Key findings

National Development Financial Institutions: Trends, Crisis Response Activities, and Lessons Learned

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In recent years, there has been renewed interest in national development financial institutions (NDFIs). NDIs can act countercyclically, fill market gaps, and catalyze private finance for developmental goals including through demonstration effects and market creation. However, NDFI interventions can also be controversial.
Critics cite complaints of competition with commercial banks, crowding-out of private investment, and support to objectives of political elites, rather than addressing sustainable development objectives. Some have been criticized as inefficient and mismanaged.
This report distills lessons learn from efficient NDFIs by reviewing the arrangements under which they operate. A review of NDFIs COVID interventions is also conducted.

Objectives and research questions

As many countries are opting to establish new NDFIs and expand operations of the existing institutions in response to the COVID-19 pandemic and to support post-COVID recovery, this report reflects on lessons learned from well-performing NDFIs to inform policymakers and practitioners. The re reviews the arrangements under which NDFIs operate to identify best practices. NDFIs COVID interventions were also reviewed to assess to what extent were well targeted to affected viable borrowers, effective at mitigating a credit crunch. The potential impacts on NDFI financial sustainability of such interventions is also discussed.

Methods

The report conducts a functional assessment of the selected institutions as well as a review of their operational environment. The approach is based on insights from World Bank experience supporting NDFIs. The report follows the approach to evaluate the performance of state-owned financial institutions of the World Bank Integrated State-Owned Enterprise Framework (IESOEF).
The paper also reviews COVID-19 programs implemented by NDFIs supporting small business in 13 countries, covering 80 percent of total NDFI assets, looking at their design features, disbursement indicators and aggregated credit growth.

Results

The effectiveness of NDFIs differs substantially across countries and within a country. During the COVID-19 pandemic NDFIs provided countercyclical finance contributing to avoid a credit crunch, in many cases administering public programs with governments assuming risks.
In this way, NDFIs do not need additional capital to support countercyclical activities, which limits the scope for mission creep and crowding-out of private finance post-crisis and helps preserve NDFI financial sustainability.
Several interventions supported all firms, and few programs set employment preservation conditions on recipient. The extent on support to unviable firms and fraudulent use of schemes is still uncertain.

Recommendations

NDFIs should focus on credit-constrained viable borrowers and projects, providing risk sharing mechanisms and supporting financial market creation and development. Limited subsidy provision reduces scope for crowding-out private sector, institutional corruption, and it fosters a culture of innovation at the NDFIs.
The incentives of management and staff should be aligned with the objectives of the institution through effective corporate governance, risk management, and mechanisms to evaluate the performance of NDFIs. NDFIs should be supervised according to their risk profile and should operate on a level-playing field. In challenging governance environments, DFIs should operate through other financial intermediaries.

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Access the report
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