assisting countries to develop the private sector is a clear understanding of the strengths and the constraints of each local market. This critical diagnostic function is now the responsibility of the Chief Economist's Office and research team in conjunction with the Bank's country and regional integration teams and in partnership with other research institutions such as the World Bank Group, the African Economic Research Consortium (AERC), and the United Nations Economic Conference for Africa (UNECA). This intelligence is used to inform the Bank's country and regional strategies, the central planning tools for its operations, and will provide a critical input as the Bank progressively shifts from a purely opportunistic or "hunter" approach to project selection to a more planned or "farmer" approach to project pipeline development.<sup>5</sup> Country and regional strategies provide the framework for the Bank's efforts to support private sector development and ensure coherence and synergies between its assistance to the public and private sectors.
- ***Enabling Environment Programs*** – Based on the diagnostic and analytical work of the Bank's research and country strategy teams, the public sector business units develop programs to address the weaknesses and constraints in the enabling environment. This may include the provision of public goods in "hard infrastructure" such as power, water, transportation, and telecommunications as well as "soft infrastructure," such as regulatory and legal frameworks, which are essential for economic growth and private sector development. These interventions are generally undertaken with government agencies and involve close coordination with development partners such as the World Bank, bilateral development agencies, and the ICF.
- ***Catalytic Transactions*** – The Bank's Private Sector Department (OPSM) takes the lead in supporting private sector operations (PSO) through a variety of instruments without a sovereign guarantee, including loans, lines of credit, guarantees, equity and quasi-equity investments, and technical assistance. These interventions are undertaken with private corporations, financial institutions, or state-owned enterprises and in partnership with other development-oriented organizations in order to attract other investors by creating a strong demonstration effect. The Bank seeks to take maximum advantage of its unique positioning at the interface between the public and private sectors – the Bank's so-called "sweet spot" – to maximize the development impact of its PSO. The Bank's Treasury Department takes the lead in operations to enhance the development of the capital markets. Any constraints encountered when processing private sector and capital market operations are fed back into the Bank's diagnostic and enabling environment improvement functions.

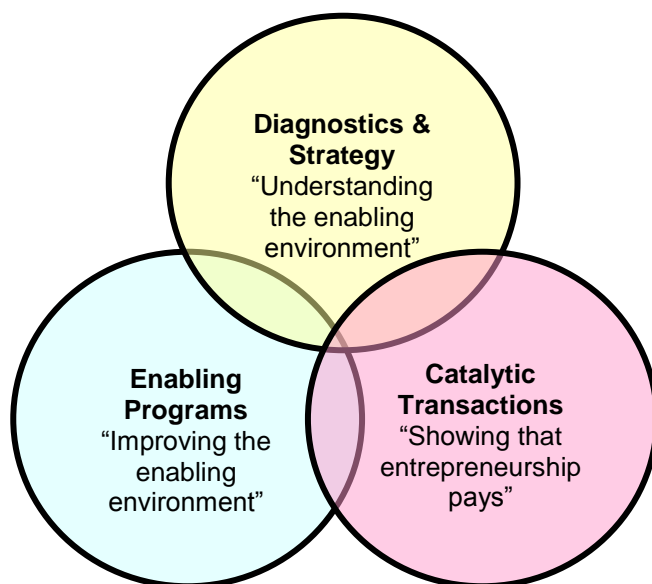
2.6 As shown in Figure 2 below, for the Bank to play an efficient and effective role in PSD, all three legs of this PSD triangle must function in close coordination through continuous communication and synchronization of activities. Lessons learned through the implementation of enabling environment programs and PSO should be systematically reflected in diagnostic and strategy development work through an iterative process.

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<sup>5</sup> In the "hunter" mode, the Bank waits for attractive project opportunities to be presented to it by sponsors or potential cofinanciers. In the "farmer" mode, the Bank proactively develops a pipeline of project opportunities by working with governments and sponsors from the project concept phase.

Figure 2

The Private Sector Development Triangle



### 3. PRIVATE SECTOR OPERATIONS

3.1 Although the Bank has played a major role in assisting African governments to improve their investment climates for over 40 years, it is only since 1991 that the AfDB has assisted entrepreneurs by directly financing private sector operations and other transactions without the support of a sovereign guarantee from the host country (collectively referred to as PSO).<sup>6</sup> Although the Bank’s role is to maximize overall development impact rather than maximize profits, a high-performing private sector portfolio also creates wealth and generates profits for the Bank and investors alike.

3.2 Building a high-performing portfolio requires a coherent and sustained effort at all stages in the “business chain.” Upstream, the Bank needs to ensure that it has a robust project selection process that enables it to select and commit to the “best projects.” Downstream, the Bank needs robust processes for managing its portfolio to ensure quick and effective implementation, to identify and rehabilitate projects going off track, and to secure and recover the Bank’s assets when problem projects cannot be turned around. Across the entire business chain the Bank needs to ensure that its processes are both effective and efficient. Achieving a high level of “productivity” will ensure that the Bank is able to maximize its development impact within a given resource base. The primary strategies for ensuring robust project selection, effective portfolio management, and optimal productivity are elaborated below.

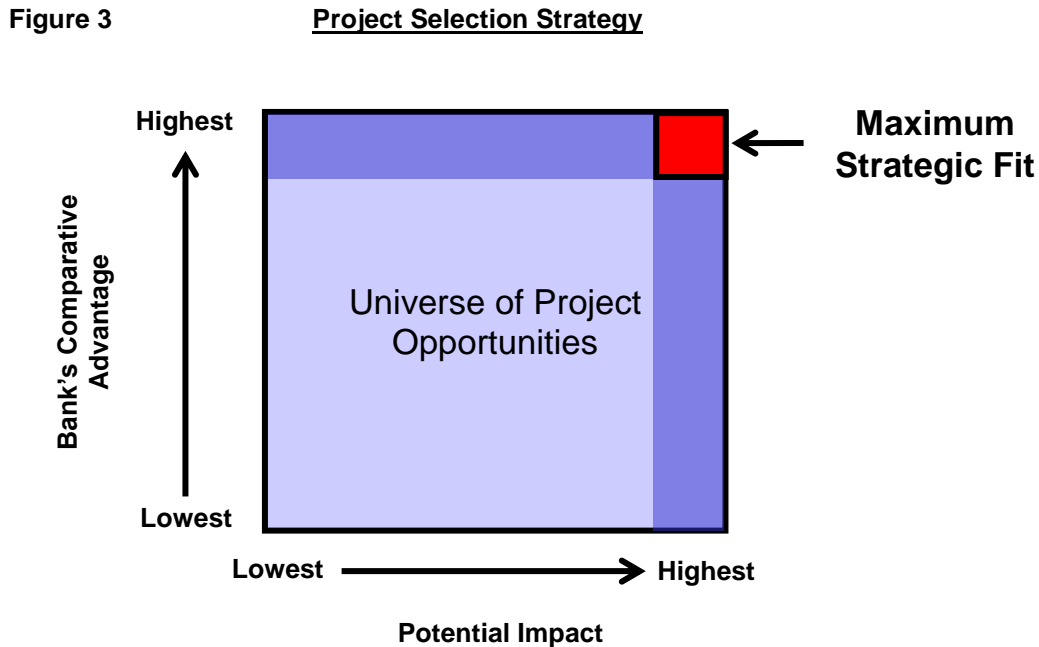
#### Upstream – Project Selection

3.3 Figure 3 below illustrates the Bank’s strategy for selectively building a high-performance portfolio. The starting point is to identify the universe of possible investment opportunities. Project opportunities come from a variety of sources including direct client inquiry, contacts from conferences and investment promotion seminars, cofinancing proposals from partners, references from the Bank’s public sector operations, and increasingly from a pipeline of projects developed

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<sup>6</sup> The Bank may finance majority publicly owned enterprises without a sovereign guarantee if the enterprise is both commercially operated and creditworthy.

by the Bank itself.<sup>7</sup> From this universe of project opportunities, the Bank seeks to quickly narrow the field to a relatively small number of projects that provide the maximum strategic fit.



3.4 The project filtering process is arguably the most important process within the Bank. It enables it to build a high-performance portfolio (effectiveness) while helping to minimize the resources expended on projects that do not meet the Bank's standards (efficiency). Project filtering is undertaken by evaluating projects along two primary dimensions: *potential impact* and *comparative advantage*. The process begins by assessing project opportunities in terms of the potential impact, based on five key impact criteria:

- ***Strong Development Effect*** – Projects that contribute to economic growth, entrepreneurship development and local employment, provide regional integration benefits, catalyze other investments, and create a positive demonstration effect with large developmental externalities;
- ***Robust Commercial Viability*** – Projects that are able to service their liabilities, represent good value for money, and lie within the Bank's risk tolerance;
- ***Environmental and Social Sustainability*** – Projects that minimize potential negative environmental externalities, are socially responsible and gender-sensitive;
- ***Legal Compliance*** – Projects that comply with the Bank's policies and rules, minimize complexity, and minimize the risk of money laundering or other forms of fraud that could damage the Bank's reputation;
- ***Additionality and Complementarity*** – Projects where the Bank can bring value-added that other investors or commercial financiers cannot or will not provide and which avoid unnecessary duplication with other development partners.

<sup>7</sup> The Regional Integration Department (ONRI) has proposed a business plan that would position it at the center of the Bank's upstream project development activities.

3.5 Having identified the projects with the highest impact potential, the filtering process then narrows the field further to those high-impact projects that provide the greatest leverage of the Bank's sources of *comparative advantage*, based on five key criteria:

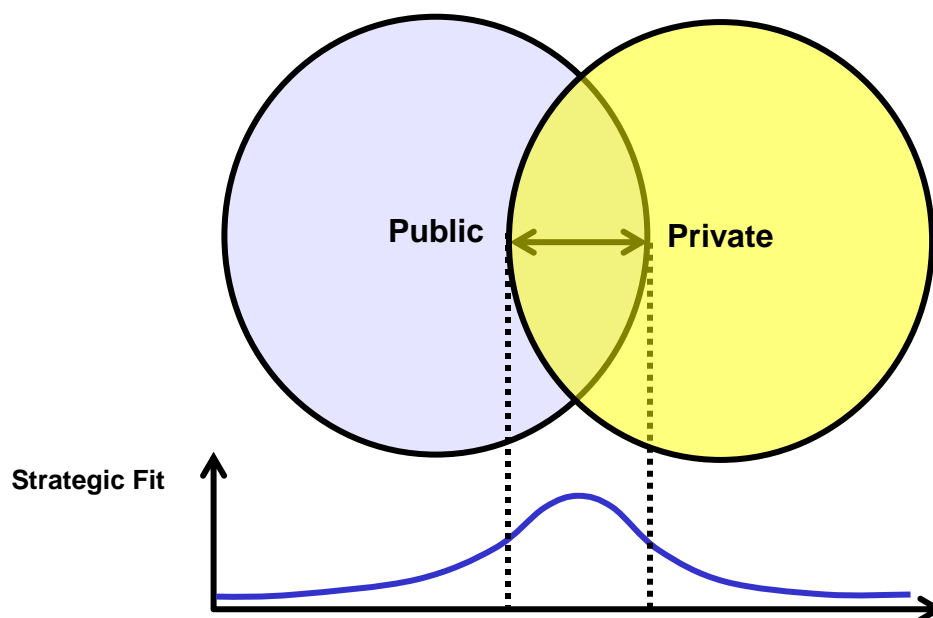
- **Resources** – Projects that take maximum advantage of the Bank's ability to mobilize a broad package of financial instruments (often combining resources from its commercial and concessional windows when dealing with PPPs) and technical expertise;
- **Influence** – Projects that take maximum advantage of the Bank's ability to mitigate political risks for investors, to assist governments to get a fair and equitable share of the benefits, and to address complex environmental and social sustainability issues;
- **Reliability** – Projects that take maximum advantage of the Bank's long-term perspective on African development issues and its willingness to trade short-term profitability for long-term development benefits;
- **Scale** – Projects that take maximum advantage of the Bank's balance-sheet size and its ability to attract other investors and financiers into the African market;
- **Risk Management** – Projects that take maximum advantage of the Bank's ability to manage risks for itself and for its partners (proactively exploiting the innovations in the international capital markets such as local currency financing and risk transfer products).

3.6 The process of identifying, filtering, and selecting projects is as much art as science. There are many factors that add to the challenge of pipeline development, for example, *timing*: not all project opportunities are ready for consideration at the same time and therefore cannot be compared alongside each other. *Sector and scale*: how can small projects in microfinance be fairly compared to large infrastructure projects? *Location*: how can projects in one country be compared to another? *Positioning*: how to compare projects where the Bank is the lead financier to those where it plays a support role? Given these issues, three other sets of crosscutting factors influence the Bank's choice among project opportunities: (i) *public-private partnerships*, (ii) *secondary benefits*, and (iii) *regional development corridors*.

- **Public-Private Partnerships** – As illustrated in Figure 4 below, the projects that provide the best strategic fit, the Bank's "sweet spot," generally lie at the intersection of the public and private sectors. Projects that have both public and private sector features (often referred to as public-private partnerships or PPPs) take maximum advantage of the Bank's unique positioning as a Pan-African institution that provides development assistance to both the public and private sectors.

Figure 4

Maximizing Strategic Fit  
(the “sweet spot”)



- The further to the right that projects are positioned in this framework (purely private sector), the more commercial financiers have comparative advantage and the less the Bank is really needed. The further to the left that projects are positioned in the diagram (purely public sector), the more bilateral organizations and NGOs have comparative advantage. The Bank is naturally endowed with sustainable comparative advantage for PPPs (in the middle). This is reinforced by its ability to mobilize both commercial and concessional funding for low income countries (LICs) to help them meet their development needs without increasing the public debt burden, which is key for countries that have gone through the HIPC debt reduction process.
- **Secondary Benefits** – Experience has shown that the Bank can maximize the strategic fit when it focuses on projects where there is significant potential for “secondary benefits” beyond the core project. For example, industrial projects often require the development of new infrastructure in the form of power, transportation, telecommunications, water, etc. By participating in such projects, the Bank can facilitate an “upsizing” of public infrastructure to take advantage of potential economies of scale, whereby financial and socioeconomic benefits can be shared between the private sector operator and the public more generally.<sup>8</sup> The Bank also looks for opportunities to develop local linkages to industrial projects in areas such as training of local labor, upstream development of local supply-chain SMEs, and downstream development of processing industries to increase the value-added and local content of the exported goods.
- **Regional Development Corridors** –The opportunities for secondary benefits can usually be maximized if projects are clustered in areas that take advantage of natural endowments such as population, geography, geology, or weather. These areas, frequently referred to as regional development corridors, have the highest potential to create a critical mass of

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<sup>8</sup> Recently the Bank participated in a Nickel mining operation in Madagascar where the private operator agreed to scale-up the proposed power plant by an extra 30 MW that will be sold into the public grid.

economic activity whereby economies of scale can make the development of essential public infrastructure commercially viable. Regional development corridors are often anchored around zones with known or high-probability deposits of extractable minerals, whose commercial exploitation can generate the necessary wealth to finance the development of key public goods. The Bank has a crucial role to play in the extractive industries to ensure that African governments are able to maximize the medium-term economic benefits of mining operations for the long-term development of other sectors of their economies. The Bank will encourage developers with strong corporate social responsibility and environmental sustainability values and discourage investors looking for quick gains at the expense of Africa's long-term development.

### **Downstream – Portfolio Management**

3.7 Identifying and approving the “best projects” is a necessary but not sufficient condition to ensure the development of a high-performing portfolio. Robust downstream processes are also essential to get operations disbursed, to monitor implementation, and to take timely corrective actions if projects go off-track.

3.8 To ensure high-quality “portfolio management activities”, in 2001 the Bank created a dedicated portfolio management team. The terms of reference of the portfolio management team has evolved in recent years and includes four primary groups of activities: (i) *transaction administration*, (ii) *project management*, (iii) *workouts*, and (iv) *exposure management*.

### **Efficiency and Productivity**

3.9 From upstream project selection to downstream portfolio management, the Bank needs to ensure that its processes are not only effective but also efficient. Achieving a high level of “productivity” will ensure that the Bank is able to maximize its development impact within any given resource base. There are three primary areas specific to the Bank's private sector operations where enhanced productivity can be achieved: (i) *business processes*, (ii) *organizational structure*, and (iii) *technology*. In addition, there are opportunities for substantial productivity gains by more effective use of *partnerships* with other institutions.

3.10 **Partnerships** – Given the enormous financing requirements on the continent, a fourth key element of the Bank's PSO productivity improvement strategy is to leverage its own resources through closer collaboration with other development partners. Potential development partners can be broadly divided into four groups: (i) *development finance institutions (DFIs)*, (ii) *donors and NGOs*, (iii) *commercial financial institutions*, and (iv) *corporations*.

- **Subregional DFIs** – The Bank's most natural PSO partners are Africa's subregional development finance institutions<sup>9</sup>. Although the Bank has a long history of working with these institutions, the full potential of these partnerships has only been partially exploited. Through closer collaboration, the subregional DFIs and the Bank can exploit greater synergies that stem from complementary sources of comparative advantage. The subregional DFIs, with their field presence and local knowledge, provide a logical conduit for the Bank to reach out to small and medium scale enterprises that it cannot reach effectively on its own. The Bank, with its strong credit rating and economies of scale, can assist the subregional DFIs by providing competitive packages of debt, equity, and technical assistance financing. The Bank could also offer a number of new services

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<sup>9</sup> The Development Bank of Southern Africa (DBSA), the Industrial Development Corporation of South Africa (IDC), the East African Development Bank (EADB), the West African Development Bank (BOAD), the Central African Development Bank (BDEAC), the Preferred Trade Agreement Bank (PTA), Shelter Afrique (SA), the African Export-Import Bank (Afrexim), and the Ecowas Bank (EBID).

to DFIs to take advantage of the Bank’s scalable infrastructure at very low incremental cost (e.g. treasury investment services, procurement, communications technology).

- ***International DFIs*** – In addition to the subregional DFIs, other international organizations such as the IFC and other MDBs as well as the bilateral DFIs such as Proparco, FMO, and the DEG are natural PSO partners for the Bank. In the past, the Bank operated rather independently and took less than full advantage of the potential benefits of partnering with these institutions. The Bank is working to strengthen these partnerships through mechanisms such as annual retreats to improve collaboration and new financing facilities that promote greater productivity by reducing the duplication of efforts.<sup>10</sup> The Bank will seek opportunities to leverage the experience and know-how of sister institutions to bring to Africa products and services that have been successfully used in other parts of the developing world.<sup>11</sup>
- ***Donors and NGOs*** – Many donors and NGOs are interested in supporting private sector development and are willing to provide either financial or technical resources for these activities. For example, the Bank, with the strong support of Japan, has created the Enhanced Private Sector Assistance for Africa initiative (EPSA) to channel donor support for private sector development. The Bank intends to build on EPSA to mobilize more resources and to create new financing vehicles that target special objectives, such as clean energy.
- ***Commercial Financial Institutions*** – There are dozens of world-class international and local commercial banks and other forms of financial institutions that have strong corporate social responsibility and environmental sustainability values and who are interested in working with the ADB. Many of these institutions are highly liquid and are looking for ways to put these resources to work. Through a new “World-class Partners Initiative,” the Bank seeks to identify strong development partners through which the Bank can derive economies of scale. This initiative will be a particularly appropriate vehicle for the highly resource-intensive sectors such as microfinance and SME development. It will also be suitable to introduce new instruments to the continent, such as securitization of workers’ remittances or other collateralized or structured lending instruments. Under this initiative, the Bank will also expand on cofinancing mechanisms with top-tier commercial banks, such as risk-sharing agency lines.<sup>12</sup>
- ***International and Local Corporations*** – There are also many sound international and local corporations that have strong corporate social responsibility and environmental sustainability values and are interested in working with the Bank. The Bank intends to identify those “world-class” corporations that can become strong development partners and through which the Bank can derive significant economies of scale. This will be

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<sup>10</sup> The ADB is working with the FMO, Proparco, and the DEG to develop a facility called the African Financing Partnership, which will significantly harmonize procedures and enable the member institutions to increase their operations without increasing the processing costs, while maintaining the highest quality standards.

<sup>11</sup> For example, the International Finance Corporation (IFC) assisted the Bank to undertake its first subordinated debt operation. The Bank is working with the Asian Development Bank on a microfinance securitization operation. The European Bank for Reconstruction and Development (EBRD) is assisting the Bank to develop capacity in the area of syndications. The ADB is working with the Multilateral Investment Fund of the Inter-American Development Bank (IADB) to bring microfinance and remittance products and services that have been highly successful in Latin America to Africa.

<sup>12</sup> The Bank extended its first risk-sharing agency line to Nedbank of South Africa. Under this arrangement Nedbank identifies, appraises, and administers loans in agreed sectors and the Bank shares up to 50% of the risk. The first transactions under this facility are now being processed.

particularly appropriate for the resource sectors such as mining or agriculture, where the local SME development opportunities are greatest. It will also be suitable for infrastructure, where there are opportunities to replicate successful projects in one country elsewhere on the continent. To reach these corporations, the Bank will substantially expand its participation and investment in conferences, trade shows, and other events that typically attract strong corporate participation. The Bank will also seek to facilitate project opportunities between other parties operating in Africa by creating a “marketplace” for potential investors, financiers, promoters, and contractors to network.

## **4 CONCLUSIONS AND RECOMMENDATIONS**

4.1 In 2004, the Board of Directors approved the Bank’s first comprehensive strategy for private sector development on the continent. Although it remains broadly relevant, the current paper provides some refinements to the Bank’s PSD strategy and presents a more complete update of the PSO strategies to reflect the evolution in the Bank’s operating environment and its strategic priorities.

4.2 Private sector development is an institution-wide priority and responsibility for developing and implementing the Bank’s PSD strategy is shared among many business units. Given recent institutional reforms, the Bank’s PSD efforts are based on three interrelated activities: (i) enabling environment diagnostics and strategy development, (ii) enabling environment programs, and (iii) catalytic transactions. For the Bank to play an efficient and effective role in PSD, all three legs of this PSD triangle must function in close coordination through continuous communication and synchronization of activities.

4.3 The Bank’s primary PSO objective is to build a significant portfolio of high-performance and highly catalytic projects that create a strong demonstration effect. To achieve this, project selection is based on criteria that target operations with maximum strategic fit; i.e. those with high developmental impact and that maximize the Bank’s comparative advantages. In practice, this means the Bank tends to focus on public-private partnerships that support the formation of strategic development corridors and provide opportunities to scale up public goods and create local linkages. However, identifying and approving the “best projects” is a necessary but not sufficient condition to ensure the development of a high-performance portfolio. Robust downstream processes are also essential to get operations disbursed, to monitor implementation, and to take timely corrective actions if projects go off-track. Moreover, from upstream project selection to downstream portfolio management, the Bank needs to ensure that its processes are not only effective but also efficient. Achieving a high level of “productivity” will ensure that the Bank is able to maximize its development impact within any given resource base.

4.4 Given its more than 40 years of experience on the continent, its public-private organizational structure, its Pan-African cooperative governance structure, and its AAA credit rating, the AfDB is uniquely positioned to act as “honest broker” for private sector development on the continent. To fulfill its responsibilities as the apex Pan-African financial institution, the AfDB plays three important roles in private sector development: (i) advisor, (ii) financier, and (iii) partner. Increasingly, the Bank will shift from being an end investor in private sector operations to becoming more of a conduit for catalyzing real private investment. To accomplish this, the Bank will progressively deploy risk-sharing instruments that will enable it to leverage its risk capital base and strong project origination expertise.