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Pre and post investment process
Management of credit risk: the IDC way ...

- The major cause of DFIs/Banking problems are directly related:
  - Lax credit standards for borrowers and counterparties.
  - Poor portfolio risk management.
  - Lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of the counterparty.

- Credit risk is simply defined as the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms.

- The goal of credit risk management is to maximise DFI’s/Bank’s risk-adjusted rate of return by maintaining credit risk exposure with acceptable parameters.
The Board of directors should have the responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and credit policies. The strategy should reflect the institution’s tolerance for risk and the level of profitability the institution expects to achieve for incurring various credit risks.

Senior management should have the responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk at both the individual credit and portfolio levels.

DFIs should develop and implement policies and procedures to ensure that the credit portfolio is adequately diversified. Such policies should establish targets for portfolio mix as well as set exposure limits on single counterparties and group of connected counterparties, particular industries or economic sectors, geographic regions and specific products.

New products must be subjected to significant planning and careful oversight to ensure the risks are appropriately identified and managed. Any new activity/product should be approved in advance by the Board.
Pre and post investment process (cont.)
Operating under a sound credit granting process …

• DFIs/Banks must operate within sound, well-defined credit granting criteria. These criteria should include a clear indication of the bank’s target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit and its source of repayment.

• Overall credit limits should be established at the level of individual borrowers and counterparties and group of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures. These limits help to ensure that the granting activities are adequately diversified. In order to be effective, limits should generally be binding and not driven by customer demand.

• Credit proposals should be subject to careful analysis and effective evaluation and an effective evaluation process must establish minimum requirements for the information on which the analysis is to be based. There should be policies in place regarding the information and documentation needed to approve new credits, renew existing credits and/or change the terms and conditions of previously approved credits.
Once a credit/facility is granted, it is the responsibility of the business unit in conjunction with the credit support team, to ensure that the credit is properly maintained.

There must be a system in place for monitoring the condition of individual counterparties, including determining the adequacy of provisions and reserves. These should include measures to:

- Understanding the current financial condition of the borrower or counterparty;
- Monitor compliance with existing covenants;
- Assess, where applicable, collateral coverage relative to the obligor’s current condition;
- Identify contractual payment delinquencies and classify potential problem credits on a timely basis; and
- Promptly direct for remedial management (Workout & Restructuring).
• DFIs/Banks should develop and utilise an internal risk rating system in managing credit risk. An internal risk rating system categorises credit into various classes designed to take into account gradations in risk.

• Information systems and analytical techniques must be in place to measure the credit risk in all and off-balance sheet activities. These should provide adequate information on the composition of the credit portfolio, including identification of any concentration of risk.

• A system for monitoring the overall composition and quality of the credit portfolio should be in place.

• Institutions should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios and should assess their credit risk exposure under stressful conditions.
Pre and post investment process (cont.)
Ensuring adequate controls over credit risk ...

• A system of independent, ongoing, assessment of the institution’s credit risk management process must be established and the results of such reviews should be communicated directly to the senior management and the board.

• Credit granting function should be properly managed and that credit exposures are within parameters set by the board and senior management.

• Limit systems should ensure that granting of credit exceeding certain predetermined levels receive prompt management attention.

• A system should be in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

• Effective workout programs are critical to managing risk in the portfolio. The workout function must be segregated from the area that originated credit. Workout should provide valuable input into any credit restructurings.
Pre and post investment process (cont.)
The IDC appraisal process …

Applications from existing / prospective businesses
Proactive identification & development of business opportunities

Initial Screening & Basic Assessment

Feasibility Completed
Term Sheet
Due Diligence

Feasibility not fully investigated
MOU/Co-operation Agreement
Feasibility Study

Proposal Submission
Approval of viable transactions at an appropriate committee

Legal Agreements
Disbursement
Post Investment Management

Interventions in businesses experiencing difficulties, including business support, restructuring of facilities, etc.
Structuring of funding depending on client’s needs.
Consultation / interactions with expert departments

Average turnaround times:
• Vanilla transaction – 4 weeks
• Equity transaction – 8 weeks
Pre and post investment process (cont.)
The IDC appraisal process …

Basic Assessment
Application must be formal and complete (Business Plan)

Establish compliance to criteria (incl. economic merit) – basic assessment within Strategic Business Unit (SBU)

If complying, supply a term sheet (a non-binding offer, subject to approval – it commits the client)
Due Diligence Investigation

Ideally done by team of 3 spending 4 to 5 days with applicant covering:

- Investment details (Funding required, structuring)
- Management (Integrity, capability, stability)
- Marketing (Market opportunities, stability)
- Technical (Property, plant, people, security)
- Financial (Past performance, gearing, profitability, sensitivity)
- Environmental impact (Specialists, EIA)
- Pricing & Development impact (Key mandates of DFI)
- Portfolio, Sector, Product, Cross Border & Counterparty impacts

A Due Diligence Checklist must be completed at the end of the process
Pre and post investment process (cont.)
The IDC appraisal process …

**IDC’s Peer Review Mechanism**

Any person, no matter how experienced, can make an error. Furthermore, in any due diligence, various assumptions are made. It is therefore of value to have somebody who was not close to the due diligence, questioning the assumptions and approaches.

A peer review offers opportunities for training and skills transfer. It also allows a team member the opportunity to get comfort on his/her work, to get a second opinion on problematic issues, to test assumptions made, discuss alternative approaches and capture learnings for future due diligences.

It is necessary to have a formal process in place for peer review to ensure consistency of application across operations SBU’s.
Proposal Submission to a Credit Committee
A refined version of the term sheet is issued. Amended to accommodate findings of the due diligence process, negotiations and inputs from expert departments:

- Evaluations Department;
- Environmental Department;
- Corporate & Structured Finance Department;
- Risk Management Department (including risk comments); and
- Legal Department.

All analyses, findings, comments and recommendation collated into a standardized proposal or report and submitted to a credit committee.
The role of an expert department is to pass on their skill sets to others in the Corporation to enable leadership, product development, improved quality, reduced time delays and remove duplication.

This is achieved through:

- Learn
- Teach
- Monitor

**Expert:**

- skilled or knowledgeable person; and
- somebody with a great deal of knowledge about, or skill, training, or experience in, a particular field or activity
Legalise

- Legal due diligence (if necessary);
- Preparation of legal agreements;
- Signing of the legal agreements;
- Registration of security instruments.
IDC’s does not have “rules” as to what it will or will not fund.

However, it does have some funding norms:

- Historical profitability;
- No default;
- Achieved income security >= 1.5 times;
- Capital security >= 0.8 times;
- Expansion <= 30% of NAV;
- Proven budgeting ability;
- Positive credit checks;
- Structure exceeding IDC norms does occur if motivated.
The main activities of W&R include Turnaround, Restructuring and Litigation,

- Finding new investors or a Strategic operating partner;
- Appointing consultants;
- Providing business support;
- Restructuring the operations of the distressed client;
- Implementing a scheme of arrangement (Sec 311); and
- Taking control of the management of a client.

Restructuring of the client's Balance Sheet through:
- Conversion or partial conversion of debt finance to equity;
- Deferment and/or capitalisation of capital and/or interest repayments;
- Writing off a portion of the exposure;
- Injection of additional funding to an existing client in distress; and
- Recommending Business Support.

- Working closely with Legal Department on clients under liquidation or which have Ceased Operations;
- Sale of assets and closure of operations; and
- Negotiating settlement offers.
IDC’s Control Environment in the Investment Process

Pre-investment
- Enquiry
  - Application: business plan
- Screening: investm. criteria
- Term sheet
- Scheduling: multi-disciplinary teams
- Due diligence
  - check-list
  - fin. norms
  - FICA
- Expert advisory services
- Submission
  - prescribed format
  - risks mitigated
  - credit checks
  - risk grading
  - pricing
  - lessons learnt
  - limits / policies breached
- SRC / PRC

Investment Decision
- Investment Comm.
  - composition: EXCO members
  - "independent" Chairman
  - External members
- Decision (minutes)
- Legal process
- Conditions precedent / restrictive conditions
- Draw down

Post-investment
- Valuable rights
  - Directorships
  - Fin statements
  - Provisions / impairments
  - Restructuring
  - Credit control: IMC
  - Client relationships
  - Collateral
  - "Red Lights"
  - Collection
  - Hospital care
  - Equity monitoring
  - Covenants / milestones
  - Fees
  - EHS monitoring
  - CAM process (delegation of authority)

Exits
- Monitoring
  - Correspondence
  - Valuable rights
  - Negotiations
  - Collateral
  - Valuations
  - Early settlements policy
  - Write-off reports
  - Liquidations
  - W & R
  - Legal
  - Personal sureties

"Internal Audit and Risk Management provides assurance"
"Corporate Governance non negotiable"
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Concluding remarks
Key success factors …

Overall aim to maximise developmental impact, while safeguarding financial sustainability

- Adherence to a comprehensive set of investment guidelines
- Economic merit is not negotiable
- Thorough due diligence
- Risk mitigation (e.g. country risk assessment, transfer / country / political risk cover)
- Investment limits (counterparty, industry, country, region)
- Appropriate financial structuring
- Supply / off-take agreements
- Hard currency generation
- Emphasis on strong sponsor support (financial, marketing, technical)
- Portfolio diversification
- Corporate governance / legal
- Compliance with international standards (labour, environmental, etc.)
- Promoters’ financial contribution
Concluding remarks (cont.)
IDC’s successes are built on strong pillars …
Concluding remarks (cont.)
Some take-aways …

“If you want to be incrementally better: Be competitive. If you want to be exponentially better: Be cooperative.”
Source Unknown

“No one lives long enough to learn everything they need to learn starting from scratch. To be successful, we absolutely, positively have to find people who have already paid the price to learn the things that we need to learn to achieve our goals.”
Brian Tracy

“A bad business decision (or mistake) in the presence of good corporate governance is tantamount to a concern. A bad business decision in the absence of good corporate governance is tantamount to a disaster”
Mervyn King,
The King Code of Corporate Governance (I & II)
Thank you ...