

Independent Evaluation of Non-Sovereign Operations, 2006-2011 Main Conclusions and Key Messages

Introduction

The AfDB launched its private sector operations in 1991 to support private sector projects and entities incorporated in its RMCs.

This Evaluation reviews the performance of these private sector (non-sovereign) operations. It focuses on the Bank's portfolio of 137 investment operations and 38 technical assistance projects that were approved by the Board between 2006 and 2011, and which account for a total approved investment volume of UA 3.9 billion, of which UA 3.5 billion is committed.

The evaluation assessed four aspects of the Non-Sovereign Operations Portfolio: the strategic alignment of the portfolio, the performance of the portfolio, the risk management framework and risk exposures, and institutional efficiency.

The evaluation highlights positives relating to the catalytic effect of the Bank's operations, the risk management framework and growth in private sector operations in LICs. In contrast, it notes negatives relating to the one Bank approach, the



reach to SMEs and MSMEs, and inefficiency in the approval process.

Management agreed that the evaluation raised some fundamental questions, namely (i) consistency of the Bank's private sector operations (PSO) policies; (ii) managing risks in the best interest of the Bank; and (iii) improving the Bank's



AFRICAN DEVELOPMENT BANK GROUP



pev
Operations Evaluation Department
Département de l'évaluation opérations

business processes through policy, strategy and a business plan.

Data was collected from document reviews, staff and client interviews, and field visits to a sample of projects. Bank practices and performance metrics were benchmarked against those of peer institutions. This brief presents the main conclusions and key messages from the evaluation.

Main Conclusions

1. To date, the Bank's private sector operations have focused narrowly on investment activity rather than on broader market reforms. They have made relatively little use of other instruments such as guarantees, trade finance facilities and technical assistance. Furthermore, the Bank has not been proactive in identifying and developing viable investment projects on the ground, relying instead on sponsors to approach the Bank with requests for funding support.
2. In general, the private sector portfolio is well-aligned with the Bank's sector-level targets. However, the Bank's reach to micro and small enterprises through credit lines is not evident. Bank support for privately-led infrastructure projects has had profound, positive effects on development, though more could be done to identify and structure projects to enhance regional trade and integration.
3. The Bank's policies, processes and incentives need to strike a balance between volume growth, portfolio risk and development effectiveness. Growth and selectivity in the equity portfolio has not been steered by a considered policy framework, though this is now being addressed. Finally, the Bank lacks adequate policies and procedures to manage projects in jeopardy, which greatly increases its risk of financial loss.
4. The Bank has inadequate monitoring procedures to enable it to gather credible results data during supervision. This limits its ability to judge outturn development effectiveness.
5. In terms of profitability, the Bank's loan portfolio is still relatively young and its profit contribution not yet evident. However, there has been a recent increase in non-performing assets. Also, the Bank has yet to realize any capital gains from its equity portfolio, which is currently yielding negative returns overall. Finally, the Bank does not have adequate systems in place to calculate net profit contribution for individual operations, and cannot therefore determine the relative



profitability of large vs. small investments or the effect of resource-intensive projects.

6. The May 2010 General Capital Increase has created more headroom for the Bank to expand its private sector operations going forward. To date, the Bank has managed the growth of its private sector operations within the defined exposure limits for the overall portfolio and for single clients and sectors. This, along with the new capital allocation methodology should allow the Bank to implement its strategy whilst managing its scarce resources. However, there are target growth areas within the private sector strategy that need to be monitored closely to remain within prescribed capital and risk limits, including equity investments and exposure in LICs and fragile states. Furthermore, AfDB's policies should address the issues related to exit strategies to provide guidance for investment officers.
7. The Bank uses a standardized credit approval process, which is not always warranted in the case of smaller or lower-risk investments, where delegated authority would likely prove more efficient. For loans, the Bank has adopted a new pricing framework that brings it into line with other commercial and multilateral banks, and more closely reflects the underlying credit risk.
8. Efficiency measures for the Bank fall short of those in other institutions. Other MDBs employ streamlined procedures or framework agreements, combined with delegated

authority, which help to expedite approval times for certain classes of investment.

9. Recommendations arising from these findings include the following:
 - (i) Clarify the link between the Bank's priorities at the transactional level and its broader strategic objectives; deploy a broader range of instruments to address failings at macro, sector and regulatory levels, and which promote local currency and trade finance; and review the strategy for financial sector support to ensure that these interventions achieve their intended reach and development goals;
 - (ii) Leverage the Bank's use of technical assistance and capacity building to add value to clients; strengthen its policies, procedures and staff resources for project monitoring and evaluation; review its equity portfolio to identify



and address the reasons for underperformance; and introduce a performance measurement system with scorecards that balance incentives for volume growth with other priorities such as client responsiveness, profitability and development effectiveness.

(iii) Review the coherence of the private sector strategy and associated objectives with its risk management framework, to address possible future constraints on priority areas like equity investment and support of low-income countries and fragile states; consider delegating approval authority to levels below the Board; reinforce its procedures and systems in relation to loan collateral and address the apparent under-pricing of its loan operations; and establish a dedicated workout function for at-risk investments.

(iv) Proceed with decentralization to place a critical mass of private sector staff in the field, with adequate support from the OPSM ecosystem; review approval procedures with the help of client feedback to identify areas of duplication, repetition or low value-added; develop streamlined procedures or framework agreements for approval of investments that fall below specified risk criteria; upgrade its Management Information System and introduce time-recording to track staff activities during project origination and supervision; and address

current deficiencies in the budgeting process to ensure that budgets for private sector operations are credible and sufficient.

Key Messages

1. Bank investments helped catalyse UA 20 billion of co-investment at the project level. The Bank has provided useful counter-cyclical support following the global economic crisis. It has not been proactive in identifying and developing viable investment projects on the ground.
2. The Bank supports private enterprises through direct lending, equity investment and intermediation, but actual reach to micro and small enterprises is less evident in credit lines. Bank support of privately-led infrastructure projects has had profound, positive effects on development. More could be done to identify and structure projects to enhance regional trade and integration.



3. In general, the private sector portfolio is well-aligned with the Bank's sector priorities. However, the link between transactional priorities and strategic objectives is not clear. Credit risk and prudent exposure limits could constrain pursuit of the strategic focus on LICs and fragile states. Policies, processes and incentives need to strike a balance between volume growth, portfolio risk and development effectiveness.
4. The Bank has made relatively little use of other instruments such as guarantees, trade finance facilities and technical assistance.
5. The Bank's ADOA system provides an ex-ante estimate of project development results on the basis of which all projects are expected to have efficacious development outcomes and/or Bank additionality. Yet the Bank has inadequate monitoring procedures to enable it to gather credible results data during supervision. Private sector projects supported by the Bank have made a wide range of contributions to development. The Bank could use technical assistance in pursuit of greater development effectiveness.
6. The loan portfolio is relatively young and its profit contribution not yet evident although there has been a recent increase in non-performing assets. The Bank does not have adequate systems in place to calculate net profit contribution for individual investments.
7. The Bank has adopted best practices from both peer MDBs and commercial banks for its risk management framework. The Bank has remained within defined exposure limits for the private sector portfolio overall, and for single clients and sectors but exceeds some country limits under the new exposure framework.
8. The Bank uses a standardized credit approval process, which is not always warranted. The weighted average risk rating is within the target band, though it has risen recently due to increased interventions in LICs and fragile states.
9. The Bank's project approval processes are cumbersome and employ more steps than other MDBs. Other MDBs employ streamlined procedures or framework agreements, combined with delegated authority, to expedite approval times.
10. Bank staff exhibit skills across most sectors and disciplines, but more staff are needed with experience in project workouts and investment recovery.
11. The Bank's decentralization roadmap aims to increase its capacity to source and process more operations in the field.





About the AfDB: The overarching objective of the African Development Bank Group is to spur sustainable economic development and social progress in its regional member countries (RMCs), thus contributing to poverty reduction. The Bank Group achieves this objective by mobilizing and allocating resources for investment in RMCs; and providing policy advice and technical assistance to support development efforts.

The mission of the **Operations Evaluation Department** is to enhance the development effectiveness of AfDB initiatives in its regional member countries through independent and instrumental evaluations and partnerships for sharing knowledge

Director: Rakesh Nangia, r.nangia@afdb.org

Manager, Project Level Evaluations: Mohamed Manai, m.manai@afdb.org

Operations Evaluation Department, African Development Bank

BP 323, 1002 Tunis-Belvedere, Tunisia

Tel : (216) 71 102 841 Fax : (216) 71 194 460

Helpdesk: opevhelpdesk@afdb.org

Website: www.afdb.org/opev

OPEV Evaluation Team: Mohamed Manai, Hadiza Sidikou, Grace Kyokunda

The production of this publication was coordinated by Felicia Awwontom,

Design and Production by Phoenix Design Aid, Denmark

Certified Co2 Neutral, ISO 9001/14001, DS 49001 and OHSAS 18001