Impact of COVID-19 on business models of IDFC members

Paper prepared by the IDFC SDG Business Model Working Group and edited by the DBSA for internal information purposes

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List of acronyms

AFD	Agence Française de Développement (French Development Agency)
Bancoldex	Banco Comercio Exterior de Colombia S.A. (Colombia's entrepreneurial development and export-import bank)
BICE	Banco Industrial y de Comercio Exterior (Chilean bank)
BNDES	Banco Nacional de Desenvolvimento Economico e Social (Brazilian Development Bank)
CAF	Corporacion Andina de Fomento (Development Bank of Latin America)
CDG	CDG Capital
CDP	Cassa Depositi e Prestiti (Italian investment bank)
DBSA	Development Bank of Southern Africa
HBOR	Hrvatska banka za obnovu i razvitak (Croatian Bank for Reconstruction and Development)
ICD	Islamic Development Bank
IDFC	International Development Finance Club
JICA	Japan International Cooperation Agency
KfW	KfW (German state-owned development bank)
MSME	Micro-, small- or medium-sized
PTSMI	PT Sarana Multi Infrastruktur (Indonesia infrastructure bank)
TSKB	Turkiye Sinai Kalkinma Bankasi (Industrial Development Bank of Turkey)
VEB	Vnesheconombank (Russian State Development Corporation)

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Executive summary

The Covid-19 crisis has been described as the deepest global recession in decades, despite the extraordinary efforts of governments to mitigate its effects with fiscal and monetary policy measures.

This report surveys 15 IDFC member institutions to identify how the Covid-19 crisis has affected their business models. As the pandemic has hurt millions of people and brought economic activity to a near-standstill, and its effects are still being experienced in a large number of countries, IDFC members were challenged to provide a prompt response to the crisis and this required a business model shift involving changes in strategies, funding sources, financial instruments and channels.

Through quantitative and qualitative inputs and case studies, the report reveals that IDFC members were able to quickly came up with solutions to address the short-term economic damage and the health crisis by mobilizing private resources and blending them with their own capital, and by designing new financial instruments, fast tracking approval processes and digital tools. A new approach to risk management is being developed with a focus on integrating ESG and climate risks in the credit appraisal. Most relevant to the question of cooperation, the survey indicates that the Covid-19 crisis has accelerated the partnership with all stakeholders mainly with the state and regional state authorities, other development banks, commercial banks, the private sector and NGOs.

Over the longer horizon, there is a risk that the pandemic leaves lasting scars through lower investment, an erosion of human capital and fragmentation of global trade and supply linkages, leading to a future in which IDFC members could be instrumental to improve fundamental drivers of economic growth while safeguarding the planet and people’s lives. Members should also consider the degree to which they wish to accelerate private sector mobilization as their lending capacity may reach its limit. As the pandemic has taught us the fragility of human beings, it is also a wake-up call urging development banks to join forces in order to design innovative schemes for recovery.

1. Impact of Covid-19 on business models of IDFC members

1.1 A stronger alignment with beneficiaries' needs

1.1.1 Expected impacts

The Covid-19 pandemic has hurt millions of people and has brought economic activity to a near-standstill as countries imposed tight restrictions on movement to halt the spread of the virus. In addition to the health crisis, the economic damage is strong and represents the largest economic shock the world has experienced in decades. Consequently, maintaining employment, ensuring survival of companies, accelerating equitable transition, strengthening health systems and supporting province/municipal governments are in order, the main expected impacts of the actions carried out by surveyed IDFC members.

For instance, by mid-August 2020, BNDES reported that the emergency measures that reached USD 12 billion approvals kept about 5 million jobs in Brazil while benefiting more than 171,000 companies, 99.7% of them being micro-, small- or medium-sized (MSME).

1.1.2 Priority SDGs

According to the survey, we find that SDGs 8 (Decent Work and Economic Growth)/ 3 (Health and well-being)/ 1 (No poverty)/ 9(Industry, Innovation and Infrastructure)/ 17 (Partnership for the Goals)/ 2 (Zero Hunger) are the ones IDFC members have picked as priority in light of the pandemic. A closer look at the CAF Covid-19 rescue package shows it is mainly structured around 3 SDGs:

SDG 8: Decent Work and Economic Growth

Financial assistance for micro, small and medium-sized enterprises, particularly those in sectors most impacted by the pandemic (such as hospitality, tourism, retail and transport)

SDG 3: Health and Well-Being

Medical supplies and equipment, virus testing and healthcare infrastructure construction and expansion

Research and development for vaccines and treatments, as well as other costs related to preventative care, education and mental health support in relation to Covid-19

SDG 1: No Poverty

Other economic recovery initiatives geared at underserved populations including poverty alleviation and employment programmes.

3.1.3 Priority Sectors

According to the survey, renewable energy, healthcare equipment and service, utilities, pharmaceuticals, biotechnology and life science are top of the agenda of IDFC members, as a consequence of Covid-19.

For instance, the "COVID-19 – Health in Common" initiative led by AFD is an initial response to the health crisis and its immediate economic and social consequences. The plan includes the following measures: (i) €150 million in the form of donations and (ii) €1 billion in the form of loans to address short-term challenges facing partner countries and development banks in the 19 priority countries in Africa, the ocean basins (Madagascar, Comoros and Haiti) and the Middle East.

1.2 A more ambitious resource mobilization

About 87% of IDFC surveyed members will seek greater capitalization or other forms of funding in light of Covid-19, mainly from capital markets, international funds, institutional resources and crowdfunding.

For instance, in April 2020, AFD issued two Covid-19 bonds, one of € 1.5 billion over 10 years and a second one of an amount of US$ 2 billion over 3 years. On May 2020, CAF issued Latin America's first Covid-19 response Bond, a €700 million five-year social bond to support its member countries' Covid-19 related relief and recovery costs.

1.3 A new approach to risk management

In order to mitigate the impacts of the pandemic on their expected returns, IDFC surveyed members intend to closely monitor the following risks in light to the pandemic: (i) liquidity risks, (ii) foreign exchange risks, and (iii) impacted sectors such as tourism and transport.

In addition, we find a strong awareness among members of the importance of taking into account ESG and climate risks in their credit assessment. Indeed, 80% of surveyed participants intend to integrate climate risks while 73% of surveyed participants intend to integrate ESG risks.

1.4 More innovation in tools and processes

1.4.1 Accelerating the decision- making process

Covid-19 created a sense of emergency and pushed institutions to accelerate their decision- making processes. For instance, AFD put together a fast-track appraisal of operations by teams at its headquarters in France and at the field office. In order to place the USD 250 M Covid-19 emergency package, ICD put together a fast track appraisal process, which has been cleared by the ICD executive committee and approved by the board of directors. Eventually, KfW offered a fast track loan for the companies with more than 10 employees.

1.4.2 Using innovative financial instruments

1.4.2.1 Synthetic securitisation

Synthetic securitisation is a credit-risk hedging transaction – i.e. an insurance which enables regulatory capital relief while fully keeping the legal ownership of the selected assets and therefore all related business relationships. In other words, it is a mechanism by which a bank pays a premium to the securitization fund to protect a percentage of its corporate portfolio against defaults. There are two main benefits for the banks. On the one hand, it is lowering the bank risk exposure. On the other hand, it is enabling the bank to free up equity to support new lending. This mechanism is all the more relevant as the pandemic strongly hit SMEs.

As a consequence, Caisse de Dépôt et de Gestion of Morocco is considering offering this instrument to its customers in light of the pandemic.

1.4.2.2 Guarantees

Guarantees are a strong contra-cyclical tool. We find that the Covid-19 crisis accelerated the use of state guarantees channeled by IDFC members.

CDP offered medium to long term loans targeting medium and large Italian companies to support staff costs, investments or working capital in production facilities and business activities, with a guarantee scheme covering from 70% to 90% of the loans, depending on the size of the companies.

KfW launched a package of different instruments, the “KfW Special Program 2020”, where all instruments include a 90% guarantee scheme from the State.

VEB.RF supported small and medium-sized enterprises by issuing guarantees totalling USD 1.3 billion to commercial banks that give salary loans with an interest rate of 0%. In addition, it supported working capital loans with a guarantee covering 50% of the loan amount.

1.4.3 Leveraging non-financial instruments

In light of Covid-19, surveyed IDFC members intend to focus more on research activities, advisory services, project preparation and technical assistance and capacity building to the private sector.

1.4.3.1 Research activities

JICA had embarked on research on responses to Covid-19 with emphasis on (i) health systems and Universal Health Coverage, and (ii) on establishing gender-responsive approaches to Covid-19 Response and Recovery. CAF contributed with a series of webinars in order to analyze Latin America’s economic situation and its impact on SMEs. It also sought to disseminate the strategies governments and companies may carry out to mitigate adverse Covid-19 effects.

1.4.3.2 Project preparation

In light of Covid-19, the VEB.RF Group partnered with the National PPP Development Center in Russia to support local governments with project preparation. Indeed, it offered to (i) conduct a strategic audit of infrastructural plans (government programmes, targeted investment programmes); (ii) make recommendations on whether it is practicable to use PPP mechanisms for their implementation; (iii) provide access to remote training in the application of concession agreements and PPP agreements; and (iv) conduct instant due diligence for projects and offer assistance in setting up projects.

1.4.3.3 Capacity building to the private sector

Virtual training services for supporting MSMEs have been designed by Bancóldex in the context of the current economic downturn caused by the Covid-19 pandemic. Online webinars such as "surviving in the current market to thrive tomorrow", "preparing to access financing during a crisis", "how to communicate with stakeholders during crises", "cash flow improvement", "digital transformation", and "biosafety protocols", amongst others, have been specially created to complement the financial offer and help entrepreneurs boost their businesses and regain productivity. Companies from 305 cities and municipalities have studied these online courses, and the Colombian Bank has made alliances with 34 Chambers of Commerce of the country that have been seen in "Bancóldex Virtual Campus", a strengthening tool for the companies in their regions.

1.5 Digitalization tools for better customer service

According to the survey, Covid-19 has accelerated the use of technology (VPN, robot advisor, crowdfunding platforms, etc) for different purposes: home working, easier access of services to beneficiaries and financial intermediaries. Fintechs are also being used for easier resource mobilization, customer advisory services, and better efficiency in operations. For instance, KFW introduced Blockchain technology that makes it possible to ensure that donor funds are used transparently and reliably. As a consequence, monitoring processes with high transaction costs are eliminated. In Russia, ROSINFRA is a platform designed to support infrastructure projects used by VEB prospects. Access to the largest database of projects and off-the-shelf solutions, along with online advice from leading market experts will greatly reduce project costs and enhance the quality of project preparation. In Brazil, BNDES relied on a crowdfunding platform (Matchfunding Saving Lives), to finance the supplying of materials, medication and equipment for philanthropic hospitals.

1.6 Increased partnership

According to the survey, Covid-19 has accelerated the partnership with all stakeholders mainly with the state and regional state authorities, other development banks, commercial banks, the private sector and NGOs.

For instance, CDP has been involved in the European Commission initiative "Team Europe" aimed at coordinating European Development Banks' response to the Covid-19 pandemic in partner countries. Through a re-orientation of the existing programs, Team Europe has mobilized €15.6 billion to face the Covid-19 emergency in two priority areas of intervention: health and the economy.

Following the Covid-19 crisis, AFD approved a first loan to the Federal Government of Brazil and entered into a policy dialogue with it.

DBSA engagement with SADC (Southern African Development Community) has resulted in coordinated support to provide immediate humanitarian assistance with personal protective equipment (PPE) and other emergency medical items as a strategic response to Covid-19 to support countries immediately affected, such as Mozambique, Zimbabwe, Zambia and Eswatini.

Bancóldex joined efforts with several local authorities to launch specific credit lines, benefiting 20 regions and cities with a total envelope of about USD 200 million.

2. The Agenda Ahead: Considerations and Recommendations

2.1 Setting up new investment strategies with relevant tools

Over the longer horizon, there is a risk that the pandemic leaves lasting scars through lower investment, an erosion of human capital through lost work and schooling, and fragmentation of global trade and supply linkages.

It is important that IDFC members contribute to setting the stage for a lasting recovery in developing countries. It is critical to set up new strategies with relevant tools to improve fundamental drivers of economic growth while safeguarding the planet and people's lives.

2.1.1 Strengthening national/regional value chains

Developed countries are planning to readjust their supply chains bringing some links closer to home for shorter delivery time. As a consequence, some opportunities may arise from this move. For instance, if we look at the car industry, we could argue public transport mobility may become less popular with personal cars regaining interest for households. In this regard, Morocco is planning to strengthen its position to become a hub in the car industry by (i) improving its competitiveness through deep local integration, and (ii) decarbonizing the ecosystem so that it is energy efficient and in sync with European climate targets. That is why Caisse de Dépôt et de Gestion of Morocco may consider playing a significant role in this new strategy.

2.1.2 Financing the energy transition and biodiversity conservation

The current crisis calls for building more resilient portfolios to guard against future crises such as climate change. In addition, according to scientists, some of the main causes of the emergence and spread of the Covid-19 pandemic are related to biodiversity degradation and biodiversity imbalance. One of the issues is about waste management, which is exacerbated by coronavirus waste, which has become a new form of pollution, as single-use personal protective equipment (PPE) floods our oceans.

When VEB launched a green national standard to encourage financing projects in energy production, waste management, forestry, landscape and biodiversity and adaptation to climate change, it set the tone to root transformation in the country. Indeed, Russia has an ambitious ecological program, which will cost about € 50 billion over a 6-year period. And while the government will support about 20% of it, the remaining portion will have to be found on the private market, both domestic and foreign. That is why the national standard will also come up with incentives such as coupon subsidies, tax breaks, verification process subsidies and other measures to draw investment.

2.1.3 Private sector mobilization

Although 86% of surveyed IDFC participants think the Covid-19 crisis will help catalyze private sector mobilization for impact investment, there are many challenges reported among which we find poor project preparation, difficulty in finding the right balance between expected profitability and risk appetite, internal capacity building and lack of market and regulatory frameworks.

In the longer-term recovery, it is critical to partner with the private sector through PPPs and blended finance mechanisms. Indeed, when asked about the existing instruments that will likely be used in the post Covid-19 world in their institution, IDFC surveyed members picked PPP as the second on the list of financial instruments, after long term loans. IDFC members may act as arrangers and minority lenders to rescue a sector such as the airline industry.

2.2 Systematically joining forces with multiple stakeholders for recovery

Although most IDFC members have sound equity ratios well above regulatory requirements allowing them to raise additional resources on markets, there is a risk that in the long run, the additional lending volume coupled with lower cash flow collection due to possible defaults may threaten their ability to play a countercyclical role. Indeed, their performance is constantly monitored by credit rating agencies. Moreover, states may not be in a position to increase their commitments towards IDFC members.

It is critical to create alliances between IDFC members and other national or multilateral development banks. This approach has the main benefits of resources pooling, risk sharing and better execution if roles and responsibilities are clearly defined. For instance, JICA is preparing the programs to strengthen health systems with a holistic approach including supplying material equipment for hospitals, the use of advanced technology (software) and medical workers' training. JICA calls for mutual cooperation between bilateral and multilateral development cooperation agencies and emphasizes the need to mobilize private sector resources.

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