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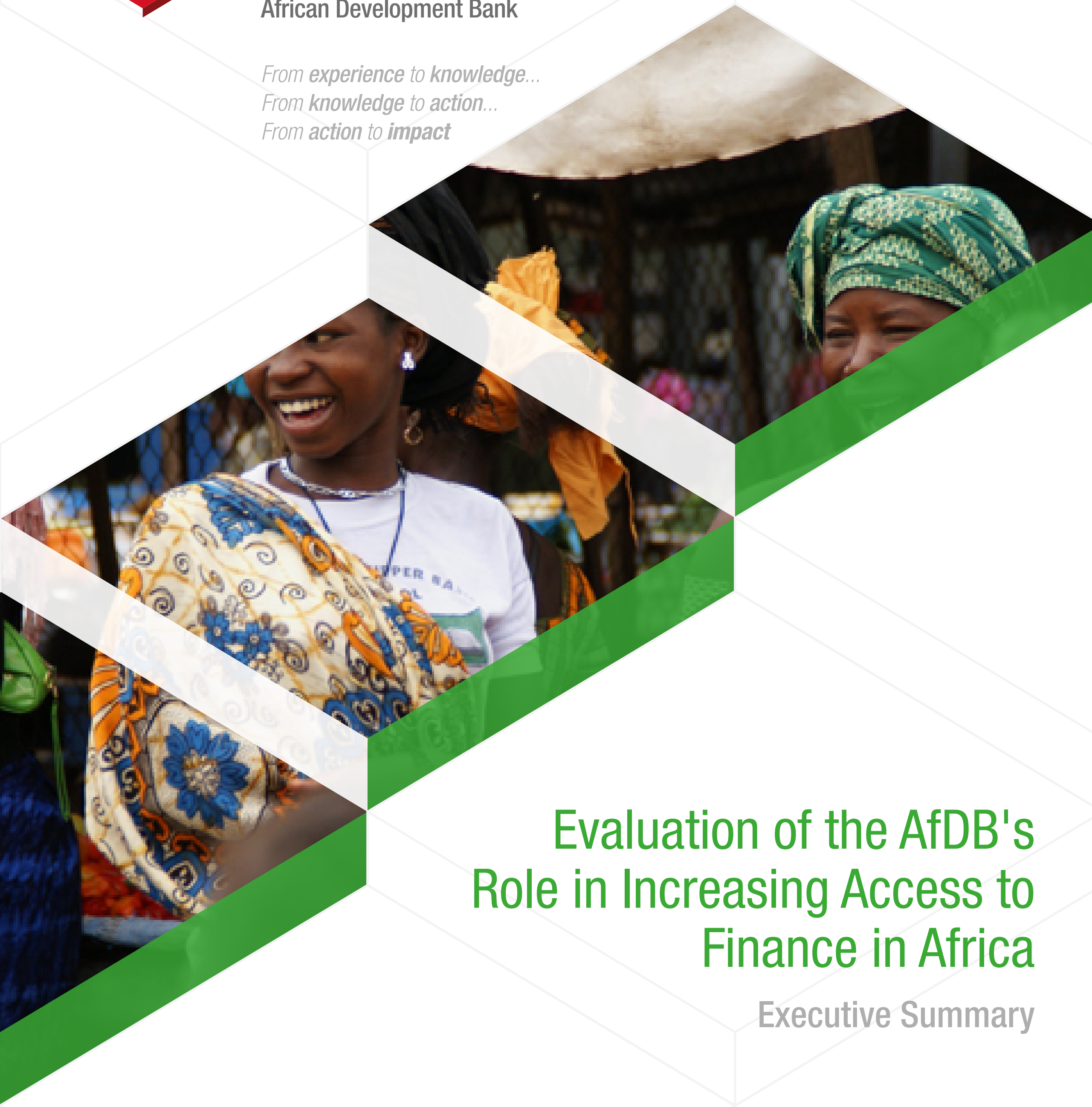

An IDEV **Project Cluster Evaluation**

Evaluation of the AfDB's Role in Increasing Access to Finance in Africa

Executive Summary

AFRICAN DEVELOPMENT BANK GROUP

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Executive Summary

Context, Objective and Scope

This report presents a synthesis of an evaluation of clusters of financial sector development operations extended by the African Development Bank (AfDB, the Bank) to financial institutions and governments in seven countries selected from the five African regions. Selected operations contributing to financial sector development were evaluated in the following countries: Burkina Faso and Nigeria in Western Africa, Cameroon in Central Africa, Namibia in Southern Africa, Kenya in Eastern Africa, and Egypt and Tunisia in Northern Africa. Egypt was selected as the country hosting the headquarters of the African Export-Import Bank (Afreximbank), which benefited from the AfDB's trade finance operations and lends to financial institutions in several African countries.The synthesis is one of the deliverables of the evaluation of the AfDB's Role in Increasing Access to Finance in Africa undertaken by the Independent Development Evaluation (IDEV) as part of its 2018–2019 Work Program. Access to finance is one of the three pillars of the Bank's 2014 Financial Sector Development Policy and Strategy (FSDPS). The other pillars are deepening financial markets and safeguarding the stability of Africa's financial systems. The evaluation aims to draw lessons from the implementation of the FSDPS in order to inform the preparation of the new financial sector development strategy[1].

Methodology and Limitations

The evaluation assessed the relevance, design, effectiveness, efficiency and sustainability of 32 financial sector development operations approved from 2011 to 2018, and organized in clusters by financial instruments. The evaluation also explored the AfDB's additionality, or its potential to distort markets, as well as the AfDB's coordination with authorities and other development partners. The evaluation purposefully focused on countries in which the AfDB had multiple operations using different instruments during the period under consideration (there was, however, only one operation in Cameroon). The 32 operations were approved for UA 2,364.6 million, which represented 27.2 percent of the total amount approved between 2011 and 2018 for financial sector development[2]. These included 15 Lines of Credit (LOCs), five Trade Finance Lines of Credit (TFLOC), three Risk Participation Agreements (RPAs), six equity participations, two grants/technical assistance, and one Policy-Based Operation (PBO). Areas of work where the AfDB has increased its focus after 2014, for example, the development of capital markets, are underrepresented in the sample, which covers the 2011–2018 period. The fieldwork took place between 22 May and 22 July 2019. Quantitative and qualitative information was collected in response to the evaluation questions using individual and focus group interviews, desk reviews, statistical data analysis and direct observation.

The main difficulties that were encountered consisted of collecting the relevant information and the fungibility of resources, limiting the attribution of the achievements to AfDB support. Thus, the performance of the operations is focused on the contribution of AfDB support to financial sector development objectives. The draft report for each country was shared with the field operation teams for their comments. Also, each draft country report benefited from the comments of two external peer reviewers. Finally, the results presented in this synthesis report were reviewed by the consultants recruited in each country and by the reference group members of the evaluation, who met on 26 February 2020 to discuss the draft report and thereafter sent written comments.

Summary of Main Findings

Access to finance remains a key constraint to private sector development and the economic inclusion of low-income populations. The selected countries cover a range of the financial sector at different levels of development. Despite progress over the past decade, access to finance remains a key constraint for private sector development in all the selected countries. A common feature of the countries observed is the dominance of the banking sector and the underdeveloped nature of capital markets, which limits enterprises' options in accessing finance. In some countries, banks enjoy sufficient levels of liquidity and are generally well capitalized (e.g., Burkina Faso, Namibia, Nigeria and Kenya). However, in other markets, banks lack liquidity and show relatively high levels of non-performing loans (e.g., Tunisia and Cameroon). Capital markets are underdeveloped in all the evaluated countries. This weak development of domestic and regional stock markets limits still further enterprises' access to capital.

The high priority given to access to finance in the FSDPS and partner countries is not reflected in the AfDB's country strategy papers (CSPs) for selected countries. All countries in the sample see access to finance, and financial inclusion in particular, as a priority for economic development and an enabler of other development goals, such as rural development, employment and women's economic empowerment. CSPs refer to the financial sector mostly as a channel to improve financing for priority sectors but do not place sufficient emphasis on the need to build strong, sustainable and resilient financial systems. Hence, the strategic priority given to financial sector development by member countries and the FSDPS is not always reflected in the AfDB CSPs.

AfDB operations were in line with FSDPS and relevant to their respective country contexts. AfDB operations mostly focused on channeling long-term funding to priority sectors of the economy. Given the broad scope of the FSDPS and significant gaps in financial sector development, the AfDB's operations were in line with the FSDPS and country needs, but they mainly focused on providing resources to financial intermediaries for on-lending to the real economy. Many other constraints that are mentioned in partner countries' strategies and the FSDPS remain unaddressed. These include weak payment systems, regulatory constraints, lack of innovation and informality, among others.

While the fieldwork focused on countries in which the AfDB had multiple financial sector operations (apart from Cameroon where there was only one operation), there was no evidence that these operations were part of a coherent Bank strategy toward financial sector development in these countries. The lack of thorough financial sector diagnostics to understand the underlying constraints may have contributed to the weak strategic clarity and focus. Except for the operations evaluated in Tunisia, the AfDB's financial sector operations are decided on their case-by-case viability and do not represent a coherent set of interventions that jointly contribute to achieving the FSDPS objectives. The lack of a Bank vision for financial sector development at the country level is also reflected by the fact that the AfDB is not visible as a leader in policy dialogue on financial sector development.

Insufficient definition of target groups and broad intended development outcomes limited the AfDB's role in advancing access to finance for the underserved. Development outcomes and the end-beneficiaries were not clearly defined in project appraisal reports and in reporting. Despite the fact that LOCs often target specific underserved and excluded population segments (such as the rural population, women and young people), information was missing in many cases. In other cases, available information shows that the intended targets represented only a small part of the portfolio of client institutions benefiting from the AfDB's LOCs. LOC objectives loosely refer to access to finance, but without defining clear targets, especially regarding reaching underserved target groups such as women and youth. Furthermore, the positioning of Small and Medium Enterprise (SME) finance as a driver of growth and job creation led to a focus on high-growth SMEs, not the underserved. While the focus on strong SMEs makes sense from a private sector development perspective (for instance, to promote enterprises' development for job creation), it risks insufficiently advancing access to finance for the underserved. The diverse financial needs of households and individuals, other than business needs (e.g., management of shocks, reduction of vulnerability/poverty, women's empowerment, access to other basic services) are hardly considered in project designs. This raises questions of strategic clarity and whether operations are effectively targeting SMEs and the underserved and excluded segments of the population.

The efficiency of the AfDB's financial sector development operations was partially satisfactory. More than half of the evaluated operations were efficiently prepared and implemented. Others faced time overruns which, in some cases, led to additional costs for clients or missed lending opportunities. Even in operations where efficiency was satisfactory, clients stated that processes were overly prolonged apart from those for repeat operations. Among the main reasons advanced to explain the situation were onerous conditions as requirements prior to disbursement, inefficient communication and the lack of an automated procurement system.

The Bank's operations tend to provide temporary solutions to financial sector development barriers. The AfDB provides much needed long-term funding to its target markets and has often helped clients access additional funding from International Financial Institutions (IFIs). However, the lack of long-term funding was addressed only temporarily through supporting end-beneficiaries via financial intermediaries. The AfDB supported regulated, financially sustainable institutions, but the likelihood that it will continue serving underserved target groups beyond the period of AfDB support is questionable. This is because most operations did not address the underlying constraints that prevent financial institutions from serving the underserved segments of the population and the economy, including SMEs. Such constraints include insufficient capacity and willingness to serve certain segments of the market, weak regulation and supervision, lack of competition, existence of information asymmetries, and high transaction costs and risks. These factors also contribute to the high interest rates prevailing in African financial sectors (Beck et al. 2011). Also, a reflection on innovative ways to increase access to finance through digital and other alternative delivery channels is largely absent from the evaluated portfolio, despite the disrupting role that technology plays in a number of African financial sectors. More recently, the AfDB has become more active in supporting the development of capital markets and digital financial services. However, these operations are not sufficiently mature and only a few are included in the sample of this evaluation[3].

Suggestions to Consider

Strategic considerations to strengthen the AfDB's role in access to finance

Conduct sector diagnostics that identify barriers to access to finance. CSPs and the subsequent selection of instruments and partners should be based on thorough financial sector diagnostics to address market failures and systemic constraints with the right instruments. Diagnostics could build on sectoral and thematic studies[4], existing studies conducted by other funders and abundant information from Making Finance Work for Africa (MFW4A). Diagnostics should go beyond analyzing the banking sector, and also consider how existing financial service providers and their offerings meet the needs of different segments of Micro, Small and Medium Enterprises (MSMEs) and the population. Financial sector experts should work closely with in-country and regional economists, not only when carrying out country diagnostics but also when preparing country and regional notes and strategy papers.

Define intended financial sector development outcomes at the country and regional levels. The AfDB can have more transformational impact if its operations contribute to a clear and shared vision for financial sector development, and financial and non-financial instruments are used in a complementary way to support strong partners (both private and public). There is a need to develop a more comprehensive narrative of how financial sector development in Africa contributes to private sector development, and to explain its links with increased productivity and economic development at the regional/country levels. CSPs and Regional Integration Strategy Papers (RISPs) or any other strategic framework with a country or regional focus should include clear objectives for financial sector development operations, with related outcomes. These objectives should stand at the same level as development objectives of other sectors and be broken down into result indicators when designing the operations.

Be more explicit on how operations contribute to address financial sector development constraints in the long run. Based on binding constraints identified in the diagnostics, project appraisal reports (PARs) should articulate how supporting specific institutions and the use of relevant instruments will contribute to the three pillars of financial sector development. A more diverse range of instruments and potential measures (e.g., capital market development, investing in financial infrastructure, etc.) to increase the availability of long-term funding should be considered during project design, not only LOCs. All operations should formulate a theory of change that is based on existing knowledge and is specific to the country or regional context and target groups.

Suggestions to improve the benefits for the intended target groups

Better define and measure the project development outcomes and the benefits for target groups. PARs should include specific, measurable financial sector development indicators in their results frameworks, including indicators that measure access to finance for the underserved. Indicators need to be defined at all levels: the financial sector, and the client and end-beneficiary levels. Wherever possible, the AfDB should use standard indicators of financial inclusion and/or indicators used in countries' financial inclusion strategies. Monitoring requirements and indicators should be discussed with partners upfront and be tracked during supervision missions. The role of investment officers in supervision missions should be revisited and clarified and, if necessary, there should be increased capacity dedicated to monitoring and supervision. For further reflection on impact management systems, the AfDB could consider applying the Operating Principles for Impact Management to ensure that impact considerations are integrated throughout the investment lifecycle. This is an emerging practice for development finance institutions and impact investors alike (see https://www.impactprinciples.org/principles).

A clear definition of what constitutes an SME needs to be included in the PARs and embedded in the CSPs. Definitions used by operations are often not clarified in the PARs, making it difficult to assess the contribution of the AfDB to SMEs. The AfDB should identify and target firms that require its support and for which it has a comparative advantage in supporting. If the AfDB uses the definitions of Regional Member Country (RMC) governments, partner financial institutions or other IFIs, it should define a methodology for measuring and aggregating impacts at the portfolio level. The strategic review of the AfDB's SME support operations (Genesis Analytics 2018) provides a detailed analysis, together with suggestions on how to tackle the challenge of defining SMEs. The Africa SME Program's working definition and practice of verifying that applied definitions can be considered an SME target group in a specific context is a step in the right direction.

Build on effective approaches to support SME finance. Supporting SMEs to contribute to growth and inclusive economic development requires addressing financial and non-financial barriers, which is best done by a dedicated team that can aggregate all SME-related initiatives. Having a dedicated team helps attract the right expertise and is more likely to set the right incentives for SME finance, which can be skewed toward larger transactions if SME finance is bundled with other operations that tend to require larger ticket sizes. Further increasing the capacity of the AfDB's 2013 Regional Africa SME Program could be a good step.

Moving from a pipeline approach to a portfolio approach. The AfDB could explore different approaches to improve the focus on intended target beneficiaries. Instead of determining a list of projects (pipeline approach) for guiding the on-lending to the intended target groups, the AfDB could test defining targets at the portfolio level (portfolio approach). Combined with tighter and strengthened M&E capacity of partners, portfolio-level targets (e.g., the number, volume and the percentage of SME loans in the overall lending portfolio) might lead to better results. However, at the strategic level, there needs to be a reflection on how to reconcile objectives such as maximizing the financial inclusion of the underserved and job creation. Along the same lines, clearer strategic objectives for on-lending to companies in fragile states could help increase the AfDB's impact in some of the countries that are most in need.

Narrowing the gender gap in access to finance requires a more deliberate approach. So far, women are mentioned alongside other population groups as intended end-beneficiaries of financial sector development operations. However, the PARs tend to lack specific considerations of how operations help reduce the gender gap in access to finance. There is broad evidence that women face multiple regulatory, cultural, social and economic barriers that hinder their access to formal financial services, and their participation in the economy more broadly (Morsy 2020). These barriers cannot be addressed through targeted lending only but require a gender-transformative approach to financial inclusion. The AfDB should reflect on how it can be more deliberate in advancing women's financial and economic inclusion through its different instruments, and how it can become more gender sensitive as an institution. This will require developing a credible results chain on how an operation is likely to address the barriers. It also implies obtaining more gender-disaggregated data on access to finance for women, with a baseline, targets and effective monitoring.

Suggestions on the range of instruments and their use for financial sector development

The AfDB should increase awareness and usage of its Partial Credit Guarantees (PCGs) among investees. The AfDB gained useful learning from its experience with the PCG in Cameroon, which should be documented and made accessible internally to build staff awareness and capacity. PCGs are a useful addition to the suite of instruments if properly structured, priced and monitored. They can be used to encourage lending to more innovative, and potentially riskier and more dynamic, activities and companies. PCGs can also be used to encourage financial intermediaries to lend to underserved market segments, sectors and fragile states, with higher perceived or real risks. While the PCG extended to Cameroon in 2015 was limited to hedging the exchange rate between the U.S. dollar and the euro, in the Senegal PCG in 2018 it was possible to track the flow of funds from the special account in which the Eurobond proceeds were held to the actual investment projects, classified according to the AfDB's High 5s.

Consider lending in local currencies. Restrictions on providing LOCs in local currencies limit their relevance and applicability. The AfDB should consider providing local currency loans and, whenever possible, leverage existing mechanisms to promote local currency financing, such as the Africa Local Currency Bond Fund (ALCBF).

Use Technical Assistance (TA) to strengthen institutions that drive sector development. A needs assessment should be conducted prior to providing technical assistance (TA) to identify capacity gaps. The AfDB could reflect further on how providing TA to a specific institution can contribute to financial sector development more broadly (e.g., by introducing an innovative financial service). The AfDB could provide advisory services to the financial sector, especially in new and emerging areas such as climate and green financing.

Suggestions to position the AfDB as a key player in financial sector development

Improve outreach and the depth of relationships with sector stakeholders, including clients. The AfDB should inform stakeholders of the financial sector policy and strategy, maintain channels of communication with the clients, and organize regular follow-up meetings to improve the efficiency and effectiveness of the operations.

Leverage the AfDB's policy influence and expertise to facilitate policy dialogue. The AfDB needs to purposefully engage in policy and regulatory dialogue aimed at addressing constraints, and strengthen regulatory environments and supervision of the financial sector. This should include working in close cooperation with, or leveraging initiatives by, other development partners such as the World Bank Group, the International Monetary Fund (IMF), and local advocacy and industry associations.

Consider increasing the resources for regional integration operations aimed at fostering regional integration around access to finance. Given the increasing role now being played by cross-border, regional or continental banks in Africa, it is paramount to support operations aimed at fostering the regional integration of financial sectors. This should help to harmonize rules and procedures at the regional level, especially among francophone and anglophone countries.

An IDEV **Project Cluster Evaluation**

About this Evaluation

This report presents the results of an evaluation of 32 financial sector development operations extended by the African Development Bank (AfDB) to financial institutions and governments in seven countries across five African regions over the period 2011 to 2018. The evaluation aims to draw lessons from the implementation of the Bank's Financial Sector Development Policy and Strategy in order to inform the preparation of the new financial sector development strategy.

Using mixed-methods to gather data on the Bank's role in increasing access to finance through the selected operations, a four-point rating scale was used to rate the 32 operations, which were organized in clusters by financial instruments.

The evaluation found that access to finance remains a key constraint to private sector development and the economic inclusion of low-income populations, but was not reflected in the Bank's Country Strategy Papers for the selected countries. Also, the evaluation team found no evidence that the operations in the countries in which the Bank had multiple financial sector operations, were part of a coherent Bank strategy toward financial sector development in these countries. The operations' target groups were not sufficiently defined, and the Bank's role in advancing access to finance for the underserved was limited. Although the operations were relevant to their respective country contexts, the evaluation found that they tended to provide temporary solutions to financial sector development barriers rather than addressing the root causes. The evaluation suggests to: i) strengthen the Bank's role in access to finance; ii) improve the benefits for the intended target groups; iii) use a range of instruments for financial sector development; and iv) position the Bank as a key player in financial sector development.

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