Development banks

Development banks are local, national, regional or multilateral financial organizations that provide long-term capital to productive sectors and for infrastructure, often accompanied by technical and managerial assistance. Some examples of multilateral and regional development banks are the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), and the African Development Bank (AFDB). Examples of national development banks include the German Development Bank (KfW Entwicklungsbank), the Brazilian Development Bank (BNDES) and China Development Bank (CDB). Their non-private status differentiates their services from those of private banks (see Banks [1]). It is worth noting that substantial differences across development banks exist, there are notable depending on whether they are local, national or multilateral.

Development banks are among the most widely used instruments of funding and assistance for projects that require long-term maturity (Mazzucato, 2011). These organizations offer funding and advice to projects that may not have access to commercial banks, as they do not necessarily provide adequate return rates in the short-term or because of local capital market imperfections. Infrastructures are a major focus of contemporary funding, since they typically involve higher capital costs and also because they are essential for providing adequate framework conditions for innovation. Direct support for innovation activities, however, has often – with notably exceptions - received less substantial financial support.

Funding by development banks tends to be operationalized as commercial ventures, set with payment or repayment schedules. Their loans are, therefore, conceptually similar to commercial loans, although with different timeframes for repayment, lower interest rates, and often the provision of substantial technical assistance for borrowers while realizing the project. Experts at these banks may provide assistance for shaping a project strategy, improving its managerial frameworks, creating performance targets and monitoring its development throughout the period of repayment, so as to increase the overall profitability of their borrowers than if they borrowed elsewhere. Development banks may also decide for equity participation, usually as minority partners, when projects are seized as strategic and to better foster their growth.

The potentially substantial role of development banks in shaping innovative performance has become more evident in the last decades, aiming at solving market imperfections that would leave risky, innovative and long-term projects without financing. Moreover, particularly multilateral development banks can help alleviate capital scarcity and unlock productive investments in low-income countries and promote entrepreneurship to foster existing industries or the generation of new businesses. However, such contributions require adequate framework conditions for projects are provided including their alignment with national strategies.

Development banks can also promote “catch-up such as endeavours to generate new technological trajectories and to create the infrastructures necessary for the diffusion of new technologies. In a number of economies, these financial institutions have proven to be vital for providing long-term capital to nascent industries, as well as to screen promising private projects and to increase their propensity on succeeding through well-defined performance targets and monitoring. By contrast, in some cases national development banks have been criticized for investing too much in traditional sectors, such as agriculture, leaving aside potentially innovative projects in nascent and higher value-added sectors.
Regarding the types of projects supported by development banks, they are, in principle, for what is considered functional for development, without necessarily providing similar profitability to commercial banks. Identifying adequate strategies and projects can involve multiple challenges. Development banks can be important instruments in coordinating strategic investments. For such impacts to materialise, however, priorities of development banks must be aligned with national strategies for industrial development, as well as with science, technology and innovation policies, in order to keep coherence and to better foster the economic performance.

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