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BRIEFING PAPER

# Rwanda: Financing for manufacturing

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## Key messages

- This briefing paper finds that the improvement in Rwanda's business environment, its regional market opportunities and continued foreign direct investment inflows are key opportunities for growth in its manufacturing sector.
- In analysing financial and economic challenges, this paper concludes that high transport and utility costs, the elevated real effective exchange rate and weakness in bank lending are key challenges to be tackled.
- Looking ahead, special economic zones should continue to be a focus alongside export-oriented investments; prudential measures could target manufacturing finance and disincentivise overly high levels of real estate lending.

## Rwanda needs more finance to fuel its manufacturing growth[1]

Rwanda is one of Africa's rising stars, having seen solid rates of economic growth since the mid-1990s. A large part of its economic success has been a result of proactive policies to facilitate a good domestic investment climate.

Despite the country's successes, developments in manufacturing have not been as encouraging. One of the reasons for this may lie in finance. At 24% of gross domestic product (GDP), Rwanda has seen higher than average investment rates compared with the average of other low- to middle-income countries. And yet most private finance has gone to other sectors, including infrastructure and real estate.

Nevertheless, financing for manufacturing has increased significantly in absolute terms, from under $40 million in 2006 to over $350 million by 2015. There has been a relative shift in financing from bank lending to foreign direct investment (FDI) with, by 2015, 61% of stock in FDI and 38% in bank lending. However, only 12% of 2015 financing stock was in manufacturing.

[1] This briefing paper is drawn from a SET report by the same authors (Calabrese et al., 2017).

## Rwanda's top three economic and financial opportunities

**Rwanda's business environment** has improved as the government has streamlined business registration processes, with the Rwanda Development Board a one-stop shop for investment registration. This progress is reflected in the country's improvement in the World Bank's Doing Business rankings, from 143rd in 2009 to 56th in 2017. Greater transparency and accountability are also reflected in Rwanda's low level of corruption, which is deemed to be below both Sub-Saharan African and global averages by the World Bank Enterprise Survey.

**Rwanda's regional market opportunities** have meant that, in recent years, its exports to Democratic Republic of Congo (DRC) have increased significantly, especially those towards the eastern part of the country. In 2015, 32.2% of Rwanda's exports went to DRC, which became the country's first export destination, ahead of Europe and Kenya.[2] This is recognised in key policy documents: the second National Export Strategy and the Economic Development and Poverty Reduction Strategy II highlight the importance of eastern DRC and Burundi as export destinations for Rwanda.

[2] UN Comtrade database, various years.

**FDI can be a key source of manufacturing investment** in Rwanda. It is stable and low cost and avoids the potential financial and macroeconomic stability concerns that reliance on portfolio flows might bring for the country's relatively small financial sector. Policy is already broadly supportive of FDI inflows, with liberalised capital controls, including from China, and a number of development finance institutions such as CDC Group and the International Finance Corporation.

## Rwanda's top three economic and financial challenges

**Rwanda's high transport and utility costs** are a key challenge. Notwithstanding the good quality of the main national roads, the country's landlocked position and the distance to the ports of Mombasa and Dar es Salaam make it expensive to import and export goods. The Diagnostic Trade Integration Study Update estimates that these costs constitute 46% of import and export values, making Rwanda less attractive in global value chains. While the energy supply has improved, its cost remains high.

**The real effective exchange rate** (REER)[3] can affect Rwandan firms' export sales and import purchasing power. The franc's REER could be more competitive in order to help boost longer-term export competitiveness. Although overall consumer price inflation has declined, other costs for manufacturers remain high and are acting as a constraint on manufacturers' competitiveness and productivity. Competitiveness in the Rwandan franc is also important, given plans for an East African monetary union.

**Bank lending to Rwanda's manufacturing sector** remains weak. Currently, banks are not lending to manufacturing but instead keep high levels of cash, or are lending to other sectors. This reflects a reluctance of banks to lend to manufacturing because they see this as being of higher risk. This perception is driven by factors such as the need to lend over relatively long periods in order to finance the capital investments the manufacturing sector needs and the fact that repayment is reliant on the profitability of operations, which can be difficult to forecast and subject to uncertainty, rather than solely on concrete collateral.

[3] We define the REER as the nominal effective exchange rate multiplied by the ratio of domestic to foreign prices. The nominal effective exchange rate is the country's trade-weighted exchange rate relative to its major trading partners.

## Looking ahead

In managing Rwanda's economic challenges and maximising opportunities,

- **SEZs should be a focus** at a domestic level as a means of overcoming infrastructural and transport challenges and boosting skills and employment in manufacturing.
- **Focusing on low-volume high-value goods** that are not energy-intensive could reduce utilities costs and make air transport more feasible and help reduce the REER.
- **Investments should have an export focus,** given the small size of the domestic market. Boosting trade through further preferential trade agreements would facilitate this.

In managing Rwanda's financial challenges and maximising opportunities,

- **Prudential measures to favour manufacturing**, such as differential capital requirements, could disincentivise overly high levels of real estate lending.
- **Deepening insurance and pension markets** could encourage mobilisation of domestic deposits, and intermediation, into manufacturing investments.
- **Strengthening 'soft' relationships** may help overcome investors' risk concerns about investing in Rwanda and reinforce areas of mutual interest.
- **Reducing investors' risk** through wholesale small and medium-sized enterprise financing, risk-sharing for venture capital and vanilla loans for larger companies could be extended to manufacturing.
- **Greater usage of 'impact accelerator funds'** would provide venture capital to manufacturing and deliver transformation through a forum for 'learning by doing'.

Full references available in **Calabrese, L., Papadavid, P., and Tyson, J. (2017)** ***Rwanda: Financing for manufacturing.*** **London: Overseas Development Institute.**

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