Chapter 8:

ROLE OF THE AFRICAN DEVELOPMENT BANK IN PRIVATE SECTOR DEVELOPMENT

The AfDB has long recognized the critical role played by the private sector in Africa’s economic development. To this end, it has provided indirect support aimed at improving the enabling environment, including through technical assistance, infrastructure project financing, lines of credit to national and sub-regional financial institutions, and the creation of sub-regional development finance institutions. However, in order to increase the development impact of its assistance to RMCs, the Bank realized that it needed to provide direct support to the private sector through targeted operations. Against the backdrop of its Medium Term Strategy (2008-12) and drawing on the lessons learned from its past efforts, the AfDB has recently decided to mainstream PSD throughout its all of its operations under a “One Bank” approach. It is in the process of finalizing a new PSP and updating its PSS with a view to increase its effectiveness and remain relevant to RMCs by ensuring that its operations contribute directly to bolstering the private sector as a means to increase inclusive growth and reduce unemployment and poverty. Going forward, the AfDB and other development partners should endeavor to scale up support for PSD in infrastructure development, access to finance, human capital development, and regional integration, as well as engagements with the private sector, including through PPPs.

Introduction

The AfDB recognizes the importance of a flourishing private sector for inclusive, sustainable economic growth and has been supporting private sector development in Africa for over 40 years. The Bank has continually taken stock to determine how it can have the greatest impact and, most recently, has undertaken a comprehensive exercise to develop a new PSP that mainstreams PSD throughout all of its operations and that will be implemented through its revised PSS. This initiative is the result of 3 key considerations:

- The most recent gross capital increase commits to implementing more non-sovereign operations in ADF countries in recognition that most shareholders cannot borrow from the Bank, yet have had to pay their share of the 200% capital increase;
- The state of play among Bank Group sovereign clients is evolving, as they have potential new sources of finance, greater appetite for private sector led growth, and are now experimenting with various forms of private sector investment and financing in infrastructure and service delivery; and
- Beyond non-sovereign operations, there is also opportunity to leverage all of the Bank’s resources to enhance the enabling environment and socio-economic infrastructure for PSD.

This chapter provides an overview of the AfDB’s evolving approach to PSD in Africa, summarizes of its key interventions aimed at addressing the main challenges to PSD, highlights the lessons learned from recent experience, and sheds light on the way forward in its continuing effort to support PSD on the continent. The AfDB will continue to refine its interventions and instruments while at the same time strengthening its monitoring and evaluation capacity to ensure that its efforts have the desired development impact.
**Historical Evolution**

Since its inception in 1969 through 1991, the AfDB provided assistance to the private sector in RMCs indirectly, mainly through interventions aimed at supporting the creation of an enabling environment through technical assistance, infrastructure project financing, lines of credit to national and sub-regional financial institutions for on-lending to private enterprises, support for the creation of sub-regional development finance institutions (including through direct equity contributions), policy-based lending, macroeconomic financial management, and regulatory reform\(^{143}\).

By the early 1990s, the Bank realized that to be more effective it needed to provide direct support to the private sector through targeted operations. In late 1990, the Bank’s Board of Directors approved the creation of a Private Sector Development Unit (PSDU), with effect from March 1991. The unit was upgraded into a department (OPSD) in 1998, and later renamed the Private Sector and Microfinance Department (OPSM) in July 2006. Through OPSM, the Bank provided direct project support to selected private enterprises and indirect support to SMEs through regional and national financial intermediaries. These were mainly operations in support of industrialization. The volume of investments remained modest (around US$ 200 million per year up to 2006). In parallel, other Bank departments continued to promote the private sector through sovereign infrastructure financing and technical assistance to RMCs.

The AfDB Board and Management believed more could be done and the Bank Group’s 2003-07 Strategic Plan specifically addressed PSD. The Bank also launched its new PSS in 2004 in fulfillment of a commitment undertaken during the AFD-9 replenishment consultations to assign more roles and responsibilities for PSD throughout the Bank. The Strategy stated “a special premium will be paid to private sector development and capacity building initiatives and programmes to bring the benefits of globalization to regional member countries, in particular through increased foreign direct investment inflows and the promotion of small and initiatives to ameliorate the enabling environment.

The 2004 PSS was not fully implemented, however, because the Bank Group operations continued to be conducted in twin silos—a dominant public sector complex and a minor private sector department— with little synergy between them. Drawing on lessons from the past, the AfDB made PSD one of its four main priorities (along with infrastructure, governance, and higher education) in its 2008-12 MTS (Figure 8.1). Moreover, it placed greater emphasis on the delivery of development outcomes, improving portfolio quality, and accelerating project implementation. At the same time, it updated the 2004 PSS for the period 2008-12 and refined its priority pillars: infrastructure, industry and services, financial intermediation, and SMEs and microfinance. The AfDB’s vision for PSD under the MTS was one in which the private sector is connected to sustainable development and poverty reduction.

**Figure 8.1: African Development Bank Group Focus**

\[\text{Source: AfDB 2008.}\]

143 AfDB 1997.
**Bank Operations for Private Sector Development**

The AfDB has provided substantial support to PSD in RMCs in the legal and regulatory environment, infrastructure, finance, higher education and vocational training, entrepreneurial development, and corporate governance (Figure 8.2). It has done so through its sovereign lending, private sector operations (PSO), Policy Based Operations (PBOs), Institutional Support Programs (ISPs), technical assistance, and knowledge products.

**Figure 8.2: Cumulative Active Projects in African Development Bank Portfolio by Sector**

![Pie chart showing sector distribution of projects](chart.png)

Source: AfDB 2008.

The AfDB is supporting RMCs to improve their legal and regulatory environment for businesses through PBOs and ISPs. The Bank’s Governance Action Plan specifies a number of operational areas of focus to assist RMCs, including improving business laws and institutions, enhancing corporate governance (through, for example, the APRM), combating corruption, supporting financial sector development (through, for instance, improved payments systems and the “Making Finance Work for Africa” program), and strengthening the legal and regulatory environment, including through the Business Enabling Environment (BEE) program. The AfDB’s support in these areas includes the creation of one-stop shops, streamlining of tax and customs administration, improving land title administration, and implementing the Extractive Industries Transparency Initiative. In addition to the increased PSO portfolio noted above, between 2007 and 2010 the Bank developed 44 PBOs, of which 21 had at least one component supporting the business enabling environment and 24 ISPs, of which 13 had components designed to improve the business environment (Box 8.1).

**Box 8.1: AfDB/OSGE Support to the Legal and Regulatory Environment in Selected RMCs**

AfDB supports legal and regulatory framework development in West Africa and in several countries including Rwanda, Mozambique, Morocco and Tunisia.

**Rwanda, PBO**: Following the 2004 and 2007 budget support programs, the Poverty Reduction Strategy Support Program III was approved in early 2009. These three operations supported Rwanda’s transition from post-conflict reconstruction to re-engagement with the international community, through enhancement of the country’s
public financial management systems and governance institutions. Key outcomes under the Bank’s budget support operations included stronger local institutions that are better able to manage their economic and financial affairs. It also improved transparency in the public procurement process. Recent legal and institutional reforms focused on protecting investors have resulted in Rwanda improving its overall ranking in the World Bank’s 2010 Doing Business Report to 67th, up from 143rd in 2008 (out of a total of 183 economies).

**Mozambique**: The One Stop Shops (OSS) is an innovative project (2009) supported by the Bank aimed at simplifying doing business in Mozambique. The 2010 Doing Business Report, which ranks countries on their “Ease of Doing Business”, upgraded Mozambique by 5 positions. Much of the gains relate to the fast and reliable access to business registration and licensing procedures streamlined through the OSS. One-Stop-Shops are administrative service centers that gather all concerned governmental departments under the same building enabling entrepreneurs to register and obtain licenses for their companies in one single location. The centers also provide other services such as issuing national identity cards, passports as well as births, marriage and property certificates. They also offer tax and social security services, notary services, and emigration services. The Bank currently finances six OSS across the country by providing them with IT equipment, training staff and financing communication programs.

**Morocco, PBO**: The Financial Sector Development Support Program approved by the Bank in December 2009 aims at improving access to banking services, strengthening the microcredit sector, improving effectiveness of the national guarantee system, sharing risk information, developing venture capital, strengthening financial market and insurance sector supervision and control, and revitalizing the financial market. This second generation reform program will benefit the Moroccan people as a whole, including the government, households, the private sector, and, in particular, small and medium enterprises.

**Tunisia, Integration Support Program (2009)**: The support reinforces Bank’s contribution to the development of the financial sector and the business environment. It supports the Tunisia’s 11th National Development Plan (2007-11), which aims to strengthen growth and employment generation. The main thrust of the program is to continue growth-enhancing reforms anchored around a deeper integration of Tunisia to the global economy and assist the Government in responding to the global financial crisis. The program focuses on, among others, helping Tunisia to restructure balance sheets of banks and insurance companies, and improve the quality and availability of financial information; Strengthening of competition policy including increased convergence of tax treatment of offshore and onshore sectors.

**West Africa, regional ISP**: The Bank is supporting access to banking services in the CFA zone by promoting the modernization of payment systems in the West Africa Monetary Zone (WAMZ). The core objective is to increase access to financial services in the CFA region from 10% (2009) to 20% (2015). The program supports the establishment of national and regional mechanisms of payment to ensure that the new systems meet internationally acceptable standards, thus promoting consumer confidence in West African Monetary Zone financial systems.


The AfDB is involved in financing infrastructure and catalyzing funds through traditional and innovative methods for both the public and private sectors in order to facilitate PSD. Over the past five years, the Bank has increased the volume of financing for infrastructure projects, as well as the proportion of financing that goes to regional projects. The Bank has also been utilizing blended financing packages and risk management instruments to attract private finance, build capacity in RMCs, and broker complex
regional projects. In addition to providing loans for infrastructure development projects, the Bank has also introduced the use of quasi-equity instruments, such as subordinated loans, to raise the overall return on investment, and/or to enhance credit structures to acceptable risk levels. To address exchange rate risk, the Bank has invested more than 25 million dollars in the Currency Exchange Fund (TCX). The Fund helps investors hedge against risks associated with project financing in local currencies. The Bank has also become increasingly more involved in providing guarantees, and participating in currency swaps markets. In addition, it is promoting capacity building in RMCs to build efficient and sustainable institutions and regulatory frameworks that are robust enough to develop even the most complex projects. The Bank is also working closely with the AU through the recently launched PIDA, and is developing a road map for the execution of a priority set of regional integration infrastructure projects.

The Bank has been promoting financial sector development and private sector access to finance in Africa, primarily by strengthening financial institutions and regulatory and supervisory institutions. Initial interventions focused mainly on providing financing to the real sector through lines of credit to financial institutions. This remains the main instrument used by the Bank’s private sector window to channel financing to private sector players through financial intermediaries. But the Bank has also been promoting microfinance institutions to cater to micro enterprises and households. Over time, the Bank has placed greater emphasis on policies, institutions, and financial infrastructure by supporting payment system reforms, funding capacity building programs aimed at strengthening institutions and supervisory capacity, and offering policy-based loans and budget support operations to foster financial sector reforms. More recently, the Bank has developed innovative direct solutions to improve private sector access to finance, including the creation of the Microfinance Capacity Building Trust Fund in 2009 and the African Guarantee Fund for SMEs.

The Bank’s support for human capital and skills development in RMCs is underpinned by its HEST strategy, which has 3 pillars (i.e., centers of excellence, infrastructure, and linkage with the productive sectors). The Bank supports the diverse needs for STI taking into account countries’ different needs and levels of development. This support includes capacity building, policy advice, building STI infrastructure, and establishing national and regional centers of excellence. It focuses on addressing the need to develop manufacturing capabilities through enterprise incubators and job creation, such as financing linkages between universities and research institutions in Rwanda using the Knowledge Transfer Partnership approach. It is also promoting linkages with the productive sectors via the Bank’s support for the Technical Vocation and Educational Training (TVET) project in Kenya (2009) and Mali’s ICT Technopole project (to be presented to the Board in 2011). In addition, the Bank is working with other development partners and the private sector to assist RMCs to: (i) assess skills needs; (ii) strengthen HEST-industry linkages; (iii) promote and support measures to increase women’s participation in STI-related training and research activities; and (iv) cultivate technological development through partnerships with the private sector.

The Bank has recently begun to promote entrepreneurial development through a variety of efforts, spearheaded by FAPA and the AfDB Human and Social Development Department (OSHD) (Box 8.2). The FAPA Regional Franchising project (2006), which is being implemented in Ghana, Senegal, and South Africa, advances franchising with the aim of contributing to economic growth and job creation. Training is offered through seminars and manuals. Its export-oriented SMEs project (2007) provided technical assistance to Ghanaian SMEs that had high potential of exporting non-traditional products, while its Growth-Oriented Women Entrepreneurs project (2005-2006) bolsters female entrepreneurship in Cameroon and Kenya (Box 8.3). Finally, FAPA’s Private Sector Capacity Building project (2008) provides business information (resource center, magazine, and radio programs), MSME competitiveness (business development centers, mini-exhibitions), special entrepreneurship programs for women and youth, and public-private sector dialogue.

144 Examples include the reform of the banking system in Egypt and the payment systems in the West African Economic and Monetary Union (WAEMU). The Bank also launched the Fund for African Private Sector Assistance (FAPA) in 2005.
Box 8.2: The Fund for African Private Sector Assistance and AfDB’s Support to Female Entrepreneurs

The Fund for African Private Sector Assistance (FAPA) was created in 2005 in partnership with the Japanese government, under the Enhanced Private Sector Assistance Initiative for Africa, as a thematic trust fund that provides untied grants for technical assistance and capacity building in support of the AfDB’s PSD strategy.

FAPA’s grants complement the Bank’s conventional financial instruments (equity investments, project loans, credit lines, and guarantees). The grants are offered to governments, regional economic communities, business associations, market regulatory institutions, business development service providers, business training and research institutions, and public/private enterprises. FAPA’s five areas of focus are in line with the PSD strategy: (i) creating an enabling environment; (ii) strengthening financial systems through technical assistance; (iii) building competitive infrastructure; (iv) promoting the development of micro-, small-, and medium-scale enterprises, particularly promoting entrepreneurship and formalization through support programs that address weak business support institutions, skills shortages in business development, weak equity capacity, and limited access to commercial financing; and (v) promoting trade by providing support to remove trade barriers and strengthening the capacity of local trade finance institutions.

FAPA is now in the process of replenishing its funds and undergoing a thorough evaluation of its projects.

One of the programs FAPA supports is for female entrepreneurs.

The AfDB recognizes the importance of female entrepreneurship and skills development. To help African female entrepreneurs, the Bank has developed the Growth Oriented Women Entrepreneurs (GOWE) projects in Cameroon (2006) and Kenya (2005). The project facilitates affordable financing by reducing the collateral requirements and enhancing the credit assessment capacities of partner banks through partial credit guarantee facilities to select participating banks in Cameroon and Kenya. These banks in turn finance underserved GOWEs, Women Entrepreneur Associations, and Business Development Service providers.

The GOWE projects also have technical assistance facilities, which cover (i) training and mentoring clients based on a thorough needs assessment and (ii) capacity building of partner institutions, including local banks, business development service providers and women’s associations. Capacity building includes technical training in relevant areas, heightening gender awareness, and in some cases, purchase or development of software tools. Technical assistance is funded by FAPA and implemented by PEP-Africa in cooperation with the International Labour Office.

The two programs together are expected to finance at least 800 women entrepreneurs, enhance and expand entrepreneurship development in these countries, create employment of at least 1,000 people, encourage banks to provide longer-term loans, and strengthen the technical and financial plans of associations of women entrepreneurs, business development services providers and partner banks.

Source: AfDB 2010 and 2011.

OHSD’s social protection unit has three main operational approaches to supporting the development of business managers and entrepreneurs in Africa: building capacity for MSMEs; facilitating access to finance; and improving the business enabling environment for MSME development. Its projects cover every region of Africa and provide capacity building usually in tandem with access to finance (Box 8.3).
Box 8.3: Examples of AfDB’s HD Department’s Support to Entrepreneurship Development

Two examples of AfDB’s Human Development Department’s projects supporting entrepreneurship are in Mauritania and Guinea.

In Mauritania, the Project to Build the Capabilities of Microfinance Operators (2007)—builds stakeholder capacities with respect to the supply and demand for microfinance services through the provision of technical training on demand and coaching to 1,500 MSE promoters and the provision of training on entrepreneurship and the creation and management of SMEs.

In Guinea, the Sustainable Social Development Project (2010) reduces poverty through entrepreneurship development, job creation and support to local governments through the strengthening of technical, organizational, and management capacity of 150 SMEs and 150 corporative associations.

Source: AfDB Human Development Department 2011.

The Bank adopted a comprehensive CG strategy in 2005, which serves as the framework for its interventions in this area. Its objective is to contribute to economic development by promoting good CG in both private (including family-owned) and public corporations to create value for shareholders and other stakeholders in a financially, socially, and environmentally responsible manner. Good CG is also a direct concern to the Bank as an equity investor in private sector ventures and a financier of development projects, which often rely on the involvement of private sector corporations and state-owned enterprises. Since adopting its strategy the Bank has taken steps to strengthen its internal institutional framework, increase knowledge transfer and dissemination, and develop effective interventions based on best practices and lessons learned. The Bank is encouraging RMCs to adapt international best practices of CG principles to their specific country context and corporations to adopt these principles. It is focusing its financial and technical assistance on the development and enforcement of CG codes and on strengthening the capacity of financial intermediaries to enforce the CG standards by including them as a key part of their lending policy (Box 8.4). The Bank is also supporting regional training, building on existing regional mechanisms.

Box 8.4: AfDB Initiatives in Support of Good Corporate Governance in Africa

Recent Bank initiatives in Corporate Governance (GC) include:

- Continuous support to NEPAD and the African Peer Review Mechanism (APRM) Secretariat, NEPAD counties, professional bodies, and Pan-African institutions, such as the Pan-African Consultative Corporate governance Forum.

- Active participation in the preparation and adoption of the common DFI’s position on CG. The declaration was signed by 31 DFIs (including the AfDB) during the 2007 World Bank Group Annual Meeting.

- Hosting an annual consultative meeting on key developments with selected stakeholders involved in CG with a view to exchanging information and improving coordination in the field (2005, 2006, and 2007).

- Organization of a workshop during the Bank’s Annual Meetings in Shanghai.

Lessons Learned

The AfDB has evaluated the lessons learned from its past efforts to promote PSD. While the Bank’s PSOs have grown substantially, particularly over the past 5 years, its other tools to promote PSD have been underutilized. This section outlines key areas requiring improvement or reorientation.

The Bank’s evaluation group reviewed its PSOs from 1997-2005 and found that almost 80% of its projects had positive development outcomes. The majority of its additionality impact was financial and the key to good performance was through support to RMCs’ business environments. Increased efforts in project planning and monitoring were also important for positive development outcomes. Though the findings were mostly positive, as indicted below, the impact of these operations could have been greater.

Although PSD has been a priority in the Bank’s operations, it has not been fully integrated into the institutional culture of the Bank, thus reducing its potential impact. The lack of integration is a direct yet unintended result of the creation of the private sector unit in 1991 which, in effect, splitting the Bank into two silos—the private sector department and the rest of the Bank. As a consequence, though PSOs grew impressively, the development impact of these operations was undermined by the missed opportunities for synergies between the Bank’s public and private sector operational departments. Country strategy papers also reflected the cleavage, showing a systematic lack of focus on PSD opportunities, challenges, and solutions. Therefore, in order to achieve the organization-wide mandate for PSD with strong, positive outcomes, the Bank must further develop the necessary roles, functions, and business processes and identify and harness the links between its sovereign and non-sovereign activities.

The AfDB could strengthen its impact through a more focused approach. The Bank has undergone several institutional reforms to make its PSO credit processes more rigorous as these operations grew rapidly in recent years. This model, which initially focused only on those directly involved with PSO business processes, could be applied. Adopting a sector-focused project identification approach and review process to address enabling environment issues upfront, along with a more targeted sovereign financing to catalyze non-sovereign transactions, could enhance the effectiveness of both types of financing.

The current resources available to finance the Bank’s knowledge products are fragmented and insufficient to mobilize the best available market and business information. Moreover, the high transaction cost involved in attracting resources to finance such activities is a barrier to their utilization. The programming and financing of research and development are also under-resourced, under-executed, and not systematically disseminated to guide the design of Bank operations. This is also the case regarding institutional knowledge management within the Bank, resulting in a limited ability to document approaches and best practices to scale up and replicate.

Currently, institutional development, capacity building, and technical assistance are primarily conducted by external consultants and financed from operational budget and trust funds without any forms of cost recovery. This is in stark contrast with other development institutions that have in-house services and capacities, such as the IFC whose advisory services staff exceeds that involved in investment transactions. A more integrated and structured approach to the mobilization and financing of technical assistance and advisory services is therefore needed. The focus should be on leveraging the Bank-wide strategy on capacity building, which emphasizes the need to support African institutions as partners in technical assistance and advisory services.

As the AfDB expands its PSO into lower-income countries, including Fragile States, with increased emphasis on microfinance, SME development, and equity investments, this will affect the risk profile of the Bank’s non-sovereign portfolio. Therefore, an increasing number of new operations will likely be rated as high risk, requiring intensified capital planning on the part of the Bank.

In order to ensure that it is getting the maximum development impact from its private sector operations, the Bank relies on its independent Operations Evaluations Department (OPEV) and its newly created (2008) Additionality and Development Outcome Assessment (ADOA) team. These entities thoroughly examine projects both at the front end (ADOA) and at their conclusion (OPEV) to make sure that the projects...
were well-designed, that development outcomes were clearly defined, that the Bank’s additionality was clearly demonstrated, and that the desired outcomes were achieved. Up unto the present, the AfDB has focused its evaluations on PSOs, leaving gaps regarding the assessment of the developmental impact of its other operations in support of PSD, including in the areas of the business environment, infrastructure development, access to finance, human capital and skills development, entrepreneurial development, and corporate governance. The Bank’s new PSP and PSS will need to address these omissions.

The Way Forward

The Bank is mainstreaming PSD throughout all of its operations against the backdrop of its 2008-12 Medium Term Strategy (MTS) and is placing greater emphasis on the delivery of development outcomes, improving portfolio quality, and accelerating project implementation.

Drawing on the lessons learned, the AfDB is preparing a new PSP and an updated PSS. Their purpose is to increase the Bank’s effectiveness so that it can remain relevant to its RMCs by ensuring that its operations contribute directly to bolstering the African private sector as a means to increasing inclusive economic growth and reducing poverty. The three main objectives are to:

Support RMCs in improving their business enabling environments and advancing their international competitiveness. This includes policy reform, regional integration, infrastructure development and services delivery, and supporting financial markets.

- Promote private sector-led economic growth by fostering entrepreneurship, providing direct and indirect support to microenterprises and MSMEs, empowering women to become entrepreneurs, and encouraging economic integration and diversification.

- Encourage social and environmental responsibility, sustainability, and good corporate governance.

The AfDB’s efforts will be guided by the following four principles: (a) ownership of PSD begins first and foremost with RMCs, (b) use of Bank resources must be results-oriented to ensure additionality and its catalytic effect; (c) Bank operations should be aimed at promoting a private sector that is sustainable, inclusive, socially equitable, open, and competitive; and (d) risk-taking must be properly paired with financial prudence.

This “One Bank” approach will therefore mainstream PSD in every dimension of the Bank’s work. Country Strategy Papers and Regional Integration Strategy Papers from the country and regional departments will be central to this effort as they will provide the framework for multi-stakeholder review and identify priority areas for policy dialogue, policy-based operations, investment financing operations, and analytical economic and sector work. Business enabling environment operations will include knowledge products, policy-based operations, and sovereign projects. Non-sovereign operations will include private sector operations, sub-sovereign operations, and technical assistance and advisory services. Risk management, additionality and development outcomes assessment, and monitoring and evaluation will continue to be used to ensure additionality, effectiveness, financial sustainability, and catalytic effects. All these will be couched against the single optic of PSD.

Going forward, apart from supporting RMCs in improving investment climates, the AfDB and other development partners should scale up their resource support for infrastructure, finance, human capital (especially higher education and skills development), and regional networks in line with its MTS. The Bank should also scale up its engagement with the private sector through PPPs and support for changes in trading structures and practices. Stakeholders in PSD, including the Bank, should catalyze the private sector by scaling up successes such as big reformers, the ICT and tourism sectors, and regionalization of business, finance and infrastructure development. Unleashing financial, entrepreneurial and knowledge resources in RMCs will also support PSD and create a more sustainable and inclusive pattern of growth and development.