1. What is the concept and purpose of development banking?

Development banking means different to different people, in different places, and at different times. This only goes to show that development banking has evolved since it was first conceptualized as an ‘instrument of development’. However, in its original form and in its broadest definition, it is a type of financial intermediation to help the country reach a higher and sustainable level of development. On the wider context, the desired level of development includes the whole spectrum of socio-economic progress. Development banking therefore can also be defined as a form of financial intermediation that provides financing to high priority investment projects in a developing economy. Both definitions imply that the purpose of development banking is to bring the country to a higher level of development.

2. What is a development bank?

A development bank is a ‘bank’ established for the purpose of ‘financing development’. A traditional definition of a development bank² is one which is a national or regional financial institution designed to provide medium-and long-term capital for productive investment, often accompanied by technical assistance, in less-developed areas. Development banks fill a gap left by undeveloped capital markets and the reluctance of commercial banks to offer long-term financing.

3. Is there a difference in the terms, ‘development bank’ and ‘development finance institution’ (DFI)?

The terms ‘development bank’ and ‘development finance institution’ are synonymous with each other although the term ‘development bank’ represents a simpler language. In some context, however, the term ‘development finance institution’ is appropriate to use because the term ‘bank’ connotes, among others, a deposit-taking activity, which in some countries DFIIs are not allowed to undertake. But in the context of ‘financing development’, both terms, however, are used interchangeably.

4. What are the major roles of a development bank?

A development bank has at least five major roles in the economic development of a country: (a) as an initiator, i.e., with a ‘supply-leading’ role (in anticipation of future

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¹ ADFIAP is the focal point of all development banks and other financial institutions engaged in the financing of development in the Asia-Pacific region. Its mission is to advance sustainable development through its members. Founded in 1976, ADFIAP has currently 106 member-institutions in 41 countries and territories. The Asian Development Bank is a Special Member of the Association. ADFIAP is also a founding member of the World Federation of Development Financing Institutions composed of regional associations in Africa, Asia-Pacific, Latin America and the Middle East. ADFIAP is an NGO in consultative status with the United Nations' Economic and Social Council.

² Development Bank, Encyclopædia Britannica 2003
demand) such as in technology transfer, strategic industries, environment issues, etc. (b) as an institution-builder, i.e., developing new methodologies and systems in raising capital and increasing investments through non-traditional areas such as financing large projects via Build-Operate and Transfer/Lease/Own (BOT, BOL, BOO), bonds, microfinance, etc. (c) as a catalyst, i.e., taking a lead role in creating new financial packages with involvement of commercial banks and other financial institutions such as loan syndication of large projects, guarantee schemes for start-up industry sectors, etc. (d) as a development advocate, i.e., promoting the ‘business of development’ such as job generation, domestic resource mobilization, countryside development, urban renewal, etc. and (e) as a bank of last resort, i.e., providing finance to projects which no other financial institution will fund, thus promoting new and innovative economic activities, e.g., funding for inventors, cooperatives and high-risk investments.

5. When and where did development banking started?

Development banking started during the time of industrial expansion in countries now considered to be more developed. More than a hundred years ago, the United States is already industrialized, and even earlier, Great Britain and a number of Central European countries developed their own industrial base. These industrial countries reached their level of industrialization through the long-term investment financing of banks that, at the time, performed the entrepreneurial function of taking on the risk of entering into new fields of production. Those institutions involved in long-term financing were known as industrial banks. One example of this type of financing was the construction of the railroads in the United States which goes even back to the 1700s.

6. When and how did the ‘present-day’ development banks come about?

The number of development banks has increased rapidly since the 1950s (post World War II), having been encouraged by the International Bank for Reconstruction and Development (usually called the World Bank) and its affiliates. Many national development finance institutions (DFIs), as development banks were also called, were established in many countries around the world during the period. Some of the large regional development banks include the Inter-American Development Bank, established in 1959; the Asian Development Bank, which began operations in 1966; and the African Development Bank, established in 1964.

Several development banks have also been set up outside the auspices of the U.N. The Islamic Development Bank, with membership from the Organization of the Islamic Conference, began operations in 1975. The International Bank for Economic Cooperation was established in 1963 with the Soviet Union, Bulgaria, Czechoslovakia, East Germany, Hungary, Mongolia, Poland, and Romania as members. Cuba and Vietnam joined later. Its purpose was to finance trade among its members. These nations also belonged to the International Investment Bank, established in 1970, to make loans for economic development.
7. What was the rationale in setting up development banks?

The need for development banks stemmed from the following reasons. First, war-devastated countries and developing countries needed an “instrument” to accelerate long-term investment to achieve rapid growth and create employment. They could not rely on the “status quo”. Second, to achieve a higher degree of efficiency and in pursuit of employment objectives, a policy decision was taken to rely on the private sector as engine of growth. Third, the then existing financial sectors in these countries were dominated by commercial banks which were contented with short-term banking activities and were either not willing nor not in a position to support national priorities of long-term investment in the real sectors. Finally, it was generally felt that there was a clear case of market failure, requiring national governments to intervene in the financial markets. The common underlying principle however is that long-term resource allocation should be done by business-oriented financial institutions *vis-à-vis* direct allocation by the government.

8. Who owns the development banks?

Development banks may be publicly or privately-owned and operated, although governments frequently make substantial initial contributions to the capital of private banks. The form (share equity or loans) and cost of financing offered by development banks depend on their cost of obtaining capital and their need to show a profit and pay dividends. In Asia and the Pacific, about 9 out of 10 development banks are owned by governments.

9. How many development banks still exist today?

There are over 500 development finance institutions all over the world, or an average of three per country serving mostly for the industry, agriculture and trade sectors. In certain countries, however, there are other specialized DFIs, such as an SME Bank (serving small and medium enterprises), housing bank, technology bank, infrastructure bank, etc.

10. What are the ‘general’ types of development banks today?

There are four general types of development banks: (a) policy banks which directly support the national government’s economic policy plans and directives as can be found in Japan, China, Korea and Malaysia (b) special-purpose DFIs which support focused sectors of the economy, e.g., SMEs in Thailand, agriculture in India, infrastructure in Malaysia, etc. (c) multi-purpose DFIs (sometimes called universal banks, in some context) which support both development projects as well as commercial businesses as can be seen in the Philippines, Indonesia, India, etc. and (d) commercially-oriented development banks which support development through commercial banking services such as in Singapore.

11. What are the emerging ‘models’ of development banking?

There are three emerging ‘models’ of development banking going into the future: (a) the policy banking model which provides directed finance through government-supported
development banks whose capital are sourced from government, quasi-government and
government-guaranteed funds, as can be found in Japan, China, Korea and Malaysia (b)
the universal banking model which provides long-term finance plus advisory services
through investment and commercial banks whose capital is sourced from the international
financial markets and from their own financial instrument offerings as can be found in
Singapore, India, Sri Lanka, the Philippines, etc. and (c) the 'standard' banking model
which provides development finance through independent development banks whose
capital are sourced ‘on their own’ with little or no support from government, as can be
found in Thailand, Indonesia, etc.

12. Are development banks profitable institutions?

The concept of profit per se is different in the context of a development bank, as it also
considers in its ‘bottom line’ at least three critical aspects, i.e., economic, social and
ecological, aside from the financial returns. In financial terms, therefore, profit
maximization is not the overarching objective of a development bank, as compared to
other financial institutions with private interests and stockholders which expect financial
dividends. Having said these, a study of development banks in the Asia-Pacific region
reveals that these institutions are profitable, financial-wise.

13. What is the difference between a development bank and a commercial bank?

There are several differentiating factors between a development bank and a commercial
bank. Some extreme observations below are made in order to emphasize “traditional”
differences between the two in order to emphasize the point. Actual practice, of course,
differs from commercial bank to commercial bank and from development bank to
development bank. As the country’s capital markets develop, there shall be less
difference between these specialized institutions and the similarities shall become more
apparent. With this as a premise, the traditional differences between development and
commercial banks are in the following areas:

a) Impetus for the Creation of the Institution: A development bank is created as an
instrument of economic development while a commercial bank is created by
business opportunities.

b) Posture Relative to Business Opportunities: A development bank is supposed to
be pro-active as it should take an active role to promote projects and to develop
institutions (entrepreneurs). The projects chosen are those that are consistent with
the economic development priorities. A commercial bank is known to be reactive
to business opportunities. It requires bankability only after the entrepreneur’s
decision has been made; it waits for the idea to culminate into a funding
requirement.

c) Types of Projects Supported: For a development bank, there is an explicit effort to
support economic development projects. The following desired ‘impact’ projects
form the basis for scanning for opportunities: import substitution (at competitive
prices); exports; increased local demand; regional development (for example,
tourism); and increased industrial efficiency through better technology. For a
commercial bank, the abovementioned goals are not the starting point for the identification of projects. Rather, they would most likely be side-benefits. A commercial bank has little concern for these objectives, except for the viability of the bank transaction. In short, a development bank’s activities are *project-based* while that of the commercial bank are *transaction-based*.

d) **Search Process for Projects Financed:** A development bank goes into a planning cycle, identifying which are the likely areas to go into. For example, if it determines that exports is an area to be promoted, then it conducts a marketing study and seeks entrepreneurs to implement related projects. For the commercial bank, the search process is different. It asks, “Are you an exporter?”, then looks at that entrepreneur’s cash balance to determine if there is a marketing opportunity for the transaction.

e) **Project Promotion Activities:** A development bank offers counseling and advisory services for enterprise development and promotion as part of its development lending process. A commercial bank offers legal and business advice, appraisal services and credit investigation, usually for a fee. It undertakes very little project promotion and institutional development. Its emphasis is on client development and marketing.

f) **Strategic Goals:** A development bank has a more difficult strategic objective because it is involved with the concerns of the country, specifically economic development. Aside from this, after providing financing, it is also concerned with developing the enterprise. Developing them explicitly would mean additional costs to the bank. Enterprise development dramatically limits the number of accounts that a development can handle because this is time-consuming. A commercial bank’s main concern is to generate profits. Other benefits are only incidental. With a commercial bank’s cost-consciousness, economic development would be its last priority.

g) **Criteria for Financing:** A development bank assumes project risks and does not insist on too much collateral. It will provide financing as long as the other criteria are met. A commercial bank pays less attention to the project in relation to the collateral requirements. However, the more progressive banks are lending against project cash flow and without collateral.

h) **Assessment of the Loan Proposal:** A development bank employs project appraisal as a means to determine the viability of the project submitted for financing. Project appraisal looks at the technical, financial, marketing, management, environmental and economic aspects of the project. Loan repayment is based on the cash flow to be generated by the project. A commercial bank uses risk asset management as tool to assess the borrower. It looks at the so-called 5 C’s of credit, i.e., character, capacity, capital, collateral and condition. It bases loan repayment on the capacity of the borrower to pay (even from other sources) than from the ‘project’ itself. Thus, it can be said that development bank financing is *project-focused* while that of a commercial bank is *borrower-oriented*. 
i) **Term of Loans Extended**: A development bank provides mainly *term loans* (maturity of more than one year). On the other hand, a commercial bank provides mainly *short-term loans* (less than one year maturity).

j) **Sources of Loan Funds**: A development bank is dependent on concessionary, long-term funds, e.g. pension funds, funds from multilateral financial institutions like the World Bank, Asian Development Bank, etc. It has traditionally limited access to domestic or commercial funds. A commercial bank has a strong deposit base and its corporate borrowers are also depositors. They can match its commercial borrowing against its own short-term loans.

k) **Lending Policies for Cyclical Industries**: A development bank supports its clients in spite of short-term cycles while a commercial bank does not like cyclical industries.

l) **Resource Mobilization**: A development bank undertakes project promotion work to match concessionary long-term financing while a commercial bank mobilizes deposit funds from small depositors which are lent out to large companies.

m) **Client Relationship**: A development bank relates more to clients as borrowers. There is less day-to-day business relationship. Trade transactions of a commercial bank allow for frequent monitoring and close client relationship.

n) **Scope of Institutional Mandate**: A development bank is essentially a specialized institution. It has limited branching and range of products. The commercial bank has a generalized charter. It can offer a wide range of products (especially in the case of universal banks) and can open more branches.