

# **NATIONAL PROMOTIONAL BANKS AS ACTIVE FINANCIERS: THE CASE OF KFW**

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# What is KfW?

- KfW is Germany's state-owned national promotional bank (NPB)
- As of 2015, it is the 2<sup>nd</sup> largest NPB in the world (following the China Development Bank) in terms of total assets
- Mission: to support the German government implement or expand policies that would otherwise go unfunded by the private market
- Largest programs in green technology, energy efficiency, SME financing, and export financing



# KfW in Historical Perspective

- **1948:** KfW founded with Marshall Plan funds (begins in 1949)
- **1950:** First export financing program
- **1952:** First SME program
- **1958:** First foreign loans (India, Sudan, and Iceland)
- **1962:** Adopts responsibility for Germany's international cooperation
- **1971:** KfW launches the SME Programme, the first self-financing program for domestic investment
- **1984:** First environmental program
- **1987:** First foreign currency issue (USD)
- **1990:** Invests in former GDR, then Central/Eastern Europe
- **2000:** First securitization program
- **2002:** Restructuring after compromise with the European Commission
- **2004-2016:** Variety of new financing programs for student loans, environmental protection, SMEs, and energy efficiency

# Structure and Governance

- KfW is composed of five primary units:
  - ▣ Förderbank (Domestic Promotional Bank)
  - ▣ Mittelstandsbank (SME Bank)
  - ▣ IPEX (Export Bank)
  - ▣ Entwicklungsbank (Development Bank)
  - ▣ DEG (Private Development Finance Bank)



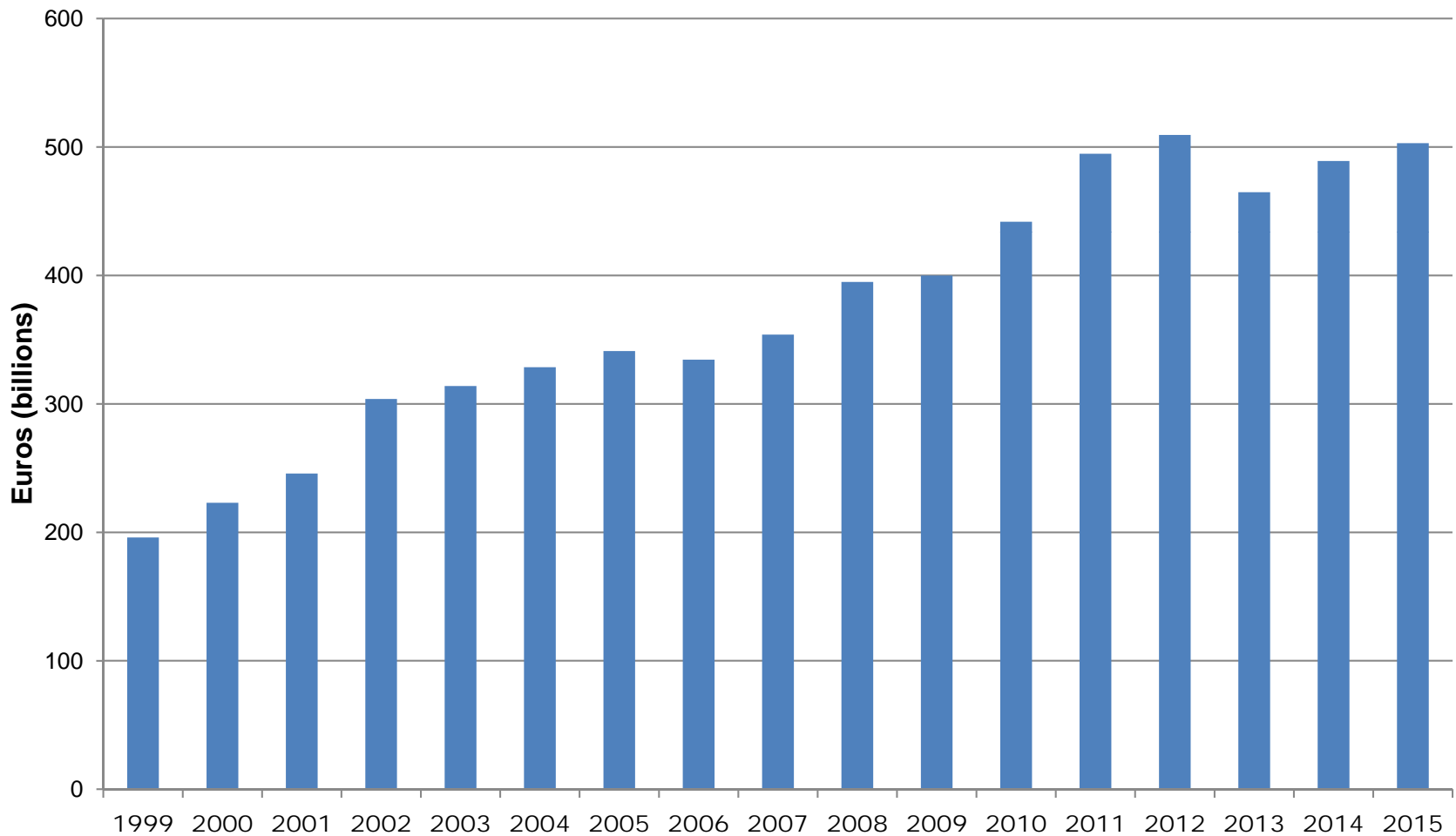
- Ownership: 80% Federal Government, 20% State Governments
- All existing and future obligations are fully guaranteed by the Federal Government
- Supervised by the Ministry of Finance and, as of 2013, BaFin (German Financial Supervisory Authority)
- Exempt from European Banking Directives

# Operations

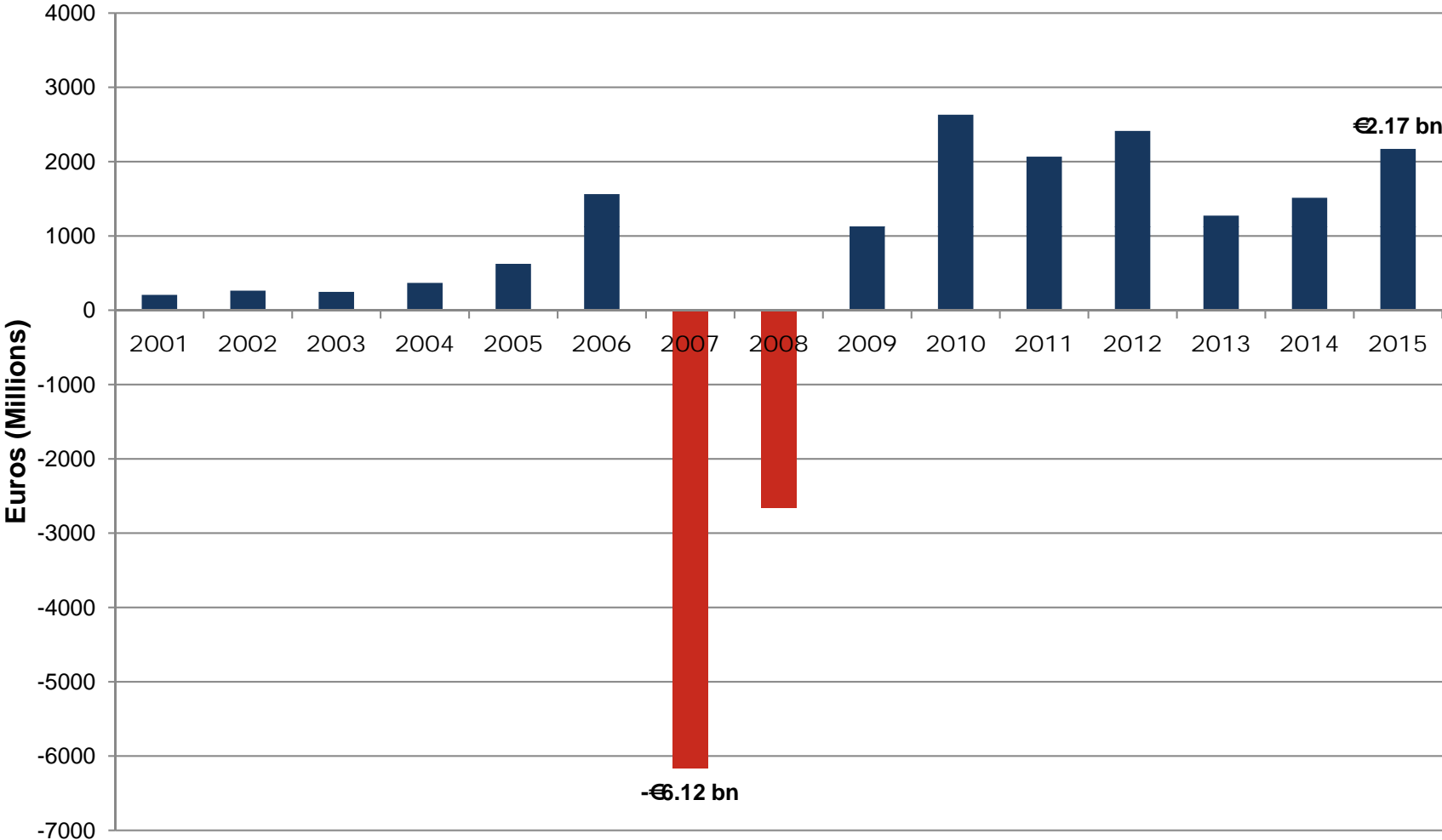


- In 2015, KfW had assets of **€503 billion** and issued **€79.3 billion** in new promotional business volume
- To fund its promotional business, KfW raised **€62.6 billion** on the international capital market
  - ▣ USD (45%), EUR (37%), GBP (7%), AUD (4%), JPY (2%), others (5%)
  - ▣ Issues benchmark bonds, public bonds, and private placements
  - ▣ Issued first negative interest rate benchmark bond in Oct 2015
- Primarily on-lends through domestic German commercial banks, takes no deposits
- KfW is exempt from corporate taxes and profit distribution

# Total Assets (EUR billions): 1999-2015



# Consolidated Profit (EUR millions): 2001-2015

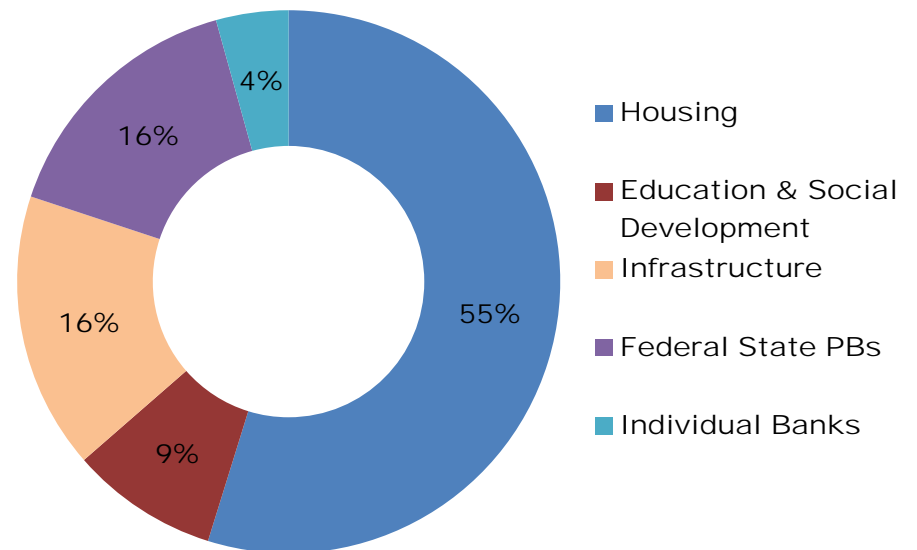


# Components of KfW: Domestic I

## KfW Förderbank (KfW Promotional Bank)

- Total 2015 Lending Volume: €30.1 billion
  - ▣ KfW's largest "unit," comprised of municipal and private client bank/credit institutions
  
- Housing Investment
  - ▣ Energy-efficiency loans
  - ▣ Home Ownership Programme
  
- Education/Social Development
  - ▣ Student loans
  - ▣ Continuing professional development
  
- Infrastructure
  - ▣ Loans for municipal projects
  - ▣ Social infrastructure (refugee housing)
  
- Promotional institutions of German states
  
- Individual Bank Financing
  - ▣ Refinancing of export loans
  - ▣ Products for European/global SME and environmental projects

2015 Promotional Bank Breakdown



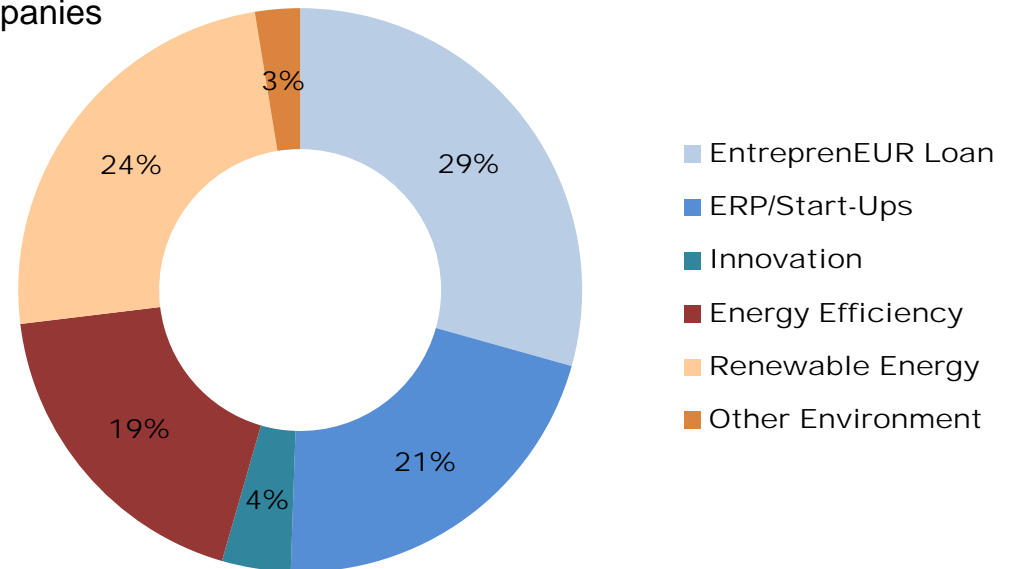


# Components of KfW: Domestic II

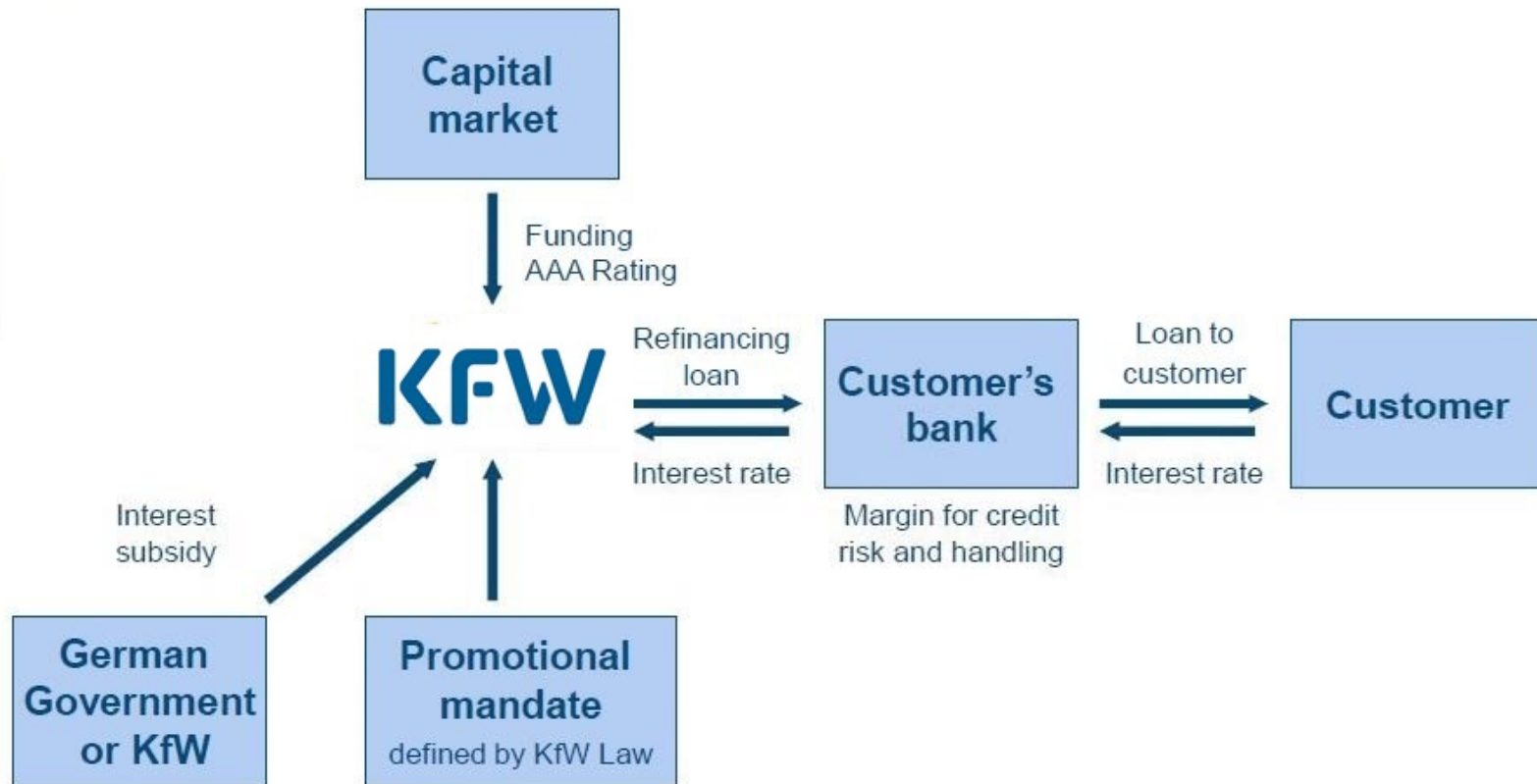
## KfW Mittelstandsbank (KfW SME Bank)

- Total 2015 Lending Volume: €20.4 billion
- Projects focus on SMEs, innovation, and environment
- SME Financing:
  - ▣ EntreprenEUR Loan (investments in SMEs)
  - ▣ ERP loans for start-ups and young companies
- Innovation:
  - ▣ ERP Innovation Programme (R&D)
  - ▣ EntreprenEUR Loan Plus (investments in innovative SMEs)
- Environmental:
  - ▣ Environmental protection
  - ▣ Energy efficiency projects
  - ▣ Renewable energy projects
  - ▣ Offshore Wind Energy

2015 SME Bank Breakdown



# KfW Domestic Business Model



# Components of KfW: International

## □ **KfW IPEX-Bank**

- ▣ Total 2015 Lending Volume: €20.2 billion
- ▣ Objective: Provides financing for German exports and foreign investments in Germany
- ▣ Operates on a commercial basis and competes with private banks



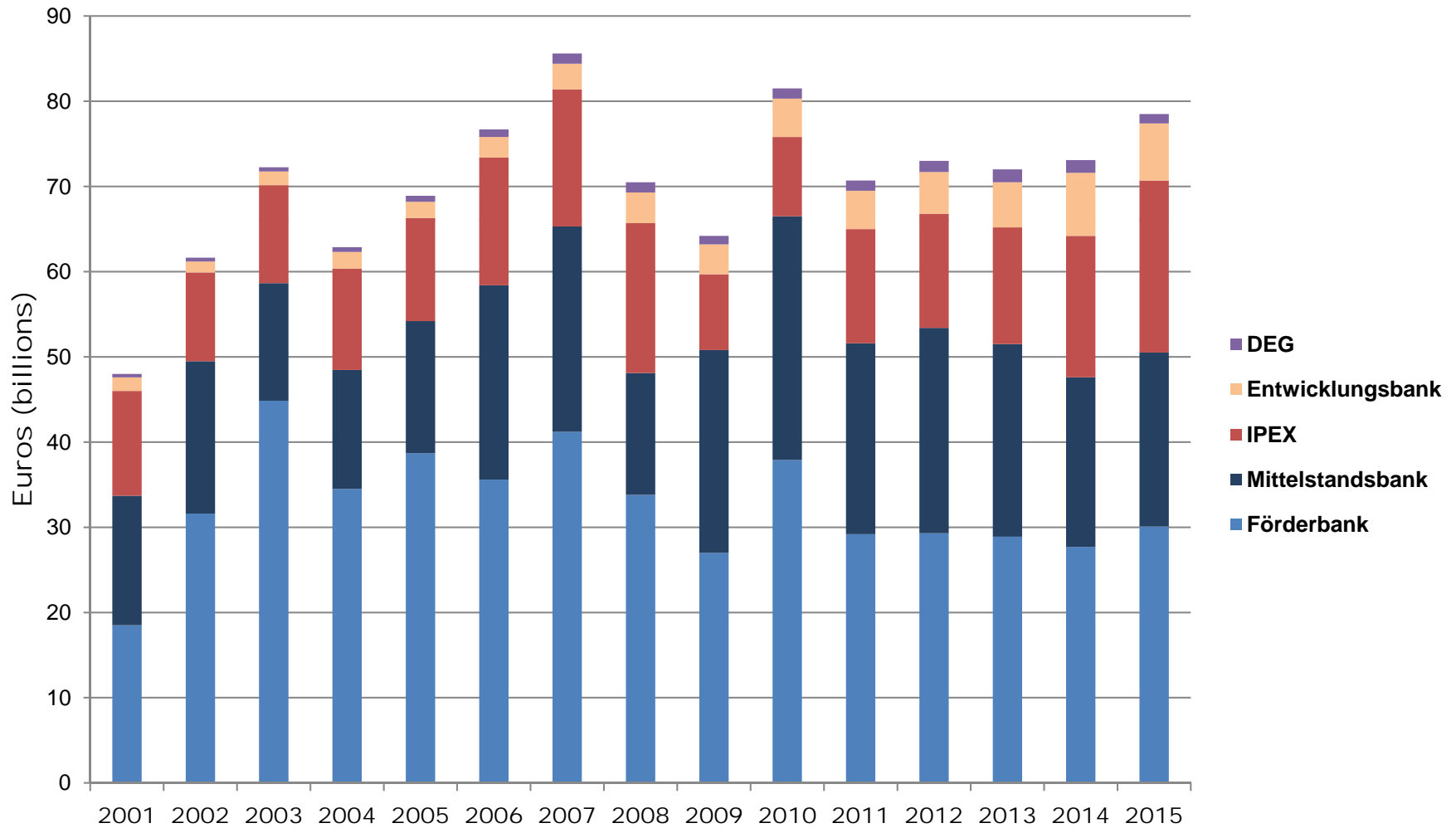
## □ **KfW Entwicklungsbank (KfW Development Bank)**

- ▣ Total 2015 Lending Volume: €6.7 billion
- ▣ Objective: Provides financing to governments, public enterprises, and commercial banks in developing countries. Use market rate loans, subsidized loans/blended finance, and concessional aid and grants.
- ▣ Particularly active in SME financing and microfinance

## □ **DEG (German Investment and Development Corporation)**

- ▣ Total 2015 Lending Volume: €1.1 billion
- ▣ Objective: Promotes the development of private enterprise in developing countries through loans and minority equity stakes
- ▣ Operationally similar to the IFC

# New Funding by Unit (EUR billions)



# KfW as an Active Financier



We argue that KfW is defined by three important characteristics:

- **Economic objective, government backing**
  - ▣ Designed to compensate for market failures and promote socially-beneficial projects that are underfunded
  - ▣ Financially backed by the German government
  - ▣ Cooperates with commercial banks
  
- **Access to policymakers and regulators**
  - ▣ Can achieve policy synergy with the government through a “carrot and stick” strategy
  - ▣ Provides essential market and on-the-ground knowledge to policymakers
  
- **Technical expertise**
  - ▣ In-house experts provide more detailed knowledge of economic trends
  - ▣ Serves as an advisor to new economic and promotional legislation

# Promotional Policy Cycle

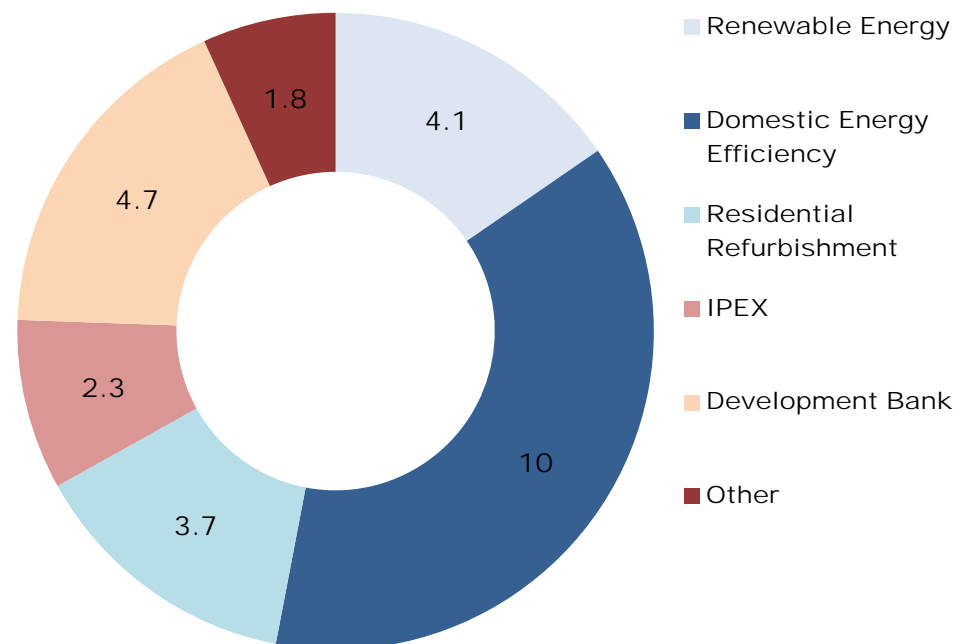


- **Policy mandate and coordination with German government**
- **Leverage market for funds and distribution**
- **Scaling back or modification of project after market creation**

# Green Financing

- Since the early 1980s, KfW has been an active promoter of green technology—in efficiency, renewables, and protection
- In 2015, approximately 37% of total lending (€26.6 billion) went to environment-related projects
- Most funding goes to domestic energy efficiency projects
- KfW aims to provide subsidized financing to achieve the German government's ambitious Energiewende initiatives
- In 2015, KfW issued €3.7 billion in Green Bonds

**2014 Green Financing (billions of Euros)**



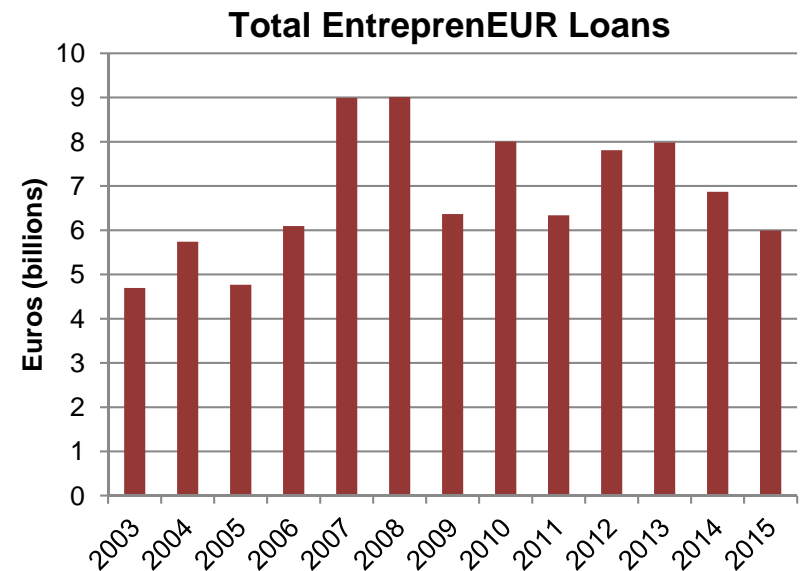
# 2008 Financial Crisis and Aftermath

- Exemplifies the double-edged sword of being a government agency
- Responsible for poorly-performing assets
  - ▣ In 2001, IKB asked KfW to purchase the 33.2% share package from Allianz/Münchener Rück in order to prevent a pending divestiture
  - ▣ In 2007, KfW assumed 70% of the losses from the total risk protection, and provided liquidity guarantees, resulting in the raising of KfW's balance sheet risk provisions to €4.95 billion
  - ▣ KfW's annual net loss in 2007 was over €6 billion
- Provided an important countercyclical role
  - ▣ Implemented a multiyear economic stimulus plan for German enterprises (€40 billion) and for energy efficiency and infrastructure measures (€10 billion)
  - ▣ Minimal losses from the Domestic Promotional Bank/SME Bank
  - ▣ Implemented KfW Special Programme, which invested €14.1 billion
  - ▣ KfW estimated that by 2012, its financial activities had saved 370,000 jobs
  - ▣ Increased European promotional activities



# SME Programs I

- SMEs are disadvantaged because they (1) lack direct access to capital markets, (2) weak bargaining position, and (3) inability to diversify risk
  - ▣ KfW provides: long-term loans, equity investments, and consulting
- In 2015, 40% of new domestic commitments went to SMEs
- Largest program is the KfW EntreprenEUR Loan (Unternehmerkredit)
  - ▣ Started in 2003
  - ▣ Targets SMEs
  - ▣ Issued over 200k individual loans
  - ▣ In 2007, KfW assumed 50% of the risk from the commercial on-lending banks
  - ▣ Max €25 million per project
  - ▣ Loans of 5, 10, or 20 years



# SME Programs II



- EntreprenEUR Loan Plus
- Designed to promote improved financing for innovative SMEs
  - Up to €7.5 million per project
  - Can finance up to 100% of eligible investment costs
  - Interest rates from 1%
  - Lasts 7 years in total, up to 5 years for working capital
  - Firms must prove innovativeness (e.g., received a patent or EU/national research grant)
- Risk-sharing: KfW and the EIB each bear 25% (total of 50%) of the the risk from the on-lending commercial bank
- Total commitments up to €500 in the next few years

# New Directions for KfW



- KfW has highlighted three focus areas for the future:
  - ▣ Climate change
  - ▣ Demographic change
  - ▣ Globalization and technical progress
  
- Further development of new financial instruments
  - ▣ Securitization
  - ▣ New structured funds for climate change/SMEs
  
- Increasing coordination with EIB and European NPBs
  - ▣ Growth of collaboration in joint funds
  - ▣ Participation in the Juncker Plan

# Replicability of KfW?

To what extent is KfW's model exportable to other contexts? We offer a few cautionary notes:

- Requires a strong legal framework
  - ▣ Necessary to avoid investment being made for political—rather than economic or social—objectives
  - ▣ Reduces opportunity for corruption
  
- Requires a functioning financial sector
  - ▣ KfW heavily relies on financial markets to both raise and distribute capital; it cannot serve as a replacement for financial market development
  
- Requires technical capacity
  - ▣ Determining a “market failure” is inherently difficult, and implementing projects across sectors is information-intensive
  - ▣ Also needs policy clarity from the government to choose which areas are the most important

# THANK YOU

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