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COOPERATION OF THE PRIVATE SECTOR WITH NATIONAL PROMOTIONAL BANKS AND INSTITUTIONS IN EUROPE

ELTI General Assembly, Prague

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Agenda

Introductory notes

- Private commercial banks often suffer from market failures → governments created National Promotional Banks and Institutions (NPBIs) that are a subset of National Development Banks (NDBs) in the academic literature
- 3 questions to be answered today:
  1) What is the theoretical backgroungd of NPBIs?
  2) What is the best distribution model for NPBIs (direct/indirect/hybrid)?
  3) What is the role of NPBIs as financial instruments´ providers in the EU?

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Information about the speaker

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- 2022+ Executive Director, **Institute of Sustainable Finance**, Faculty of Finance and Accounting, Prague University of Economics and Business, Czech Rep.
- 2021 Author of a study „**The National Development Bank of the Czech Republic**" (Narodni rozvojova banka, "NRB") conducted by Prague University of Economics and Business
- 2014+ Vice-Chairman of the Supevisory Board, **Czech Export Bank**
- 2009+ Researcher at Institute of Economic Studies, Faculty of Social Sciences, **Charles University**, Czech Rep.

Agenda

Theoretical background

- NPBIs/NDBs = specialized financial institutions with the official mandate to fulfill public policy objectives
- NBDs can address **market failures** unlike commercial banks: i) long-term finance; ii) credit rationing as a result of information asymmetry, lack of collateral, and risk aversion; iii) procyclical lending.
- NDBs also deal with **suboptimal market conditions** (e.g. high interest rates)
- 5 types of NDBs:

I. Multilateral development banks (EBRD, EIB),
II. National development banks (**NRB** in the Czech Republic),
III. Green development banks (UK, US, Switzerland),
IV. Export-import banks (**Czech Export Bank** in the Czech Republic),
V. Export credit agencies (EGAP in the Czech Republic)

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Distribution models

- NDBs should complement rather than compete with commercial banks → NDBs should fill the market gap through offering tailored-made products and services for a particular segment (e.g. SME*, municipalities), industry (energy), company needs (mezzanine capital for infrastructure projects) or products reflecting political goals (affordable housing)
- Product manufacturing vs product distribution → appropriate business model
- Distribution models of EU funds/products to clients:

a) **direct model** (NDB without commercial banks),

b) **indirect model** (NDB with commercial banks: KfW),

c) **hybrid model** (combination of the previous models: NRB).

*Small and Medium Enterprises

Direct distribution model

- Some NDBs have a lower level of monitoring skills and quality than commercial banks because of undue political intervention

Source: Author inspired KfW (2023). Investor presentation. October 2023

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Indirect distribution model

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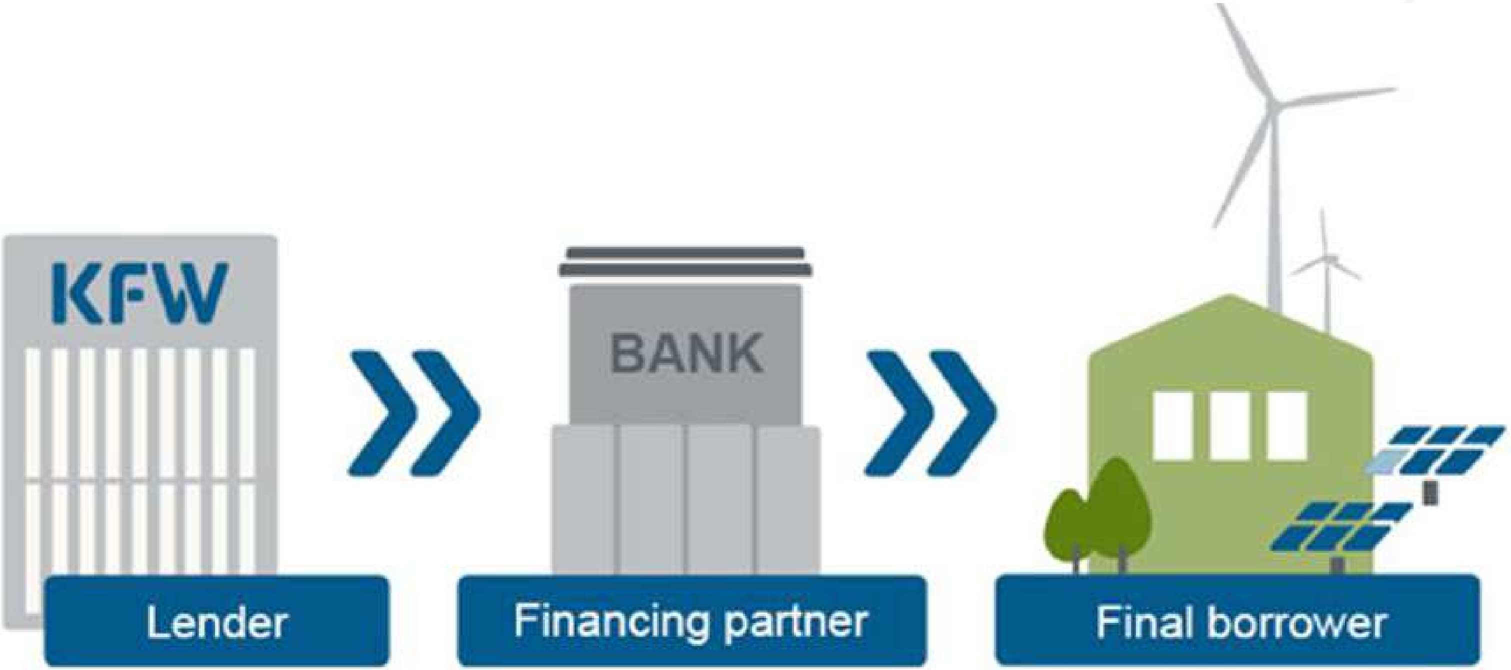

Source: KfW (2023). Investor presentation. October 2023 ffa.vse.cz

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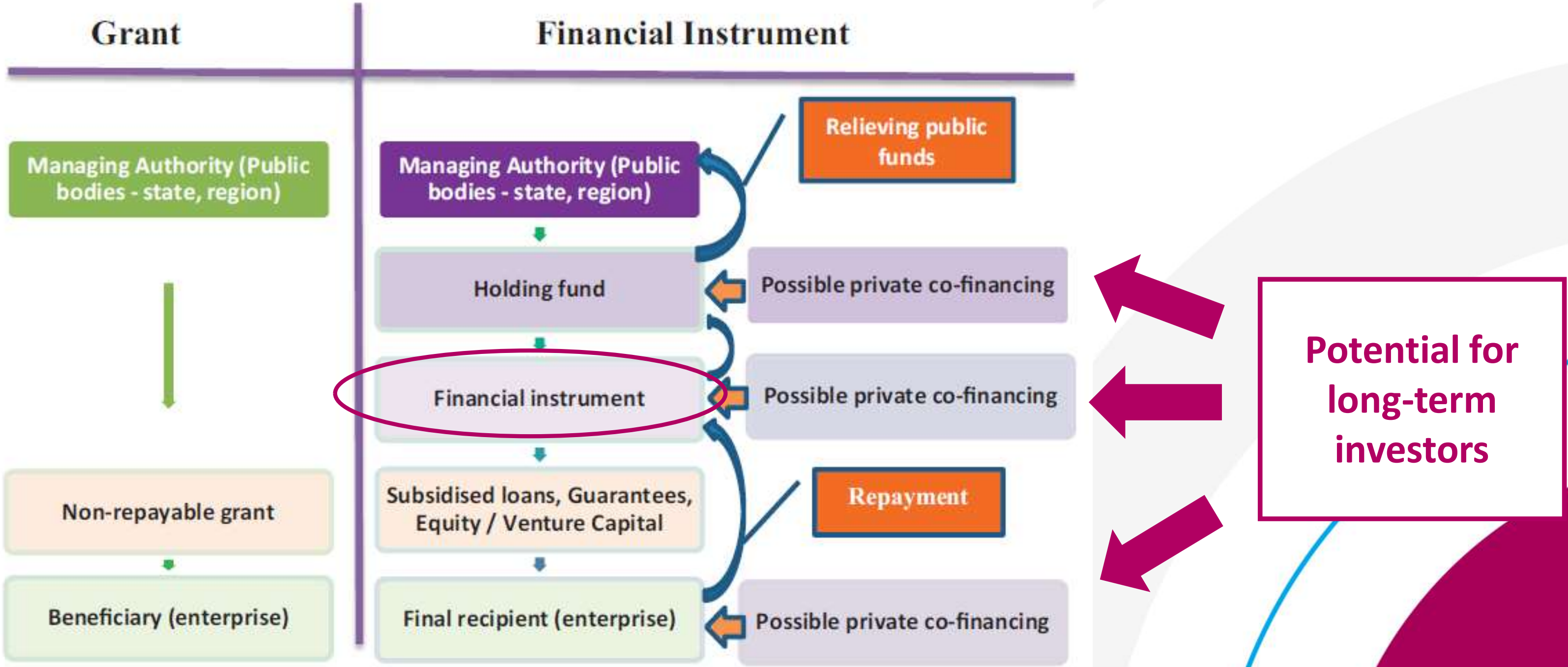
1. Introduction
2. NPBIs in theory
3. Distribution models of NPBIs
4. Financial instruments
5. Conclusion

Financial instruments

- Financial instruments in the EU: loan, guarantee, equity investment, project bond, subsidized interest rates
- Common task for NDBs in the EU: administration of EU funds and financial instruments
- **Grants (subsidies) are usually preferred by politicians/government officials to financial instruments** → typically (not only) for the Czech Rep.
- **Financial additionality** (financing on terms and conditions not available in the market) vs **non-financial additionality** (political risk cover, knowledge transfer, capacity building)
- Key reasons: one-off grants (vs. revolving nature of financial instruments); similar administrative burden of grants and financial instruments (typically, obtaining a loan requires less information compared to the extensive documentation needed when applying for a grant)
- **NPBIs should evaluate the multiplier effect of their products** (e.g. an economic benefit of 1 Euro provided by a NPBI) → evidence-based decisions

Grants vs financial instruments



Source: Nyikos, G. et al. (2020). Do financial instruments or grants have a bigger effect on SMEs' access to finance? Evidence from Hungary. Journal of Entrepreneurship in Emerging Economies, 12 (5): 667-685.

NPBIs as long-term investors

- The maturity-lengthening role of NPBIs is more feasible if they are:
  I. **well capitalized***,
  II. have proper liquidity management,
  III. possess adequate amounts of liquid asset holdings.
- **Assumption: NPBIs are well-governed and have high monitoring skills**
- Poorly managed NPBIs, which do not keep out narrow private and politically vested interests, will probably end up in a fragile financial position with high nonperforming loans and low credibility.
- The maturity-lengthening role of NPBIs is more relevant for countries that have governments with stronger credibility, finances, and net worth than countries with governments plagued by credibility concerns, over-indebtedness, and excessive fiscal deficits.

* It depends on the level of bank regulation (e.g. the NRB is heavily regulated because it has a full banking license and follows CRR II/CRD V, what is not so common in the EU).

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Concluding remarks

1. NPBIs should complement commercial banks
2. The hybrid distribution model combines advantages of direct and indirect models
3. Under-capitalized NPBIs have limited capacity for long-term lending and financial instruments.

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Empirical research on NBDs 1/2

Positives of NDBs

i) NDBs lend longer than commercial banks,
ii) NDBs finance projects with positive externalities,
iii) NDBs address market failures in the syndicated loan market,
iv) NDBs act countercyclically during global liquidity cycles,
v) NDBs recently focus more on ESG* and sustainability,
vi) NDBs can fulfill the “ESG non-compliant“ gap (financing “non-green“ assets).

*Environmental, Social, Governance

Empirical research on NBDs 2/2

Challenges for NDBs

i) NDBs suffer from government failures owing to their poor corporate governance and political capture,

ii) NDBs provide cheap credits to politically-connected firms that could have obtained financial support from commercial banks,

iii) NDBs increase their lending activity in election years,

iv) NDBs subsidizes firms that could fund their projects with alternative sources of capital,

v) NDBs are not significant players is some countries (e.g. in the CR)

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Useful sources

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Thanks for your attention.

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