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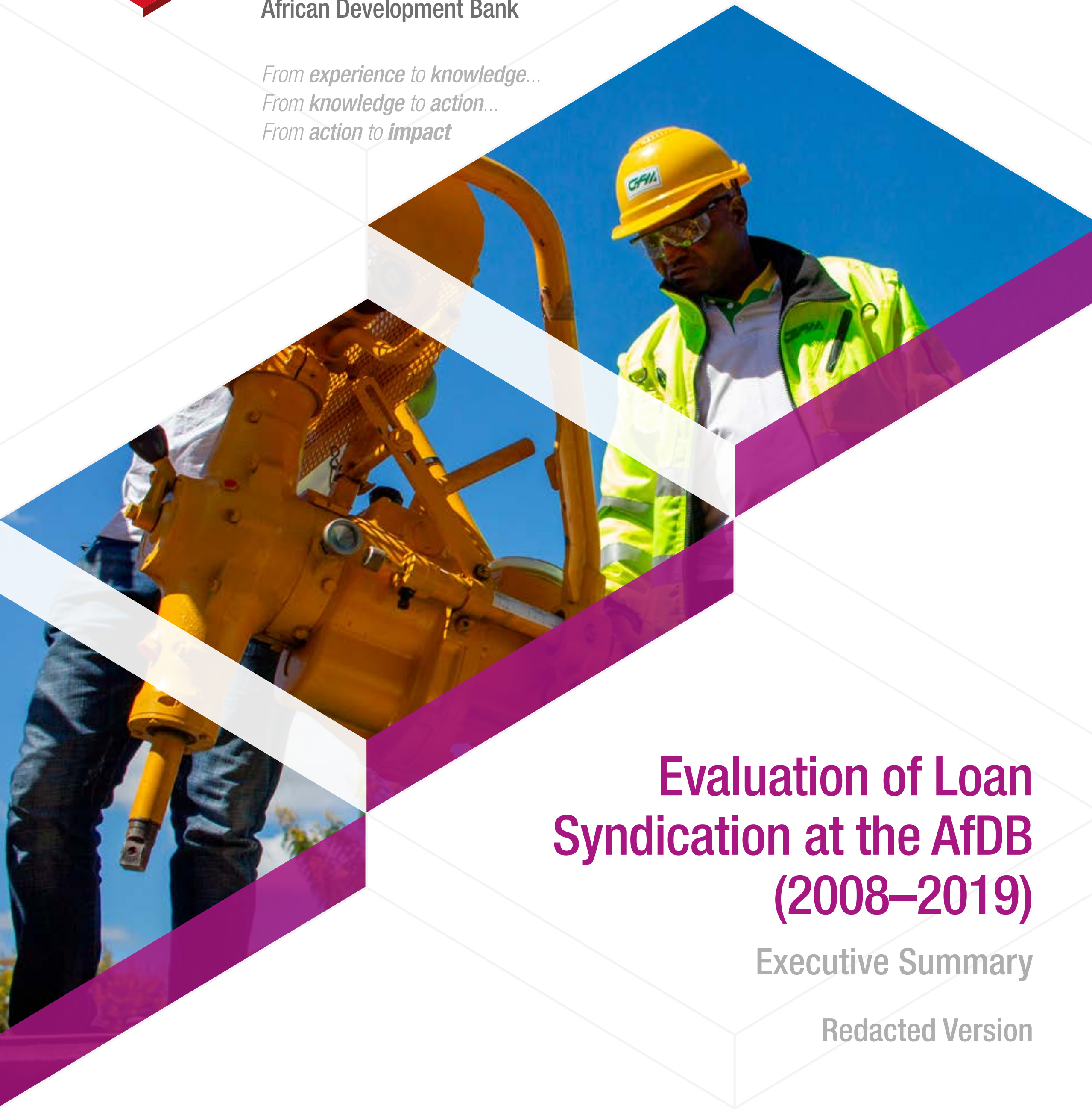

Evaluation of Loan Syndication at the AfDB (2008–2019)

Executive Summary

Redacted Version

An IDEV **Thematic Evaluation**

AFRICAN DEVELOPMENT BANK GROUP

May 2021

Executive Summary

Background

As part of the evaluation of partnerships at the African Development Bank Group (the Bank, or the AfDB), Independent Development Evaluation (IDEV) sought to assess the performance of the Bank in mobilizing resources from the private sector through loan syndication. This report presents the findings, lessons and recommendations of that assessment over the period 2008–2019. It is a distinct component of the evaluation of the AfDB's partnerships that presents additional evidence on how the Bank is mobilizing resources and partners to further its development agenda for Africa. The evaluation findings give an overview of the performance over the past decade, while highlighting the recent improvements and persisting challenges.

The Bank started considering loan syndication as a specific product in the 2000s. In November 2008, it approved the Operational Guidelines for Syndication of Non-Sovereign Guaranteed Loans (ADB/BD/IF/2008/279), which were revised in 2017.[1] From 2008 to 2016, syndication was a support unit embedded in the Bank's Private Sector Department. In a second period, from 2017 to 2019, the most important institutional evolution was the creation of the Department of Co-financing, Syndication and Client Solutions (FIST), which had a division responsible for syndication and co-financing (FIST.1).

Since the launch of the Bank's syndication program, it has closed five syndicated transactions as Mandated Lead Arranger (MLA) or Coordinating Bank. These transactions are: (i) Transnet (South Africa, 2011); (ii) Lake Turkana (Kenya, 2014); (iii) Eskom (South Africa, 2016); (iv) Redstone (South Africa, 2019); and (v) Cocoa Board (Ghana, 2019)[2]. The total value of these transactions stands at US$3.7 billion in three sectors, namely, energy, transport and agriculture. There was a concentration of invested resources in the infrastructure sector (energy and transport), with energy accounting for 64 percent of total resources. In terms of regional distribution, the loans have mainly benefited the Southern African region, specifically South Africa, with a total of 62 percent in both the energy and transport sectors.

Evaluation Framework and Methodology

This evaluation provides the AfDB Board of Directors and Management with evidence-based findings on the performance of loan syndication at the Bank. It covers the different syndication operations conducted from 2008 to 2019. Three strategic areas of concern were articulated around: (i) the adequacy of the Bank's approach to loan syndication; (ii) its performance over the period; and (iii) its organizational structure. The main findings of this report are presented under the three criteria of relevance, effectiveness, and efficiency. To rate the performance, the evaluation used a four-point rating scale of Highly Unsatisfactory (1-HU), Unsatisfactory (2-U), Satisfactory (3-S) and Highly Satisfactory (4-HS).

The evaluation followed a mixed-method approach. This included mainly qualitative analysis, such as literature and project reviews, stakeholder interviews, and a benchmarking with comparator organizations, namely, the International Finance Corporation (IFC), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IDB) and the Asian Development Bank (AsDB). The quantitative evidence was derived from the portfolio analysis and external data on syndicated loans.

The evaluation faced challenges that were addressed to ensure the quality of the analysis. These challenges were: (i) the limited documentation during the 2008-2017 period due to a lack of systematic monitoring; (ii) the limited data obtained from benchmarked organizations due to confidentiality concerns in dealing with the private sector; and (iii) the limited number and low maturity of the closed syndication deals.

Relevance: Was the Bank's approach to loan syndication adequate?

The relevance of the Bank's approach to syndication has been rated as Satisfactory. The evaluation concluded that the Bank's approach to syndicating loans was relevant and coherent with the approaches of similar benchmarked organizations. The Bank has indicated through the High 5s its intent to increase the share of syndication in its resource mobilization efforts and the function was aligned with the Bank's priorities and policies.

The loan syndication approach was aligned with the Bank's key policies and strategies, including the High 5s, the 2013-2022 Ten-Year Strategy (TYS) setting the long-term agenda for substantial involvement in Private Sector Development (PSD), the 2013 Private Sector Development Policy, and the 2013–2017 Private Sector Development Strategy. The Syndication Guidelines were also approved in accordance with the Bank's General Authority of 2000, in addition to the Revised Private Sector Operations Policies, the Policies for Lines of Credit, Agency Lines, and Guarantees to Private Sector Financial Institutions and the Non-Sovereign Guaranteed Loans guidelines.

Syndicated loans have been identified as an appropriate instrument to boost resource mobilization from the private sector and increase the Bank's leverage in various sectors, mainly infrastructure. The Bank's syndication program was considered a useful and adequate instrument that fits both the needs of the Bank's clients, regional member countries and potential investors.

The Bank has shown an increasing interest in mainstreaming syndication operations into its Non-Sovereign Operations (NSOs) and has developed adequate tools to achieve this objective. However, the syndication function lacked a clear strategy which hampered its relevance. This clarity was made critical by the new economic environment in Africa and the challenging and highly competitive market segment of development finance institutions (DFIs) as well as commercial banks in which the Bank is operating.

At the operational level, the 2008 Loan Syndication Guidelines were found to be relevant, consistent with Bank processes, and following best practices from comparator organizations at the time. However, they lacked clarity of roles and responsibilities, leading to coordination issues in their implementation. Interviews indicated that the Revised Guidelines of 2017, integrating the creation of FIST, provided more clarity on the loan syndication processes, while integrating them into the new Bank architecture, thus ensuring consistency with current Bank practices and the creation of a specific syndication division.

Despite notable improvements, some gray areas regarding the division of roles, processes and the respective roles of investment officers (IOs) and syndication experts[3] (SYNEXs) at the origination stage persist. Processes have not yet been fully integrated within the existing workflows and the Bank systems to foster coordination, efficient implementation, and accountability.

Effectiveness: To what extent was the Bank successful in syndicating loans?

The effectiveness of the syndication function of the Bank has been rated as Unsatisfactory. The implementation of syndication and the achievement of results thereof did not meet expectations, mainly due to the low level of mobilization and the limited number of deals that the Bank led and brought to financial closure over a decade. It should be noted, however, that with the creation of a division for syndication and co-financing, the Bank has recorded some positive evolution over the past three years. Guidelines as well as staffing have been improved to ensure that MLA deals are pursued more adequately. Yet, challenges persist and remain to be addressed.

Overall, the evaluation found that the Bank's syndication function produced limited results over the ten-year period under review. Before 2017, with the implementation of the High 5s and the Development and Business Delivery Model, the function was hampered by years of under-prioritization as a top source of mobilizing private financing. While during a first period from 2008-2016, some key and landmark syndication deals were closed, the overall performance was found to be rather opportunistic, unstable and not systematic. Following the creation of FIST, from 2018, the performance of the Bank's syndication has improved with what could be seen as a spike in potential deals in the Bank's pipeline. The positive evolution could be explained by the renewed interest at the senior management level to increase the share of co-financing and syndication in the Bank's lending. However, the noted evolution still represents only a fraction of the real potential of the Bank.

From 2008 to 2019, the Bank syndicated US$3.7 billion, representing an average Private Direct Mobilization (PDM) of US$336 million per year. This performance was considered significantly lower than expected, given the amounts mobilized through traditional co-financing for the private and public sectors. The mobilized sum of US$3.7 billion is only 2 percent of the total US$179.26 billion mobilized by the Bank from both public and private sectors during 2008-2019.

It should be noted, however, that while the Bank may have closed fewer deals than other institutions, the average amounts of the deals closed was relatively high, at over US$500 million. Out of the five loans, two have been contracted for projects financed by privately-owned entities, while three involved state-owned enterprises (SOEs) with the autonomy to borrow directly from the market. The total amount raised from commercial and institutional lenders for all types of syndications amounted to US$2.75 billion (US$1.78 billion from commercial lenders only), while the total contribution of the AfDB was US$0.95 billion, resulting in a leverage of 1:2.89 over an eleven-year period. The average contribution from the Bank was US$189 million compared with US$550 million for other investors.

Since most of the projects are still ongoing, the evaluation could not assess the development results achieved in a comprehensive way. However, it was concluded that the various projects approved have a significant potential impact in the countries of operation. For example, the loan to Eskom in South Africa has been instrumental in financing the company's five-year capacity expansion program (2015-2020) to alleviate the energy crisis in South Africa. The investment contributed to the increase in generation capacity of 4,800 MW at the Medupi power plant. It is also expected to help in the creation of 10,000 direct and indirect jobs in South Africa. Lake Turkana Wind Power (LTWP) is an independent power producer supported by the Bank in Kenya. Now in operation, LTWP is producing 100 percent of its expected energy generation capacity of 310 MW, as all 365 turbines have been erected and the substation completed. Also, in Ghana, once completed, the COCOBOD project will likely impact over 800,000 farmers working in the cocoa sector and improve the livelihoods of around 4 million people.

Efficiency: How well was the Bank organized to deliver its syndicated loans?

The efficiency of the syndication function was rated as Unsatisfactory, mainly due to the multiple implementation challenges, among which weaknesses in internal coordination and the inadequacy of the incentives in place, notably the

Key Performance Indicators (KPIs) and the staffing. Although syndication remains a viable and relevant private sector resource mobilization instrument, the Bank is yet to achieve optimal efficiency. Mobilizing more private capital resources, including through loan syndication, would require sufficient attention to the processes in place and adequate resourcing.

Although loan syndication by Multilateral Development Banks (MDBs) is often used on large long-term projects, the evaluation found that the Bank's timelines were protracted and posed a risk to its competitiveness. Initially, the internal processes were burdened by inefficiencies that hampered collaboration. But later, with the creation of FIST and the implementation of new guidelines, this specific issue was resolved to some extent, as the syndication team became involved in the preparation stage. Nevertheless, challenges remain in the ecosystem of the Bank.

While the external perception of the loan syndication function appears positive, there was a lack of consensus internally on how syndication should be run. This has been a hindrance to FIST.1 in implementing its syndication mandate. Syndication is an institution-wide business, requiring a productive ecosystem consisting of people, products and processes that function correctly to deliver value-added transactions. It could be, moreover, a source of income for the Bank and therefore requires significant investments and preparation to ensure its effectiveness and profitability. While products and processes were found to be adequate and consistent with best practices in theory, they were not supported by effective implementation and collaboration between IOs and SYNEXs.

With regard to the syndication KPIs, the Bank's focus on Board approvals and its lending target has adversely affected its ability to deliver syndicated loans. IOs were found to mainly focus on achieving their KPIs, which until recently was obtaining Board approval for their projects. This situation has led to inadequate incentives, whereby IOs sought few syndication mandates and, after Board approval, were not always invested into ensuring the success of the syndicated tranche. Despite noted improvements, issues that continue to affect syndication's efficiency include: (i) the quality of the project and its pricing, which could reduce its attractiveness for commercial co-financiers; (ii) the lack of appetite of IOs for syndicated loans and co-financed deals where the AfDB would play the lead role; and (iii) IOs' focus on the delivery of the AfDB tranche of a deal, which in turn is a disincentive to pushing harder to secure the MLA role.

Interviews reveal that there are limited incentives for IOs and SYNEXs to collaborate systematically. IOs have limited interest to include co-financing or syndication in the financial structure of their projects and therefore to rely on SYNEXs to support the transaction from the origination to the financial close. The recent introduction of KPIs that push for more co-financing and syndication will contribute to making IOs and SYNEXs jointly responsible for increasing the share of co-financing and syndication in the overall lending.

Lessons

Lesson 1: Deals are likely to be more successful and closed relatively faster when processes are efficient.

One of the main advantages of syndication for the borrower, is the speed at which the loan can be obtained compared to other avenues. Establishing efficient processes that ensure timely delivery are essential for business growth, borrowers' confidence and the Bank's track record. To be successful, the AfDB's syndication model, while different from commercial banks, should adopt a private sector business mindset. This means improving the processes to be as efficient, agile and quick as possible and as permitted by Bank rules, to respond to both the Borrower's needs on time but also satisfying commercial co-financiers needs.

Lesson 2: Reducing the average size of syndicated deals could increase the Bank's activity.

The average value of the five syndicated deals closed by the Bank is over US$500 million. This level places the Bank in the top segment of DFIs capable of mobilizing vast resources for significant projects in Africa. While pursuing only large-scale loans could be a comparative advantage, it also affects the Bank's effectiveness, as these transactions take longer to complete and may be dependent on public guarantees, economic prospects, or other political factors.

The current pipeline shows an increase in the number of potential deals, with the total average value to be syndicated declining to US$300 million per year. This highlights an opportunity for the Bank to also syndicate smaller deals (albeit with a minimum ticket size), thus increasing the Bank's experience and outreach. Processing deals with high amounts may be attractive as they require the same investment of time as smaller tickets, but increasing the number of closed syndicated deals by working on smaller loans could also be positive to establish the Bank's experience, outreach, and success track record.

Lesson 3: Coordination and cooperation between IOs and SYNEXs are essential factors for success.

When IOs and SYNEXs collaborate actively on deals, this reduces frustrations and leads to better results. To this end, it would be good for all internal parties to develop the same understanding and vision about a deal's potential to be closed and to work together to remove all hurdles that might prevent success. A collaboration culture should, therefore, complement the culture of compliance to ensure the efficient co-management of the deal. Precious time could be wasted if IOs and SYNEXs do not develop this collaborative spirit from the onset with the single purpose of achieving the Bank's lending and syndication mandates.

Lesson 4: Building a strong network of lenders is another key to success.

Strong networks are one of the critical factors for success in syndication. Placing deals on the syndication market is conditional on having attractive deals and pricing. More importantly, an excellent and reliable network of private banking institutions that lend credibility to the Bank's projects and are ready to sign onto the Bank's transactions is necessary. Building such networks requires time, experienced staff, and high exposure to the market actors. Furthermore, it is beneficial to establish a database of potential banks that have experience in specific sectors of interest (energy, transport, IT, etc.) to ensure that the syndication opportunities pursued by the Bank as the MLA offer value addition to the respective sponsors.

Lesson 5: Adequate delegation of authority empowers IOs and SYNEXs to close deals.

When deals are negotiated and presented to the AfDB Board, they have often not been finalized, especially the syndicated part. This creates a risk of failure or delays in later negotiations if the conditions approved by the Board cannot be significantly revised. Successful deals by other organizations (IFC) are negotiated in principle with all partners and participants before the Board approves the deal. The approval empowers Management to negotiate, within a margin, the final terms of the deal. This authority implies that the Board is informed of the final terms without the need for a second approval. This approach has proven to be both time- and cost-effective.

Lesson 6: Concentration could boost syndicated loan performance and the Bank's additionality.

Studies show that syndicated loans perform better when: (i) they are led by banks with a good track record in syndication and lending portfolios concentrated in specific sectors; and (ii) banks choose syndicate partners that have similar lending specialization.[4] Also, additionality in syndication is strongest: (i) when DFIs such as the Bank respond to markets with limited resources for syndication operations for the private sector, or unusually low global liquidity; (ii) when the DFI's presence in emerging markets and sectors helps alleviate nascent industry risks; and (iii) when there is evidence of strong catalytic effects of the loans.[5] For the AfDB, this could translate into ensuring that syndicated loans focus more on: (i) countries with limited syndication opportunities to set precedents that could boost market confidence; (ii) sectors with a strategic interest where it has a comparative advantage; (iii) improving lending terms, especially in areas such as enhanced terms and the cost of debt, and exploring more opportunities for local currency financing; and (iv) developing in-house expertise to become a leader and mobilize participating banks based on interest but also lending specialization profile.

Recommendations

Recommendation 1: Develop a five-year strategic framework to establish syndication as a cost-covering and revenue-generating business function, with a sharper focus on business development.

A successful syndication function will require moving from an opportunistic origination approach to a more strategic one. In this regard, the Bank is advised to ensure the syndication function is revamped into a more systematic co-financing and syndication business development-oriented function with the objective to significantly increase the share of syndication in the Bank's delivery.

Recommendation 2: Strengthen the syndication processes and delegation of authority in line with the One Bank Approach.

It is advised that Management consider putting in place a more coherent and efficient process that enhances coordination and improves the use of the syndication function by all relevant departments in the Bank. Such reform should be coherent with the Bank's overall direction laid out in the One Bank approach. It also appears important that the Board supports the development of the syndication function by granting the appropriate authority to sign-off on revised lending terms under syndications to enable deals to be quickly closed.

Recommendation 3: Provide additional incentives to promote syndication.

A strong incentive system is needed to ensure that Investment Officers and Syndication and Co-financing Officers work collaboratively to develop the syndication business in the Bank. Making the Bank a leader in the domain would require adopting a set of ambitious targets with the right KPIs that focus on active resource mobilization.

Recommendation 4: Build a team of industry specialists to support the syndication and business development capacity.

Adequate staffing capacity is key to the success of syndication. The Bank should strive to build its capabilities to support its growing pipeline of syndication operations as well develop in-house tools to support its ambition to be a leader in the loan syndication market.

Recommendation 5: Improve innovation, reporting, and learning of co-financing and syndication.

The Bank is advised to fully capitalize on existing initiatives, such as the Africa Investment Forum, and to pursue innovations that could attract financiers and lenders to invest in the Bank's operations. Finally, improving reporting, monitoring and knowledge management of syndication would help in better steering the Bank's action towards achieving its objectives. ■

About this evaluation

This report summarizes the findings, lessons, and recommendations of an evaluation of the Bank's performance in mobilizing resources from the private sector through loan syndication over the period 2008–2019. It is a distinct component of the evaluation of the AfDB's partnerships that presents additional evidence on how the Bank is mobilizing resources and partners to further its development agenda for Africa. The Bank's syndication program has closed five syndicated transactions since its launching in 2008, with a total value of US$3.7 billion, in the energy, transport, and agriculture sectors.

The evaluation found that the Bank's approach to syndicating loans was relevant and coherent with the approaches of similar benchmarked organizations. However, the syndication function lacked a clear strategy which hampered its relevance. The implementation of syndication and the achievement of results thereof did not meet expectations, mainly due to the low level of mobilization and the limited number of deals that the Bank led and brought to financial closure over a decade. Although syndication remains a useful, viable and relevant private sector resource mobilization instrument, the Bank is yet to achieve optimal efficiency.

The evaluation drew a number of lessons, including: (i) deals are likely to be more successful and closed relatively faster when processes are efficient; (ii) reducing the average size of syndicated deals could increase the Bank's activity; and (iii) coordination and cooperation between investment officers and syndications officers, as well as building a strong network of lenders, are essential factors for success.

The evaluation recommends that the Bank establish syndication as a cost-covering and revenue-generating business function, with a sharper focus on business development. It should also strengthen the syndication processes and build a team of industry specialists, providing additional incentives to promote syndication. Finally, the evaluation recommends to improve innovation, reporting and learning from co-financing and syndication.

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