Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 04-May-2019 | Report No: PIDC26838

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Ghana	P169742		Ghana Development Finance Project (P169742)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
AFRICA	Sep 03, 2019	Dec 12, 2019	Finance, Competitiveness and Innovation
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Ministry of Finance	Ministry of Finance	

Proposed Development Objective(s)

The objective of the project is to increase access to finance for Ghanaian enterprises, particularly SMEs.

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	150.00
Total Financing	150.00
of which IBRD/IDA	150.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	150.00
IDA Credit	150.00

Environmental and Social Risk Classification	Concept Review Decision
Substantial	Track II-The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Ghana is one of the few countries in Africa that have achieved successful democratic transitions over the past 30 years.** The latest peaceful transition of power took place in 2016. Political stability yielded a growth dividend, particularly in the 1990s, when economic growth stabilized and ultimately allowed the country to achieve lower middle-income status in 2011. More recently, however, weaknesses in fiscal governance have increased economic volatility, complicated macro-management and is constraining growth and effective service delivery, including for building human capital (World Bank SCD 2018).

2. **Real GDP growth continued into 2018, albeit at a slower rate than in 2017**. The expansion was largely spurred by industry. The financial and insurance subsectors have experienced a continuous contraction since early 2017, due to the cleanup of the banking sector. Economic growth is expected to accelerate in 2019. The primary driver is the oil sector, reinforced by non-oil growth which is expected to accelerate as the Government's new policies in the agriculture sector and the promotion of agribusiness begin to yield results. Further reforms in the regulatory environment of the private sector, and efforts to facilitate regional and international trade would support the agribusiness sector and strengthen the link between private sector development and jobs creation. Overall, real GDP growth is expected to average nearly 7 percent between 2019 and 2021 as the impact of the short-term increase of oil and gas coming online fades.

3. **Macroeconomic fundamentals improved significantly in 2017 and 2018**. Since taking office, the new government has turned around macroeconomic management: growth prospects have strengthened, inflation has moderated, and the external and fiscal outlooks have improved. Necessary adjustments taken in 2018 to keep the fiscal deficit at the targeted level signal commitment to fiscal consolidation. While the latest IMF/World Bank Debt Sustainability Analysis maintains Ghana's high risk of debt distress, the ongoing fiscal consolidation will help reduce debt over the medium term. In addition, the Government has been managing debt in line with its Medium-Term Debt Management Strategy. Ghana successfully issued a US$2 billion Eurobond in May 2018 and another US$3 billion in March 2019 on more favorable terms relative to peers. Finally, gross financing needs have declined, albeit still at a high level, helped by the lengthening of domestic debt maturities, and are projected to fall below 15 percent of GDP for 2019.

4. **The macroeconomic outlook is subject to four major risks**. First, fiscal risks arising from the historical tendency of higher spending in election cycles could lead to higher deficits in 2019 and 2020, with resulting adverse debt dynamics. Second, risks to the growth outlook—expected to be driven, in part, by the agriculture sector—could come from adverse weather conditions precipitating lower yields or crop losses, as well as lower international prices for agricultural commodities. Third, risks could come from external shocks arising from higher cost of financing, as normalization of US monetary policy progresses and the domestic currency depreciates. Finally, Ghana's heavy reliance on primary commodities, including cocoa, gold, and oil, together with the projected weakness and possible volatility in international commodity prices, create significant uncertainty for its growth, export receipts, and domestic revenue.

Sectoral and Institutional Context

5. **The financial sector in Ghana has grown over the past few years and remains bank-dominated**. Total financial sector assets grew from 37 percent of GDP in 2010 to 59 percent of GDP in 2017. Universal banks are dominant, with

assets equivalent to 33 percent of GDP. They accounted for 59 percent of total financial sector assets, followed by the fund management sector with 15 percent, pension funds with 12 percent, specialized deposit-taking institutions (SDIs) with 11 percent, and the insurance sector with 3 percent. Stock market capitalization has been decreasing and reached 20 percent of GDP in 2018 (from 33 percent of GDP in 2010 and 58 percent of GDP in 2011). There is a diversity of financial intermediaries comprising banks and SDIs. There are currently 23 universal banks in Ghana (including 17 foreign-owned) offering a variety of financial services, including credit, which totaled GH¢107 billion in December 2018 ($US 22 billion). Together with mobile money operators, SDIs have driven financial inclusion in Ghana.

6. **The Bank of Ghana (BoG) has taken bold measures to bolster financial stability and banks' ability to finance large transactions**. It resolved nine banks between August 2017 and December 2018. In addition, BoG has increased the minimum capital for banks to GH¢400 million (US$83 million) effective in December 2018 (up from GH¢ 120 million), leading to mergers, downgrades, voluntary winding up, and the establishment of the Ghana Amalgamated Trust (GAT). BoG is improving bank supervision, including through enforcement of prudential standards, the rollout of Basel II/III, and introduction of risk management guidelines. The banking sector is largely sound, despite high, albeit declining non-performing loans (NPLs). The Government is also preparing for the cleanup of non-viable SDIs, a critical step to restore public confidence in these institutions and boost their ability to serve the most excluded market segments, including micro, small and medium enterprises (MSMEs).

7. **The capital market is very nascent, illiquid, highly concentrated, and has not been a reliable source of long-term finance for Ghanaians firms and to critical-development sectors such as infrastructure and housing**. It is relatively small in comparison to those of other leading economies in the region (e.g., Kenya). The stock market is illiquid, with a turnover ratio of 0.3 percent in 2018, indicating minimal trading, in part due to a narrow investor base. The pension and asset management sectors are small but have a growing pool of savings that could be mobilized to fund investment; the bulk of these savings are invested in government securities.

8. **Financial intermediation has slowed in the last three years amid high credit risk, closure of some banks, and balance sheet restructurings**. Loans and advances—which traditionally accounted for the bulk of banks' assets—have now been surpassed by holdings of investments, mainly bills and securities. Government decision to settle energy sector debts through issuance of long-term bonds to banks contributed to the decline of the banks' share of loans and advances.

9. **Low financial depth is a major constraint to Ghana's private sector development, economic growth, and poverty reduction**. Ghanaian firms of all sizes lack access to term finance and face high borrowing costs, making investment in long gestation projects non-viable. Limited access to affordable external finance prevents Ghanaian firms from entering new markets and from innovating and pursuing growth opportunities that cannot be financed through their internal resources. Such opportunities could lead to more investment and job creation, particularly in the MSME sector, which in 2015 accounted for 99 percent of all business establishments and 83 percent of employment among business establishments.[1] Small and medium enterprises (SMEs) in Ghana had less access to financing than large firms and SMEs elsewhere in sub-Saharan Africa even prior to the recent decrease in financial intermediation. The IFC estimates that the MSME financing gap in Ghana was equivalent to 13 percent of GDP in 2015. In particular, the agriculture and manufacturing sectors receive a share of the credit from the financial sector that is smaller than their contributions to GDP and employment.

10. **The gaps described above are a manifestation of both demand and supply constraints**. The low volumes of SME finance reflect banks' perception of high risks associated with SME lending, and in some cases, banks' limited understanding of SME lending techniques. SMEs' limited access to finance also reflects lack of collateral and credit

[1] Per Ghana Statistic Service's definition: micro: 1-5 employees; small: 6-30 employees; medium: 31-100 employees; and large:100 employees.

histories, deficient accounting practices, and the inability to present credible business plans, aside from general lack of profitability.[2] The ability of banks to provide long-term finance requires their access to long-term funding in order to avoid maturity mismatches. However, term funding is lacking in Ghana as bank funding is dominated by short-term deposits and borrowings. In addition, from the banks' perspective, short-term financing is a risk management tool. Credit infrastructure deficiencies have also been cited by banks as a constraint to lending.

11. **The Government of Ghana has announced its intention to establish the Development Bank of Ghana (DBG) to support economic transformation in Ghana.** A Working Group has been established and is leading the establishment of the DBG. The new institution is expected to provide financing (mainly long-term) to agribusiness, manufacturing, high value services (e.g., ICT) and SMEs, using a private sector model (including by leveraging private and foreign capital, instead of relying on government revenues or financing). In addition to providing medium to long-term financing, the DBG is expected to offer credit guarantees to mitigate banks' risk of lending to certain borrowers (e.g. SMEs), and to promote/operate innovative platforms that can help reduce information asymmetries and unlock private sector capital. Given that poor corporate governance has been associated with the failure of development banks in Ghana and globally, the DBG is expected to adopt standards of sound corporate governance.

Relationship to CPF

12. **The proposed project is fully aligned with the [forthcoming] CPF for Ghana.[3]** The CPF is aligned with Government's CPESDP and the Vision of 'Ghana Beyond Aid', and it is based on the priorities identified in the 2018 Systematic Country Diagnostic (SCD). The CPF is organized around three pillars: (i) Increased Human Capital – especially in Lagging Regions; (ii) Inclusive, Job-Intensive, and Sustainable Economic Growth; and (iii) More Effective and Transparent Governance. Along with deficient access to land and electricity, the CPF identifies access to finance as a key constraint to further development of the private sector in Ghana. It highlights the importance of strengthening financial sector regulation and supervision, resolving insolvent institutions, and implementing the NFIDS as critical actions for increasing access to finance, including long-term capital for Ghana's private sector firms both small and large. In this context, the CPF notes that World Bank's "support to the government for a wholesale development finance institution will help address the provision of long-term financing particularly to SMEs and the agriculture sector—critical for the economic diversification agenda."

C. Proposed Development Objective(s)

The objective of the project is to sustainably increase access to finance for Ghanaian enterprises, particularly SMEs.

Key Results (From PCN)

13. **Preliminary indicators proposed to be used to measure project's achievement of the proposed development objective include:** (i) volume of sub-loans facilitated by the DBG, of which to SMEs; (ii) number of businesses benefitting from DBG financing, of which to SMEs and women-owned businesses; (iii) DBG's return on assets; and (iv) share of pension funds' assets allocated to non-government capital market instruments (bonds and equities).

D. Concept Description

[2] In particular, agricultural and manufacturing sectors face a difficult business environment that makes bank lending riskier. For instance, agriculture is largely rainfed and few crops are insured; and both agricultural and manufacturing firms have unreliable and costly power supply.
[3] World Bank Board Consideration of the Ghana Country Partnership Framework (CPF) is planned in FY19 (P161920).

14. **The proposed Project would support:** (i) the establishment of a development bank in Ghana that would offer wholesale medium-to-long term financing; (ii) the establishment of a universal partial credit guarantee (PCG) scheme and a fintech platform to crowd-in private sector financing (mainly for working capital); and (iii) development of capital markets to provide long-term financing (bond and equity financing). The project would also allocate funds for project management and monitoring and evaluation. The design of the DBG is expected to incorporate international best practices to ensure that the DBG delivers on its mandate in a financially sustainable manner, fostering partnerships with private sector financial institutions and international DFIs.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

The project would support complementary interventions to increase enterprises' access to finance in Ghana. The support will involve on-lending to eligible Participating Financial Institutions , particularly SMEs across sectors such as agriculture and manufacturing. The bulk of loans for the SMEs would not exceed $500k. This will done through a yet to be established Development Bank (DB), which will be the FI and will not immediately have the experience and capacity in screening sub-projects for their environmental and social impacts. Given the potential impacts of agribusiness and manufacturing on environment, public health and safety coupled with the low capacity the DBG will require a robust Environment and Social Management System to be established. An ESMF will be prepared and disclsied before on-lending commences to ensure that the use of the funds for the various activities are in compliance with requirements of the ESF standards. It is also expected that key stakeholders will be consulted on and an appropriate SEP will be prepared and disclosed prior to its implementation

Note To view the Environmental and Social Risks and Impacts, please refer to the Concept Stage ESRS Document**.**

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APPROVAL

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