The UK's strategy towards development finance institutions:

BII'S WORK WITH FINANCIAL INTERMEDIARIES

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I am a Research Associate at the ODI and a specialist in private finance for development and financial development. I have engaged with BII as an independent researcher, as an advisor on their most 2022-2026 strategy and as an ICAI team leader and subject matter expert in three relevant reviews. I hold a doctorate from SOAS. I have also acted as advisor to FSDA and as coinvestigator on ERSC-funded research programmes as well as numerous research and policy advisory work at the ODI where I have worked since 2014. This evidence is submitted in a personal capacity.

Evidence

I wish to comment specifically on BII's work with financial intermediaries as a complementary 'deep dive' to the excellent current oral and written evidence already provided to the IDC.

Financial services[1] compose 34% of BII's 2021 portfolio and 26% of its 2021 commitments. The sector is its' largest sector by portfolio and the second largest (after infrastructure) for 2021 commitments. As such the impact of these financial service investments are crucial to BII's overall impact and returns.

However, these are important criticisms of BII's approach in the sector as follows;

BIIs largest investments are concentrated in broad-based financial conglomerates which lack clear financial additionality and don't predominantly serve poor households.

- BIIs investments in financial conglomerates amount to £457.5 million of the 2021 direct investment portfolio and compose over 30% of their 2021direct investment commitments.
- Ten such investments can be identified and include major banking institution in their relevant markets such as ABSA Bank (£123.0 million), Citibank SCF (£75.2 million), Equity Bank (£37.6 million), First Bank of Nigeria (£73.9 million) and Ecobank (£36.3 million).
- Such financial services conglomerates predominantly serve wealthier households and larger corporations, not poor households - despite this often being the core of BIIs investment case.
- Such financial services conglomerates are often listed companies and have significant access to finance including from interbank markets, capital markets and well-established and stable deposit bases. As such, the case for financial additionality through BII investments appears poor.
- BII may 'ring-fence' funds for specific purposes (such as SME or microfinance) in some instances but a systematic and transparent approach to this is not apparent, and, in any case, such conglomerates could finance such operations themselves. For example, BII highlight Equity Bank in its 2021 Annual Report stating that its investments will benefit SMEs and climate but it is not clear as to how this will be

[1] Last published data for 2021 https://www.bii.co.uk/en/our-impact/key-data

operationalise nor why Equity Bank has not raised private finance for these market segments given that it is a listed company and a major bank in the East African region with the clear ability to do so.

BII continue to invest in microfinance-dedicated financial institutions despite substantial evidence that microfinance only delivers 'small' long-run impact for wages and consumption, has 'failed' to deliver transformation impact on economic growth and only delivers short-term poverty alleviation under limited circumstances. [2]

- In 202, BII made direct investments in microfinance institutions (in India and Kenya) and via intermediated equity investments via impact or similar investors.
- However, there is now a substantive body of evidence that microfinance does not deliver its once-promised positive impacts for poverty alleviation and welfare impacts in low-income households.
- Instead, at a broader macroeconomic level, while microfinance can have positive impacts on wages and consumption, the impacts are 'small' over the long-term and microfinance has no impact on economic transformation.
- There are some exceptions such in the context of absent social protection or in grossly underfinanced sectors with strong links to poverty such as smallholder farming.
- However, BIIs investments are not limited to these niche areas.
- Such issues give rise to the concern that BII is attracted to the microfinance sector because of its high returns, including from high interest rates charged to the poorest households, rather than development impacts.

BII have a confused theory of change in relation to its financial intermediaries that does not adequately reflect evidence in relation to financial development, economic transformation and poverty alleviation.

- The majority of MICs in which BII operates have reasonably well-developed financial sectors including in banking and, in some instances (such as India), well-developed capital markets. Given this, investment cases do not adequately explain how specific investments are additional nor how they might contribute to secondary impacts (such as mobilization of private finance or accelerating economic transformation).
- On occasions there seems to be a basic misunderstanding of the evidence in investment cases and theories of change. For example, BII recently published an Insights paper [3] relating to India which used data relating to financial instability (credit gap to GDP) to support an investment case that financial sector investments were justified by financial constraints on economic development. Such data is simply irrelevant to this argument. Conversely, the paper ignored data that might have been of relevance to this critical assessment such as finance development indices, firm credit constraints surveys or binding constraints analysis. The paper also ignored the evidence noted above relating to the weak or negligible impact of microfinance in MIC contexts.

[2] Jing Cai, Muhammad Meki, Simon Quinn, Erica Field, Cynthia Kinnan, Jonathan Morduch, Jonathan de Quidt, and Farah Said, "Microfinance", VoxDevLit, 3(2), March, 2023 https://voxdev.org/sites/default/files/Microfinance_Issue_2.pdf

[3] https://assets.bii.co.uk/wp-content/uploads/2023/01/06212044/Investing-for-impact-in-India_BII.pdf