Innovative Financing for Private Sector Development

Mr. Emmanuel HATEGEKA
Permanent Secretary
Ministry of Trade and Industry

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Focus of Private Sector Development

- **Private sector is an engine of economic growth and development in both developing and developed economies**

  Interventions by stakeholders targeted to private sector development should aim to:

  1. Improve business environment with a view to reducing the cost of doing business;
  2. Increase access, availability and quality of basic infrastructure services to facilitate investment and trade;
  3. Improve access to requisite financial resources needed for private sector development;
  4. Ensure adequate supply of people with entrepreneurial, production and business management skills (Human Resource Development);
  5. Build the capacity of market support institutions and provide specific firm level capacity building for competitiveness;
  6. Promote economic empowerment of small and medium enterprises;
  7. Support Export Diversification initiatives;
  8. Support regional integration agenda and internationalisation of domestic private sector.

Financing is limited by a number of challenges

1. **Asymmetric Information**
   - Borrowers cannot adequately convey creditworthiness, hindering access to finance and raising the cost of business when technical expertise has to be sought.
2. **Low Technical Capacity, Business Skills**
   - Low technical capacity to develop viable business proposals.
3. **High Costs of Borrowing**
   - High cost of local finance, low aggregate savings (high deposite rates to attract savings), short loan duration;
   - The recruitment of project design experts is costly;
   - Fees & charges levied on borrowers remains high;
   - International loans can take up to two years due to bureaucratic processes.
4. **Infrastructural Constraints**
   - Insufficient feeder roads in rural areas;
   - Limited access to nationwide internet coverage;
   - Limited access to electricity.

All the above constrain access to financial services

Innovative Financing

Innovative financing involves non-traditional applications of solidarity, PPPs, and catalytic mechanisms that (i) support fund-raising by tapping new sources and engaging investors beyond the financial dimension of transactions, as partners and stakeholders in development; or (ii) deliver financial solutions to development problems on the ground (World Bank)

Purpose:

- Directly fund the private sector in addition to ongoing efforts to improve the capacity of supporting institutions and foster environment conducive to PSD
- Resource flows are undiversified, ODA dominates - innovative financing can help diversify

To maximise impact, innovative financing should:

- Be fully additional to Government efforts to raise domestic revenues
- Supplement ODA and not substitutive to it
- Be predictable and stable over time
- Comply with principles of 2005 Paris Declaration on Aid Effectiveness and 2008 Accra Agenda for Action
- Take account of the advantages and disadvantages of specific financial instruments
- Be simple and transparent, especially when calling on private solidarity participation

Options for innovative finance:

- *Guarantee Funds*
- *Subsidy Programmes*
- *Public Private Partnerships*
- *Insurance Programmes*

IF Options: Guarantee Funds

A fixed term investment in which a third party promises to repay principal in full should the investment fail

Features

- Combination of self-sustained, GoR, and DP funded
- Can target specific groups, sectors, & risk-levels

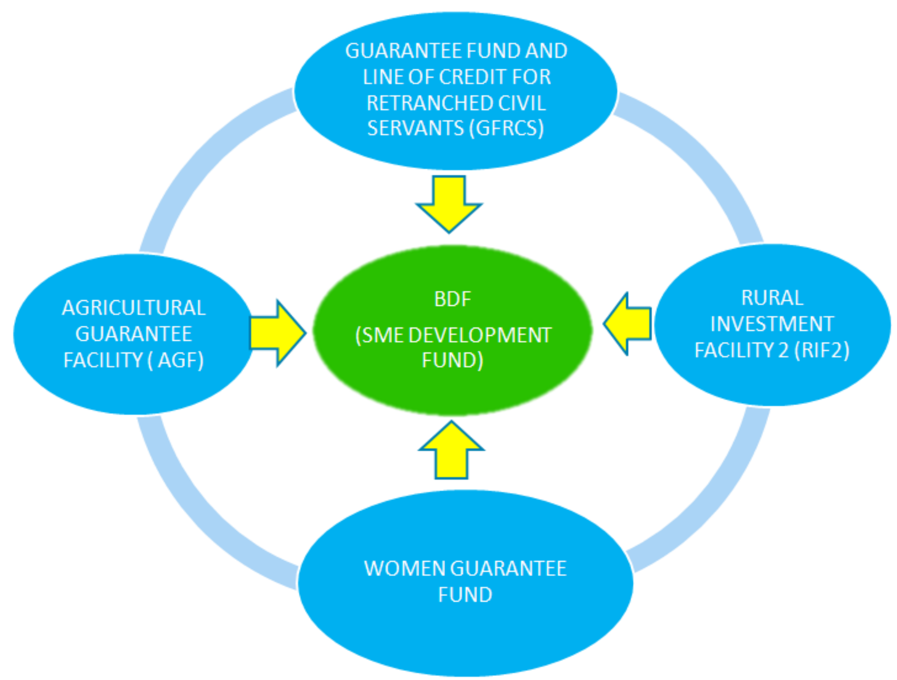
Benefits

- Addresses the challenge of <u>Information Asymmetries</u>, as centrally and independently managed and monitored funds that pool resources can base investment decisions upon more complete market information
- Motivate financial institutions to explore new market segments, and provide a gateway to investing in MFIs
- Designed to help entrepreneurs obtain bank finance by dealing with the collateral constraint - risk-sharing
- Could provide some technical assistance for SMEs in producing business plan, and a link to BDS centers, thereby addressing the <u>Low Technical Capacity, Business Skills</u> constraint.

Rwanda Context

Four Guarantee Funds in Rwanda are being centralized through an SME development fund:

- AGRICULTURAL GUARANTEE FACILITY (AGF)
- GUARANTEE FUND AND LINE OF CREDIT FOR RETRENCHED CIVIL SERVANTS (GFRCS)
- WOMEN GUARANTEE FUND (WGF)
- RURAL INVESTMENT FACILITY2 (RIF 2)



IF Options: Subsidy Programmes

Monetary assistance granted by a government/ development partner in support of an enterprise regarded as being in the public interest

Features

- Provides cooperation with a local partner that brings in knowledge of local business culture.
- Subsidies support small and medium enterprises by reducing risk for investment

Benefits

- Addresses High Cost of Borrowing to investors when commercial financing is often unavailable
- Investments have a significant, positive impact on the local economy
- SMEs will have a greater capability for investment

Rwanda Context

The Private Sector Investment Programme (PSI) - subsidy programme of the Dutch government

- PSI project is carried out by a non-Rwandan company in cooperation with a local company
- If an applicant meets PSI criteria, the programme will subsidize 50% of the project budget. Maximum project budget = EUR 1.5 million.

The Rwanda Promo Program

- Promotes development of smallholder agricultural producers, small-Scale Agribusiness (SSAs) and Small and Medium Enterprises (SMEs) in Rwanda
- **Two components of the program**
- Enterprise Development Investment (EDI): main purpose is capacity building. Max US $ 100,000 and lasts from 1 to 2 years. It is 100% grant.
- Enterprise Expansion Investment (EEI): Max US $ 250,000 and can last up to 5 years. Interest free loan.

IF Options: Public Private Partnerships

A service or business venture funded and operated through government and private sector partnership

Features

- Private sector provides financial, technical, and operational support
- In projects aimed at creating public goods e.g. in the infrastructure sector, government may provide a capital subsidy in the form of a one-time grant, so as to make it more attractive to private investors.

Benefits

- Address the <u>High Cost of Borrowing</u> for private investors by providing capital subsidies.
- Work on large projects that create public goods. These projects address <u>Infrastructure Constraints</u>, bottlenecks of development.
- PPPs improve quality of service and efficiency of management and operation through private sector participation.

Rwanda Context

The development of the Bugesera International Airport is a PPP

- Construction of international airport to meet the passenger growth in air transport at Bugesera, 25 km from Kigali.
- To comprise of a cargo and passenger terminal with capacity to handle 450 passengers/ hour.
- A roundtable will be held with interested private sector parties to discuss the final design and determine the PPP structure.
- The estimated construction cost for the new airport: 635 million USD including equipment and installations.

IF Options: Insurance Programmes

A risk transfer mechanism guaranteeing compensation for future losses in exchange for periodic payments

Features

- Private organization takes on the risk of a loss from a Rwandan public/private organization
- The insured assumes a guaranteed and known relatively small loss in the form of payment to the insurer in exchange for compensation against a large, possibly devastating loss.

Benefits

- Allows Rwandan companies to make more certain future plans, without the fear of potential growth impediments
- Help SMEs emerge from risky start-up periods

Rwanda Context

OPIC, the Overseas Private Investment Corporation, assists US based companies operating overseas.

Rwanda would benefit from a similar program, geared specifically towards SMEs in early stages of development.

Types of insurance that would benefit SMEs include:

- *General Liability Insurance*
- *Property Insurance*
- *Professional Liability (Errors & Omissions) Insurance*

Additionally, employers may be able through such a program to offer employees:

- *Health Insurance*
- *Disability Insurance*

IF Summary

Constraints	Current funding mechanisms and policies	Innovative Financing alternatives
Asymmetric Information	Newly approved law governing credit information system in Rwanda	Centrally managed and monitored funds that pool resources can base investment decisions upon more complete market information than individual investors may find difficult and costly to collect Guarantee Funds smooth the risks faced by commercial banks and micro-financers
Low Technical Capacity, Business Skills	Technical assistance through PSD projects aimed at entrepreneurial skills Development of one-stop BDS centres	Innovative financing could provide basic business services alongside financial lending services, particularly Guarantee Funds
High Costs of Borrowing	Commercial banks and microfinance institutions Existing guarantee funds including AGF, WGA, GFRCS, RIF2	Public Private Partnerships address the high cost of borrowing for private investors by providing capital subsidies Guarantee funds can reduce the cost of borrowing by reducing the risk premium charged by financial institutions Subsidy Programmes also address the high cost of borrowing to investors when commercial financing is unavailable
Infrastructural Constraints	Infrastructure development projects (GoR, DPs)	Public Private Partnerships work on large projects which create public goods. These projects often address Infrastructure Constraints.

Conclusion

- Methods of innovative financing are Guarantee Funds, Subsidy Programs, Public Private Partnerships, and Insurance Programs
- These directly address the main challenges of financing, which are asymmetric information, low technical capacity/business skills, high costs of borrowing, and infrastructural constraints
- Innovative financing can provide a much needed injection of investment into Rwanda's private sector, in addition to ODA and diversifying sources of finance
- Direct support to the private sector from Development Partners can be a win-win situation for GoR, facilitating and contributing towards higher production, economic growth and FOREX inflows
- Direct funding to independently (well-) managed guarantee or equity funds by DPs could help to overcome market failures
- DPs are encouraged to continue and expand support to foreign investors looking to invest in Rwanda (e.g. PSI Netherlands)
- A detailed analysis of innovative financing options should be undertaken:
  - A detailed study of these options would help guide GoR and DPs alike in suitable courses of action
  - This could then help guide the planned Private Sector Development Strategy