# Muhammad bin Ibrahim: The way forward for development financial institutions

Opening address by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Global Symposium on Development Financial Institutions "The Way Forward for Development Financial Institutions", Kuala Lumpur, 19 September 2017.

* * *

Selamat datang" and a very warm welcome. Thank you for the opportunity to speak today at this important gathering to discuss the way forward for development financial institutions.

In 2012, the music video "Gangnam Style" by Korean pop artist PSY took the world by storm. Being the first video to record more than 1 billion YouTube views, its infectious dance moves have become universally recognised, transcending borders and social status.

The video marked the beginning of the rise of the Korean cultural phenomenon known as Korean Wave or "Hallyu", a new growth area for its economy. Today, the export of Korean culture content, including films and music, is estimated at USD83.2 billion.

In under a decade, the sector grew to contribute 0.7% to South Korea's GDP in 2011, supported over 67,000 jobs and generated USD3.3 billion in tax revenues.

This extraordinary rise of the Korean Wave can be attributed to the growth of investment in the creative industry. The industry was boosted by the government's strategy to prioritise the sector as an engine of growth after the Asian Financial Crisis. The Korean government had earmarked 1% of the national budget for development financial institutions to kickstart the sector. Following in their footsteps, domestic conglomerates like Samsung and Daewoo started investing in film financing and video production.

Korea's experience above illustrates an important lesson for economic development. Properly structured development institutions can be a potent agent of change for private sector investment, drive growth, and forge inclusive societies. It can do a lot of good. But in reality, the real challenge is how to replicate the key factors that contribute to the success, and to achieve this more consistently across different political, economic and social contexts.

With this in mind, let me outline the crucial factors that might help us understand this phenomena:

a. First, a mindset shift to contribute more broadly to catalyse new growth areas;
b. Second, the need to strengthen accountability frameworks;
c. Third, the continuous cultivation of a strong culture of innovation; and
d. Fourth, a robust corporate governance.

### Stepping up to the plate by further developing the non-lending roles

More than ever, development financial institutions need to step up to promote new growth areas. They should perform a broader role to stimulate economic activity that would not otherwise take place. They could also improve the quality and scale of such activities. They can provide unique value propositions in terms of advisory and nurturing new growth sectors to become profitable and thus, attractive for private investors. I will highlight two successful examples.

Firstly, in the Korean Wave example, they were the first to spearhead investments in the film and music industry. At that time, commercial banks did not have the capability to assess the viability of the industry, nor accept the intangible assets offered as collateral. It was only much later,

when the industry recorded healthy profits that private investments followed. The success speaks for itself. Between 2008 and 2011, private domestic and foreign investments in the culture content industry had quadrupled to more than USD 157 million.

The second example is Uganda's first ever private bond issuance by a multinational mobile telecommunications company. The provision of a financial guarantee by a development financial institution helped to connect Uganda's poor and low income population in more than 20 rural communities by enabling access to telecommunication services. This culminated in the telecom industry that now provides 135,000 jobs for Ugandans and contributes 1.4% of its GDP.

Taking lessons from these examples, I believe that development financial institutions need to possess three key traits to promote and champion the new growth areas:

a. First, they must have specific mandates to develop and prioritise niche segments identified to be of strategic and economic importance. These will give them legitimacy with funders and partners;
b. Second, affiliations with Government, ministries and agencies to facilitate the design of appropriate government support. This will enable them to take higher risks; and
c. Third, a broader focus on socio-developmental goals allows risk-return trade-offs to take into account positive externalities for the economy.

The lessons we learnt imply that leaders must recognise and align their priorities to steer their respective institutions to contribute more broadly and strategically to economic development. This will include playing a more active role in technical assistance, and serving as key repositories of specialist knowledge, resource aggregators for strategic development projects and credible advisers to the Government.

These 'additionalities' are important ingredients in ensuring the effectiveness of development financial institutions.

**Strengthen accountability frameworks through performance standards that emphasise development additionalities**

While the notion of additionalities is not new, their link to how the development institutions are managed and governed remains generally weak. As a result, their important contributions are often not translated into tangible outcomes that are seen and felt by the stakeholders and the public at large.

This leads me to my second point. Traditionally the achievements of development institutions have always been measured predominantly by the volume of financing provided to the targeted sectors. There are several reasons for this. Non-financial development additionalities are harder to quantify the cause and effects are also not always clear. As such, more effort and investments are required to collect the data for measuring socio-economic and development outcomes that are associated with such programmes.

However, this must not hold back efforts for us to do better. They are a major channel for directing development, both at an international and domestic level. It is therefore, imperative that there is confidence in the effective and efficient use of funding aid to achieve the intended development goals. Providing this confidence can be enhanced by creating a broader and robust mechanism to measure performance.

Performance measurement systems that accord greater quantification of development impacts will strengthen accountability frameworks, with many attendant benefits. It will further reinforce the Government's developmental agenda. It will provide a mechanism to address market failures. It will ensure that funds are allocated to the right sectors within the economy. Effectively done, it

will increase the development financial institution's credibility, reputation and potential as key players in advancing socio-economic development.

In Malaysia, we are encouraging these institutions to improve performance measurement frameworks to better capture the development impact of business activities.

A number of them are already implementing frameworks to provide broader performance measures for value-based intermediation activities (VBI) which focus on the impact on the economy, community and environment. Of particular importance, they need to measure granular outcomes such as creation of good paying jobs and expansion of capacity and capability.

Another commendable example is the performance measures published by the Industrial Development Corporation of South Africa (IDC), which linked its activities to the creation of more than 340,000 jobs in the economy between 2013 to 2017. Out of this, 10% were based in rural areas. Approximately USD3.3 billion of IDC's financing-related activities could also be traced to the specific economic empowerment of targeted groups such as youth and women.

## Cultivate a strong culture of innovation within to increase value-add and catalyse private investment

Development institutions should be leading innovators in providing solutions to stimulate investment and entrepreneurship especially in uncharted sectors. In my view, a key part of their contribution to development has to be in evolving non-traditional approaches to encourage investments in targeted sectors, precisely because conventional approaches have not responded adequately.

Indeed, they should be providing the richest environment for adaptive learning, creativity and innovation to effectively serve their mandates. Innovation is also being supported through a "test and learn" approach which allows for experimentation by financial institutions in close coordination with regulators. This approach promotes a deeper understanding of risks inherent in new solutions and products, and the appropriate ways to control them. The introduction of the regulatory sandbox in several countries, including Malaysia, to support regulatory flexibilities for the deployment of FinTech reflects such a "test and learn" approach. Development financial institutions should use technology to advance the cause of their mandate.

To be innovative, development financial institutions must be able to attract and retain good leadership and talent. KfW in Germany and Business Development Bank of Canada (BDC), two global development financial institutions, were recognised as being among the top 100 employers in their respective countries in 2017. Well-designed talent strategies, and an environment that nurtures experimentation and adaptive learning with appropriate oversight and controls are key. These require bold and visionary leadership.

Another way to promote creativity is to create a facilitative environment for public private partnerships provides the best prospects to drive innovative strategies. With advances in technology, the scope and potential for such partnerships have increased exponentially. We see this in partnerships between mobile network providers and financial institutions in sharing data which can increase financial inclusion among borrowers that do not have a prior credit history. Partnerships that leverage on e-marketplaces and social media platforms also have enormous potential to increase the reach and development impact through the deployment of innovative strategies.

## Enhance corporate governance

For many institutions, the ability to significantly increase their impact is closely tied to issues of corporate governance. Narrowly defined financing targets and links between business and Government have led to suboptimal resource allocations, increased moral hazard, and market

distortions. These can pose a drag on the economy and the overall development agenda. Broader confidence can also take a hit on suspicion of undue preference in extending financing, making it more difficult to mobilise resources for development.

The critical appraisal and monitoring functions are largely shaped by the strength of its corporate governance. These require competent and professional boards to be installed, clear rules of engagement with their stakeholders, and stronger performance management standards that are aligned with development outcomes.

## Expectations and directions for Malaysian Development Financial Institutions

I would also like to share some reflections on expectations and directions for development financial institutions in Malaysia

I am well aware that development financial institutions around the world, including in Malaysia, face unique challenges. In many ways, they have to manage and balance responsibilities that are substantially more complex than institutions with narrower profit-making mandates.

In Malaysia, these institutions have embarked on initiatives over the last decade and a half to build greater financial resilience and stronger foundations for sound management. This has enabled them to pay an important counter-cyclical role during downturns, and to support economic activity in targeted segments.

However, more effort is required on critical appraisal of their development impact. It is much needed to sharpen the development focus, redirect and amplify the impact of financing activities. It will also provide the impetus for them to focus on other interventions that can increase their impact.

We intend to work with their leadership and other stakeholders in Government in the coming months to address a more focused delivery of mandates. In this respect, improving performance measurement frameworks and increasing transparency in the operations will be important areas of focus. We need to measure the right things, measure outcomes that matter and measure mandates that are relevant. This needs to be driven by a clear vision and strong leadership, and uncompromising governance.

We expect our development financial institutions to operate with the highest level of professionalism and integrity at all levels of the organisation. Indeed, we expect that given their mandates, they would lead in demonstrating how commercial principles can be fully reconciled with responsible finance and public interests.

There are many instances where development financial institutions can play a catalytic role in economic development. They can open new frontiers in discovery and exploration; accelerate poverty eradication and mitigate global climate change.

This ought to be a noble aspiration. We share a common vision for them to contribute towards the growth potential of our economies and consequently improve the wellbeing of the people.

We have an excellent program ahead to help us move in this direction. I hope it will sow the seeds for individual and collective actions that will both transform development financial institutions and enhance their impact.