

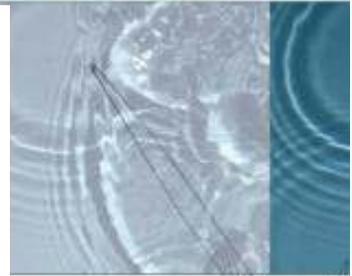
Industrial Development Corporation

Portfolio Committee on Trade and Industry

Industrial Financing to Strengthen Investment in the Productive Sectors of the Economy: the role of the IDC

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Chief Executive Officer*

20 August 2014



- **IDC in the South African Development Finance Institution landscape**
- **Introducing IDC**
- **Alignment with Government Priorities**
- **Historical Funding Activity and Development Impact**
- **Financing Process and Products**
- **Terms and Conditions related to IDC Financing**
- **Constraints, Opportunities and the Way Forward**
- **Conclusion**

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The Role of DFIs

DFIs' contribute to sustainable and developmental financing

Greater importance on social and developmental objectives

Greater importance on financial objectives

Government / NGOs

- Non-commercial focus
- Fiscal transfers and grants
- Development objectives (social)

DFIs

- Commercial and development focus
- Sharing risk
- Internally generated funds, government funds, loans

Commercial Financiers

- High commercial focus
- Private sector capital
- Financial objectives
- Known risks

DFIs should not compete with other institutions, but should play a role in crowding in private sector activity into the economy

South Africa has a number of DFIs each with their own unique mandate

Core Mandate	DFI
Industrial development	<ul style="list-style-type: none">• Industrial Development Corporation (IDC), est. 1940
Infrastructure development	<ul style="list-style-type: none">• Development Bank of Southern Africa (DBSA), est. 1983
Agriculture, land reform and rural development	<ul style="list-style-type: none">• Land and Agricultural Development Bank (Land Bank), est. 1912• Independent Development Trust (IDT), est. 1990
Black economic empowerment	<ul style="list-style-type: none">• National Empowerment Fund (NEF), est. 1998
SMME development	<ul style="list-style-type: none">• Small Enterprise Finance Agency (sefa), est. 2012• Small Enterprise Development Agency (seda), est. 2004
Housing development	<ul style="list-style-type: none">• Rural Housing Loan Fund (RHLF), est. 1996• National Housing Finance Corporation (NHFC), est. 1996• National Urban Reconstruction and Housing Agency (NURCHA), est. 1995
Youth development	<ul style="list-style-type: none">• National Youth Development Agency (NYDA), est. 2009

In addition to national DFIs, there are also a number of provincial DFIs/investment promotion agencies including Ithala Development Finance Corporation (KwaZulu-Natal), Eastern Cape Development Corporation, North West Development Corporation, Free State Development Corporation, Limpopo Economic Development Agency.

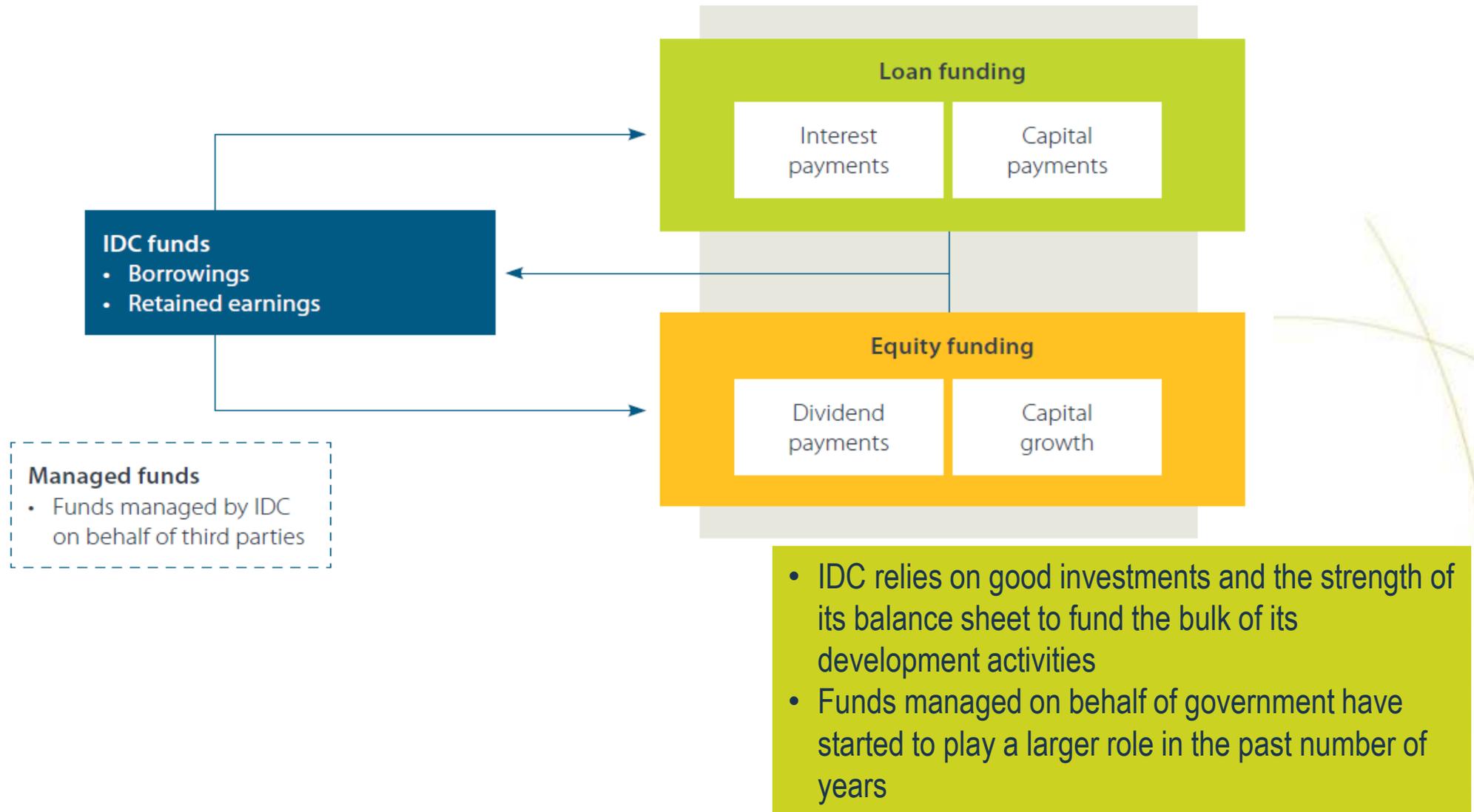
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- **Established:** 1940
- **Type of organisation:** Development Finance Institution (DFI)
- **Ownership:** State owned company, 100% owned by the SA government
- **Total assets:** R138.6 billion (31 March 2014 - group)
- **Total liabilities:** R31.6 billion (31 March 2014 - group)
- **Funding status:** Fund operations and growth from investments, pay dividends and income tax
- **Credit rating:** Baa1 (Moody's) in line with sovereign rating
- **Main business area:** Providing funding for entrepreneurs and projects contributing to industrialisation
- **Geographic activities:** South Africa and the rest of Africa
- **Products:** Custom financial products above R1m to suit project's needs including debt, equity, guarantees or a combination of these
- **Small and Micro enterprise coverage:** sefa (fully owned subsidiary)
- **Stage of investment:** Project identification and development, feasibility, commercialisation, expansion, modernisation
- **Number of employees:** 839 (June 2014)



- **Operational Footprint:**
- Head Office - Johannesburg
- 20 Regional and Satellite offices

IDC's Funding Model Relies on Sustainable Investment



IDC's Positioning in the Market Predisposes it to a Certain Type of Business Seeking Funding

Market for Industrial Finance

Funders

Not for profit organisations

IDC

Commercial funders

Typical businesses funded

- Subsistence

- Start-ups
- Expansions in businesses without a strong financial history
- Businesses where owners cannot provide collateral to the extent required by commercial funders
- Businesses operating in industries that commercial funders are not comfortable with
- Large projects where commercial funders want to share the risk

- Businesses with a strong financial history
- Businesses where owners can provide collateral to cover the loan

IDC Industrial Finance offering enhanced by sefa



The establishment of sefa as a subsidiary of IDC increases the impact of development finance in South Africa:

- Improved market segmentation means products can be tailored to the needs of SMEs and larger companies;
- Customised processes for SME funding can result in quicker turnaround times for funding for small businesses;
- Less confusion in the market about which DFI would be able to assist with providing funding;
- SME development around larger projects being established by IDC can be leveraged by sefa;
- IDC provides increased access to resources and capacity development to sefa.

Increasing Industrial Development Impact

- Prioritise sectors in which IDC will play a proactive role and strengthen sector development objectives and strategies
- Align IDC with the sector objectives of the NDP, NGP and IPAP
- Increased project development and implementation
- Provide industrial finance to further achievement of sector development objectives
- Increase regional industrial integration through the development of value chains
- Ensure effective and efficiently operating sefa

Ensuring Long-Term Sustainability

Financial Capital

- Improved management of the IDC investment portfolio
- Plan investment return and risk profile to ensure sufficient growth to replace existing cash generators
- Structure investments to increase direct equity returns
- Manage risk through appropriate investments, pricing and management of the portfolio

Human, Social, Natural and Manufactured Capital

- Human resources
 - Ensure appropriately skilled and capacitated human resources
 - Strengthen culture of performance and development
- Stakeholders
 - Improve customer service
 - Build partnerships with other financiers to leverage off different strengths and mandates
 - Increase engagement with sector players to identify opportunities
 - Develop black industrialists
 - Strengthen IDC expertise to shape and influence policy
 - Build strong communities around projects that IDC funds
- Natural environment
 - Reduce IDC's negative environmental impact
 - Reduce industry's negative environmental impact
- Utilisation of resources
 - Improve efficiencies through improved systems and processes

Summary of IDC's Main Activities

- IDC's main activity is the provision of industrial finance to businesses throughout the business lifecycle in sectors aligned with industrial policy priorities as well as developing projects in these industries.
- In addition, it is involved in other activities such as research, policy inputs and fund management for government departments; non-financial support for business; and capacity building for other DFIs.

Activities	Customers	Business lifecycle	Sectoral involvement	Funding products	Regional involvement
<ul style="list-style-type: none"> • Provision of development finance • Project development • Research and policy inputs • Fund management • Non-financial forms of business support • Capacity building 	<ul style="list-style-type: none"> • Business • Government • Other DFIs 	<ul style="list-style-type: none"> • Conceptual • Pre-feasibility • Feasibility • Product commercialisation • Establishment • Expansion • Mature 	<ul style="list-style-type: none"> • Manufacturing • Agricultural value-add • Mining and mineral beneficiation • Green industries • Industrial infrastructure • Tourism, ICT, cultural industries and other productive services 	<ul style="list-style-type: none"> • General debt • Quasi-equity • Equity • Export/import finance • Short-term trade finance • Bridging finance • Guarantees • Venture capital • Wholesale funding through intermediaries 	<ul style="list-style-type: none"> • South Africa • Rest of Africa • Global imports of South African capital equipment

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IDC is Central to and Aligned with EDD and the dti's Strategic Objectives

From EDD's 2014 Annual Performance Plan

- Coordinate jobs drivers, sector/spatial projects and implementation of the NGP for job creation, inclusive growth, industrialisation and social inclusion
- Coordinate Infrastructure development for inclusive growth, service delivery, job creation, industrialisation and social inclusion
- Promote investments, expand industrial funding and entrepreneurship and improve performance of DFIs for job creation, inclusive growth, industrialisation and social inclusion
- Promote competition, trade and other economic regulation in support of job creation, inclusive growth, industrialisation and social inclusion

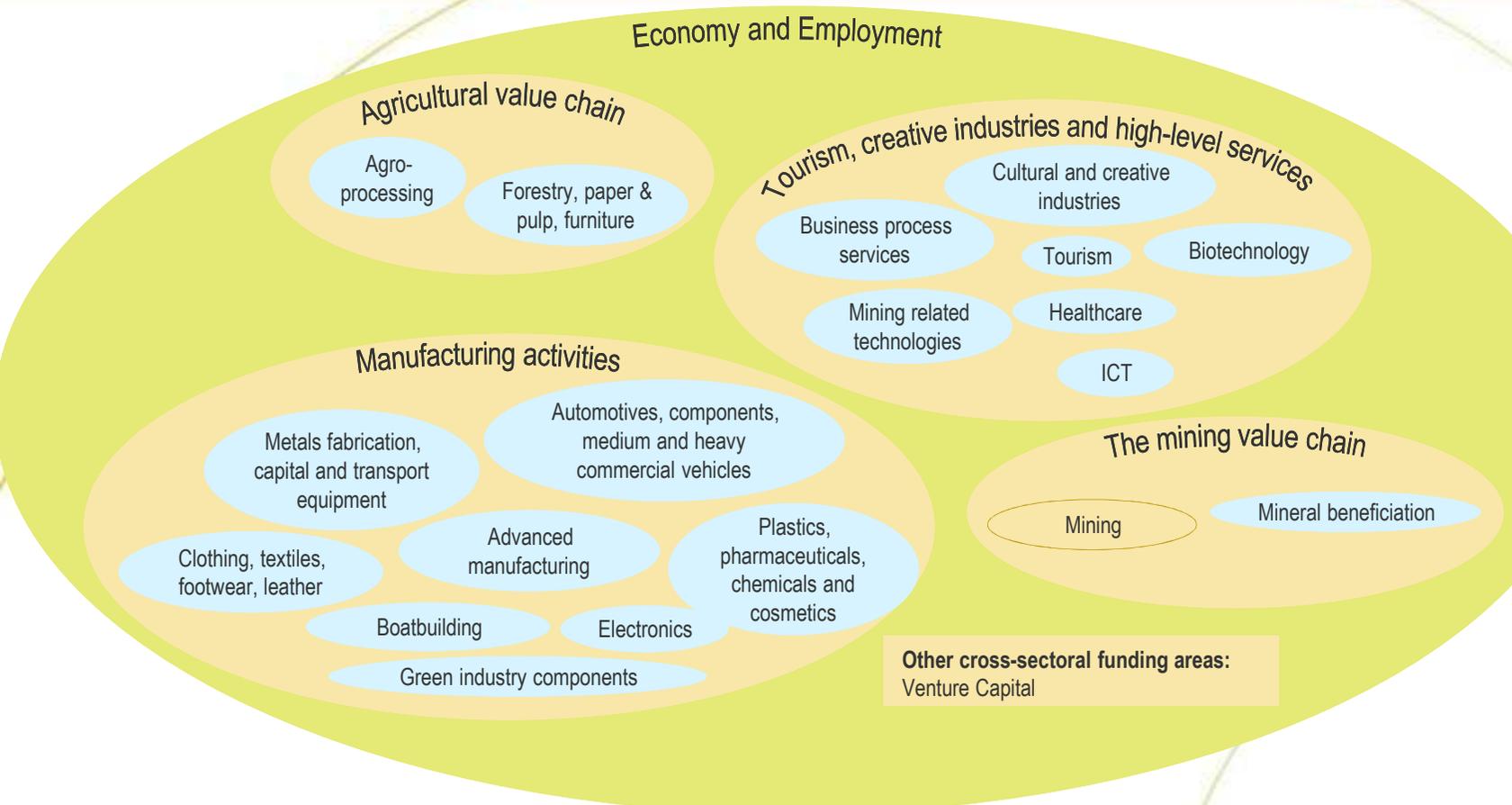
From Strategic Overview of the dti Priorities Dr Rob Davies, Minister of Trade and Industry

- Increased access to DFI finance and incentives against stronger conditionalities
- “We have not yet decisively placed SA economy on a new growth path driven by productive sectors, higher “value addition” and industrialisation”
- Industrialisation must be a central objective

From the dti's 2014 Annual Performance Plan

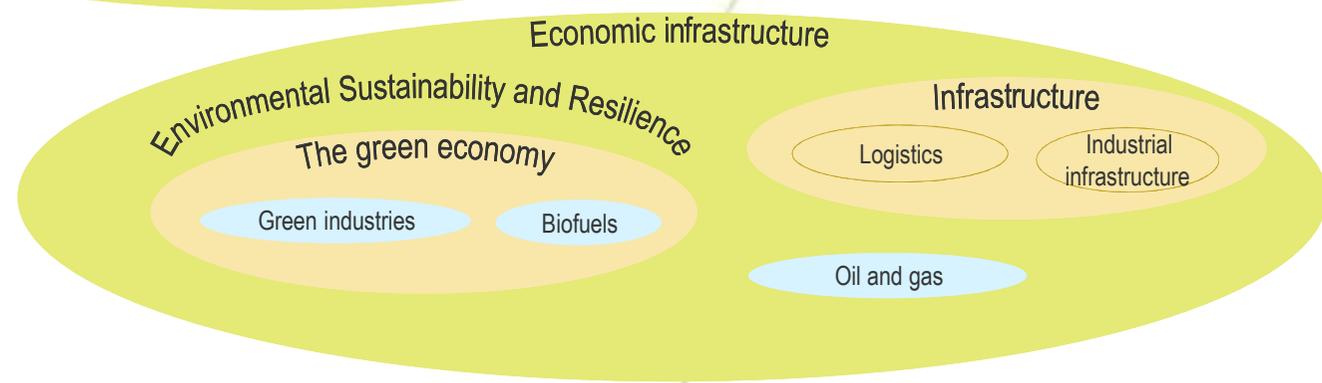
- Facilitate transformation of the economy to promote industrial development, investment, competitiveness and employment creation
- Facilitate broad-based economic participation through targeted interventions to achieve more inclusive growth

As a Part of the State, IDC Strategy Draws from Government's Programme



IDC activities are aligned to Government's programme, driving increased economic activity in productive sectors and seeking to have a greater impact on job creation, inclusive wealth, provincial distribution of economic activity and regional development.

IDC sectoral funding activities supports relevant areas of the NDP, NGP and IPAP



- NDP focus area
- NGP focus area
- IPAP focus area

Agro and New Industries Division

Business Unit

Agro-Industries



Green Industries



Strategic High Impact Projects



Venture Capital



Focus Areas

Localisation – Seed oils and oil cake; malt production; rice in RoA

Land utilisation – contract farming models; large-scale agro-processing

Innovation – Aquaculture

Renewable energy – Wind, concentrated solar and photovoltaic solar power generation

Fuel based energy – Co-generation; biogas; fuel cells

Bio-fuels – Bio-ethanol

Energy efficiency – Heat, electricity & buildings; cleaner production / industrial processes

Industrial infrastructure – Infrastructure projects that can unlock industrial capacity

High impact logistics – Increasing commodity exports; maritime

Commercialisation of South African intellectual property

– Universities and research institutions; private sector (i.e. entrepreneurial inventors / innovators)

Mining and Manufacturing Industries Division

Business Unit

Metals, Transport & Machinery



Forestry and Wood Products



Clothing and Textiles



Chemicals and Allied Industries



Mining and Mineral Beneficiation



Focus Areas

Automotive – assembly and components

Infrastructure

components – rail OEM supply chain

Fabricated metals – ship repair

Components for green industries – energy saving technologies; wind; solar components

Forestry – local community forestry; forestry in rest of Africa

Pulp – dissolved cellulose

Paper – Kraft paper

Building a conducive environment – Illegal imports; streamlined value chain

Niches – work wear; technical and industrial textiles; natural fibres

Mineral beneficiation – Titanium, zirconium, chrome-3

Energy – LNG storage

Agricultural chemicals – fertiliser; crop protection

Resins and polymers – bio-polymers

Security of supply for key inputs into infrastructure – cement; bricks

Steel cost – increase competition

Early stage projects

Commodities with opportunities for local beneficiation; linkages with downstream beneficiation

Rest of Africa

Commodities with beneficiation potential and provide linkages with SA

Services Industries Division

Business Unit

Tourism



Media and Motion Picture



ICT



Healthcare



Focus Areas

Tourist attractions – Development of tourist attractions outside main centres
Rest of Africa – Refurbishment of existing properties; new properties; business hotels

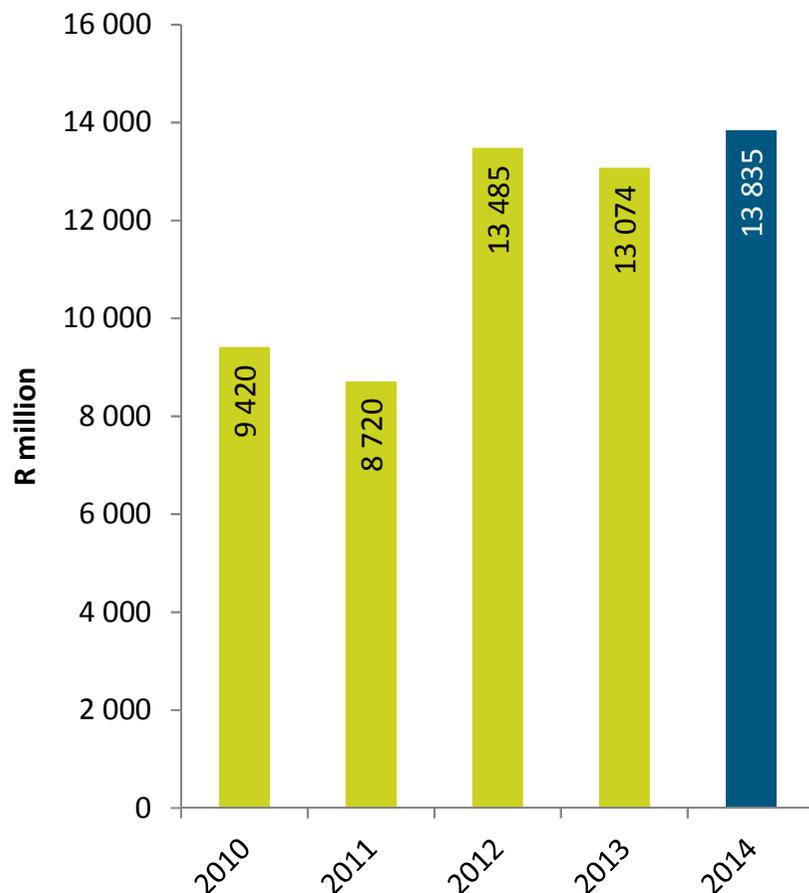
Motion pictures – film production (low, medium and high budget); audience development (digital cinemas, rural and township cinema); television series; natural history documentaries
Audience development – digital cinemas
Animation – Animation hub
Broadcasting – Pan African television broadcasters (expansion of SA broadcasters); Mobile/cable TV

Broadband – last mile fibre; wireless rural; wireless last-mile
ICT Green – e-Waste
Electronics – set-top boxes; smart meters; LED manufacture

Pharmaceuticals – Active pharmaceutical ingredients; medical isotopes; ARV pharmaceuticals; medical devices and consumables; telemedicine
Services – Hospitals in RoA and PPPs in SA

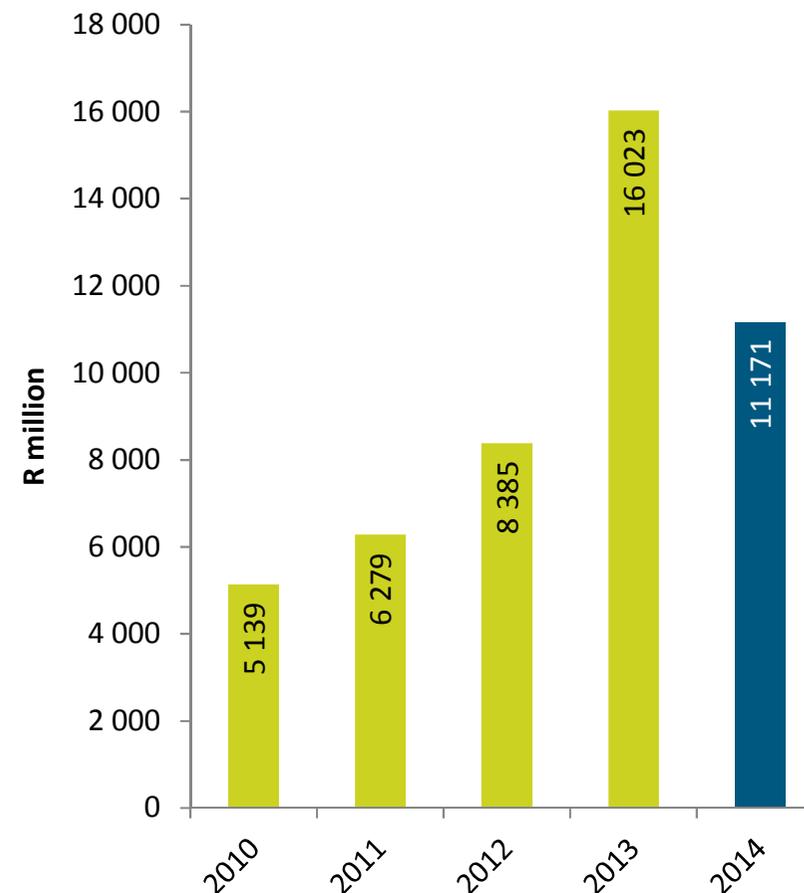
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Value of financing approvals



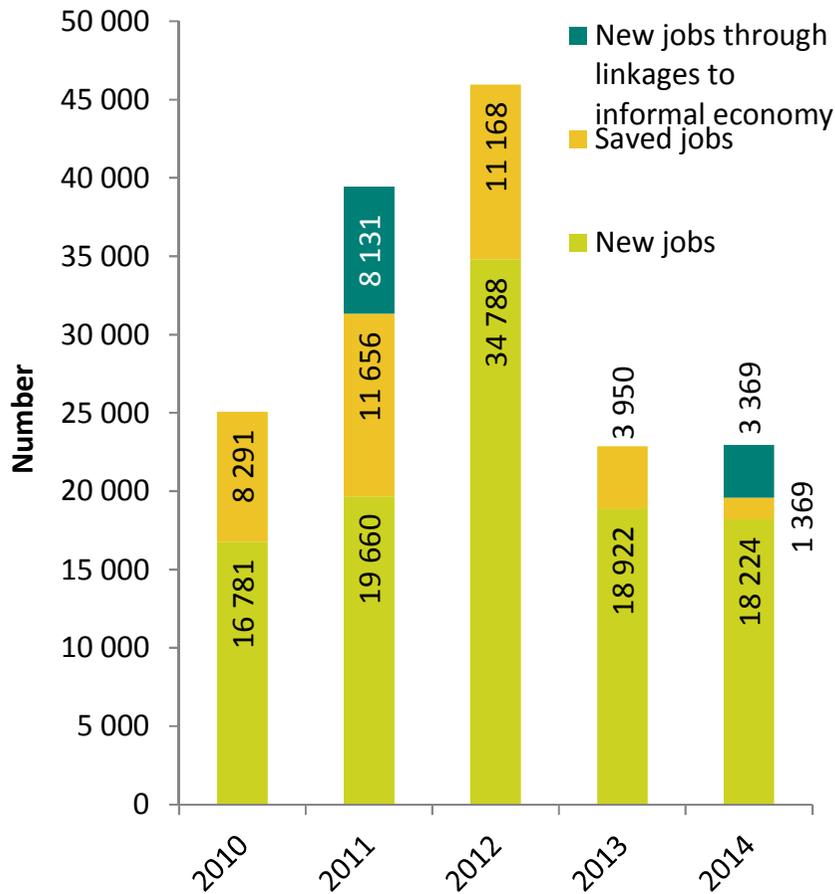
- Funding approvals increased substantially over the past five years to a cumulative total of R58.5 billion, a 78% increase from the R33.0 billion approved in the previous five-year period.

Value of disbursement



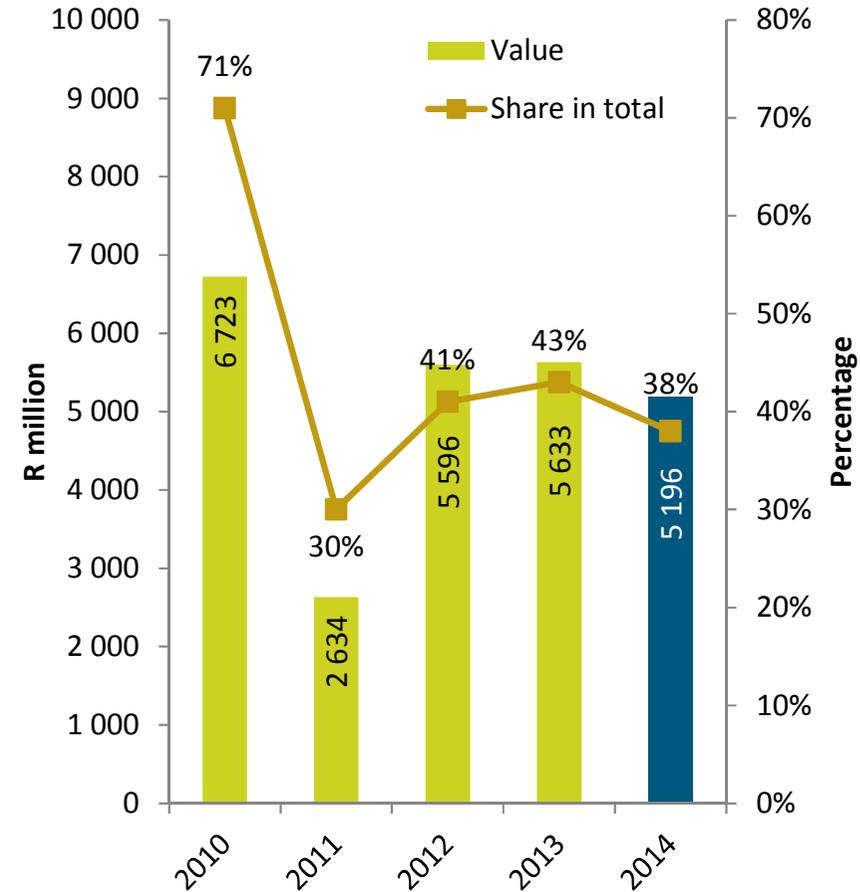
- The value of funds disbursed, the principal indicator of actual investment in the economy, stepped up from R20.3 billion to R47.0 billion over the last five years, representing an increase of more than 132%.

Number of direct jobs facilitated



- IDC financing activities over the past five years facilitated the creation of approximately 108 000 employment opportunities and saving of more than 36 000 jobs. Not included in these figures are 11 000 income-generating opportunities for people engaged in recycling activities.

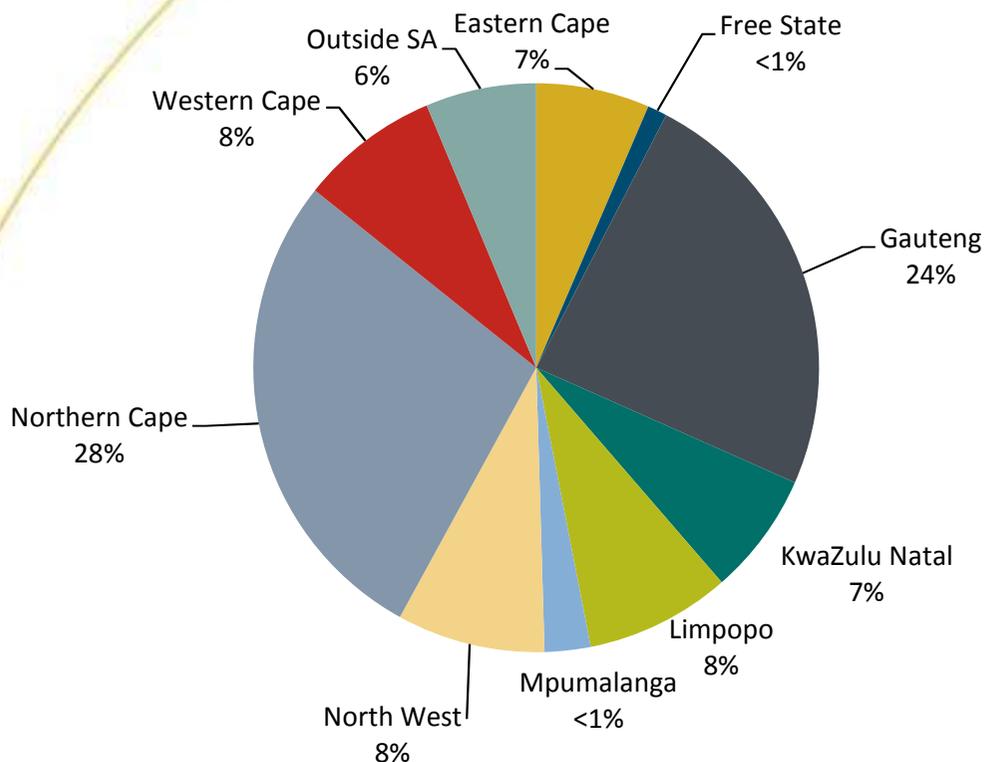
Funding to black-empowered companies



- IDC moved towards funding expansionary empowerment from 2010 onwards. Over the last five years, 44% of funding was for companies with at least 25% black shareholding.

Funding approvals by Region

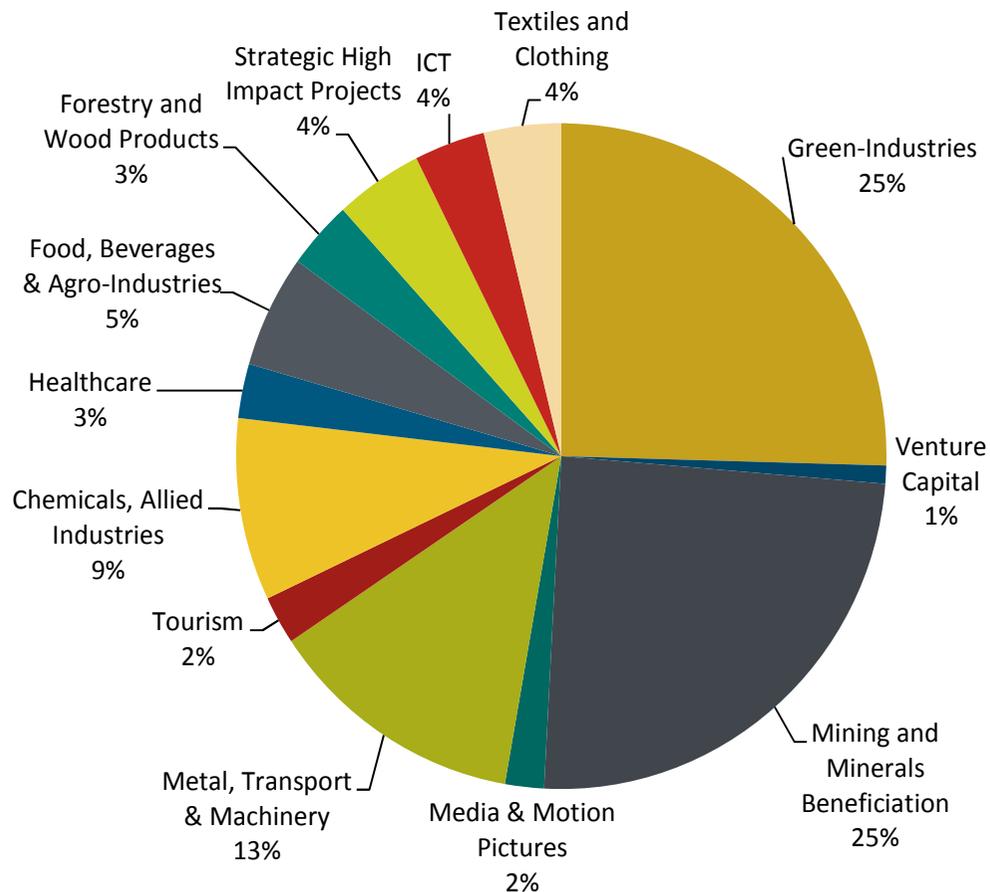
5 Years: 2008/09 to 2013/14



- The Northern Cape has benefited from a large share of IDC funding over the past five years. This included funding for renewable energy projects as well as mining and minerals beneficiation projects.
- Given Gauteng's prominence as a hub for economic activity, the province continues to attract a large portion of IDC funding – intensified by IDC's acquisition of Scaw Metals.

Funding approvals by Business Unit

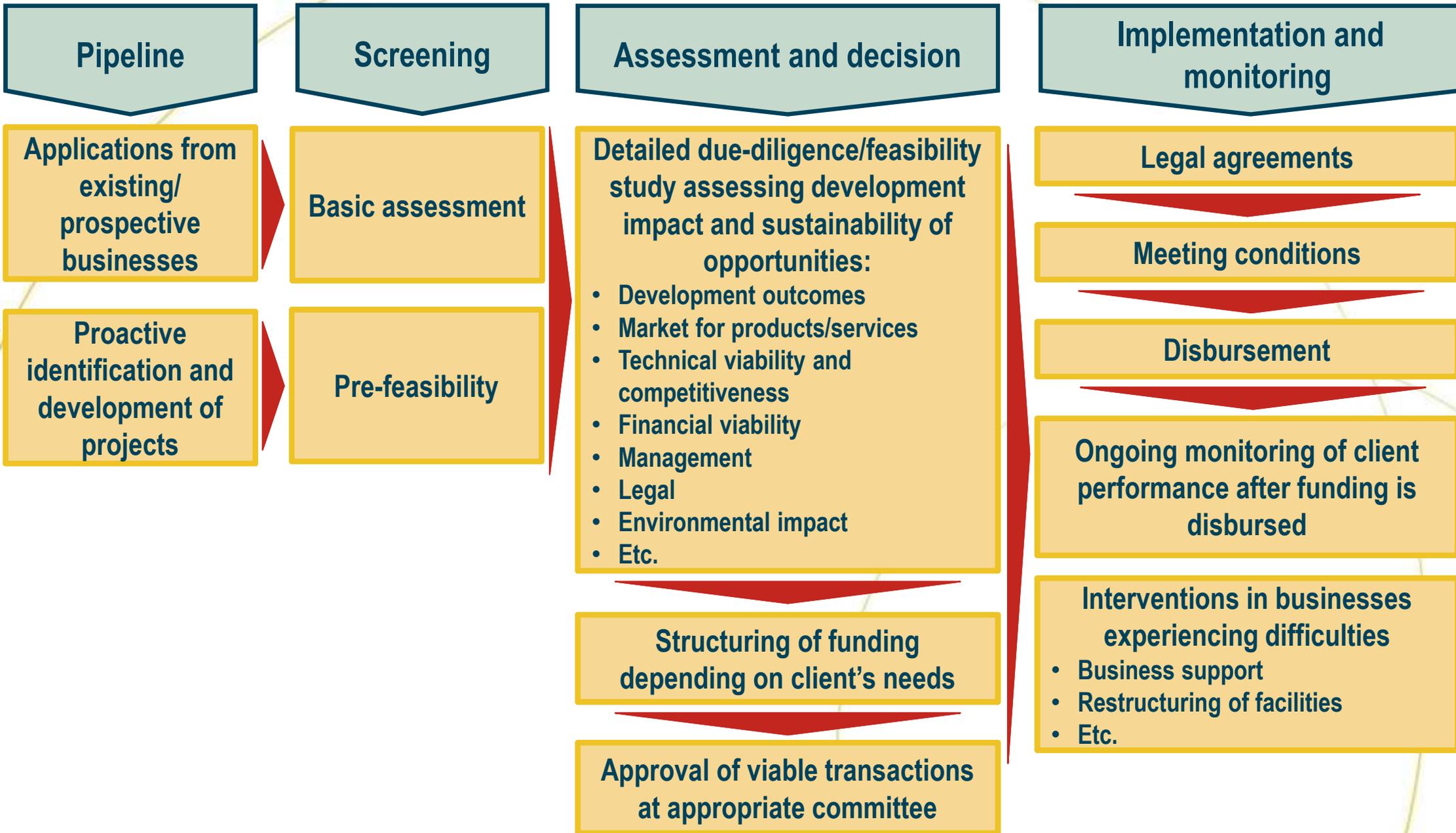
5 Years: 2008/09 to 2013/14



- IDC supported the renewable energy procurement programme, with a quarter of funding over the past five years in green industries.
- Mining and large beneficiation projects' capital intensive nature also requires large investments.
- Downstream manufacturing (predominantly represented in the graph by metals, chemicals, agro-industries, and textiles) received 31% of funding.

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Funding Process relies on intensive due diligence process to test sustainability of the investment



Funding Products suit the types of clients that require DFI support

- IDC funding instruments are designed to support the needs of clients at various stages of development; e.g. equity investment into a start up company or bridging finance to support working capital requirements of manufacturers
- Funding instruments offered by IDC include:
 - Debt (loans);
 - Equity (a share in the company);
 - Quasi-equity;
 - Guarantees;
 - Trade finance;
 - Bridging finance;
 - Venture capital.
- IDC's business support programme addresses non-financial support to entrepreneurs
- Special funding schemes are available that offer more attractive terms and targets for cross sectoral issues such as job creation or development of specific sectors. Also include funds managed on behalf of other organisations, largely the dti

Special on-balance sheet Funding Schemes in support of developmental outcomes

Scheme/Fund	Size	Description	Sources of Funds
Gro-E Scheme	R9bn	Assist companies that <u>create jobs</u> at < or = R500 000 per job	IDC balance sheet
Gro-E – Youth Scheme	R1bn	Assist companies that <u>create jobs</u> at < or = R500 000 per job owned by <u>youths</u>	IDC balance sheet
UIF Fund	R4bn	Assist companies that save and/or create jobs at < or = R450 000	IDC balance sheet – borrowing from UIF
Women Entrepreneurial Fund	R300m	Assist <u>female entrepreneurs</u> to start or expand their businesses	IDC balance sheet
People with Disability Fund	R50m	Assist entrepreneurs with <u>disabilities</u> to start or expand their businesses or to acquire businesses	IDC balance sheet
Development Fund	R350m	Assist <u>workers</u> to acquire meaningful stakes in IDC funded transactions	IDC balance sheet
Community Fund	R150m	Assist <u>marginalised poor communities</u> to acquire meaningful stakes in IDC funded transactions	IDC balance sheet
Equity Contribution Fund	R150m	Assist <u>new entrant black entrepreneurs</u> with their equity contributions w.r.t. IDC funding requirements	IDC balance sheet

Certain special funding schemes support IDC’s development outcomes such as job creation and transformation...

Special on-balance sheet Funding Schemes in support of productive sectors

Scheme/Fund	Size	Description	Sources of Funds
Green Energy Efficiency Fund	R500m	Stimulate <u>energy efficiency and renewable energy</u> investments in the commercial and industrial sectors	IDC balance sheet – borrowing from KfW
AFD Fund	R400m	Stimulate <u>small scale</u> Power Purchase Agreement based <u>renewable energy</u> and greenfield energy efficiency investments in commercial and industrial sectors	IDC balance sheet – borrowing from AFD
Pro-forestry Scheme	R200m	Support new <u>afforestation and transformation</u>	IDC balance sheet
Agro-processing Linkages Scheme	R100m	<u>Agro-processing and rural development</u> by linking established agro-processors with resource poor farmers	IDC balance sheet
Clothing, Textiles, Leather and Footwear Scheme	R750m	To fund companies in the embattled <u>clothing and textiles industries</u> to upgrade their plant and equipment to become globally competitive	IDC balance sheet

... while others target the development of certain sectors with special funding requirements.

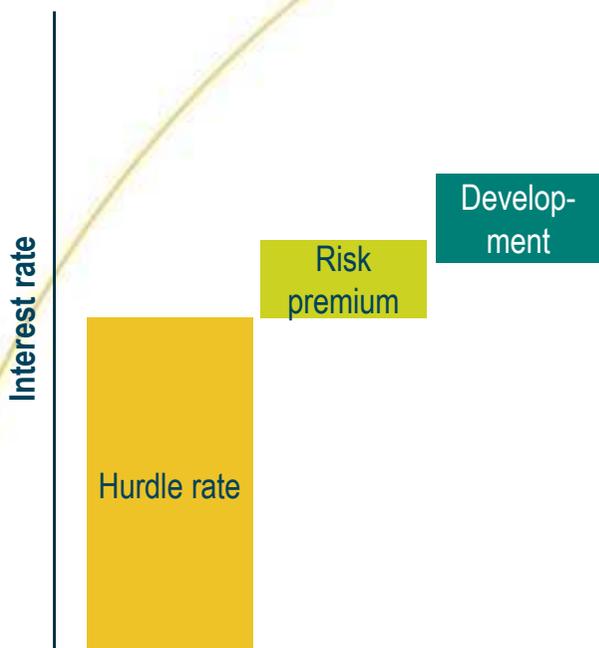
Funding Products managed on behalf of Government (Off-Balance Sheet Funds)

Scheme/Fund	Size	Description	Sources of Funds
Risk Capital Facility	R850m	Assisting with equity funding to <u>BEE-SMEs that create jobs</u>	the dti – EU grant
Technology Venture Capital	R130m	<u>Commercialisation of innovative products</u> , processes and technologies	the dti
Manufacturing Competitiveness Enhancement Program - Working Capital Fund	R765m	To assist manufacturers to access <u>more affordable working capital facilities</u>	the dti
Manufacturing Competitiveness Enhancement Program - Niche Fund	R200m	To stimulate <u>new or underdeveloped manufacturing sectors</u>	the dti
Clothing and Textiles Competiveness Programme	R3.8bn	To improve the competitiveness of the local <u>clothing and textiles</u> sector	the dti
Agro-processing Competitiveness Fund	R250m	Facilitate increased competition, growth and development in <u>agro-processing sector</u> ; through provision of finance to non-dominant players	EDD
Gold Financing Scheme	R100m	Assist <u>gold jewellery</u> manufacturers with working capital (gold) finance	the dti

IDC also manages some funds on behalf of government – in some cases complementing its own funding to companies with these incentives.

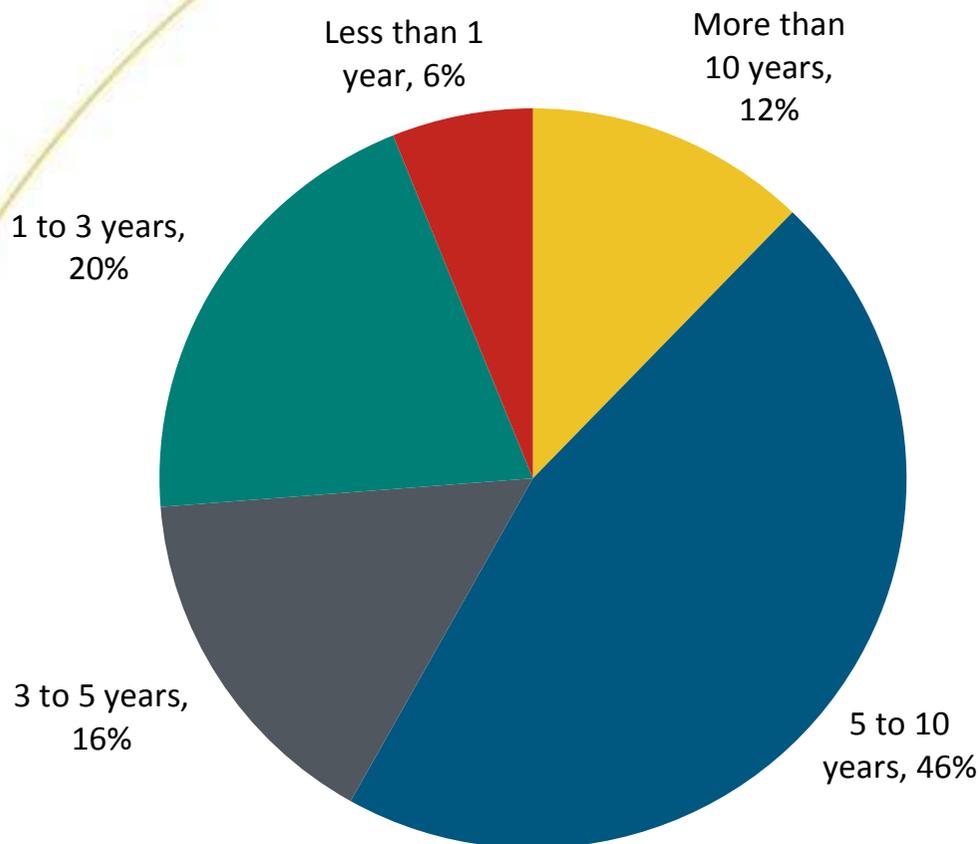
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Loan Pricing Methodology (normal funding)



- On average, IDC's loans are priced at prime - 0.5%.
- Pricing at this level is achieved by utilising special schemes – this is dependent on IDC being able to source low cost funds and cross-subsidise its lending activities with income from mature equity investments.
- Pricing of loans not granted through special schemes are done utilising a model taking into account:
 - Hurdle rate
 - IDC cost of borrowings
 - Portfolio impairment margin
 - Operating cost margin
 - Risk premium
 - Tenure (length) of loan
 - Collateral
 - Probability of default
 - Development impact
 - Includes factors such as job creation, regional development, black economic empowerment etc.
 - Pricing is lower for transactions with high development impact
- In general, the income generated by the loan portfolio should at least cover the cost of borrowings, impairments and a substantial portion of operating costs.

Tenure of IDC Loans (Number of Loans)



- As a DFI, IDC's loans are mostly long-term loans with loans with a tenure of more than 5 years making up 58% of the total loan portfolio.
- Funding for renewable energy projects resulted in an increase in loans with a very long tenure (more than 10 years).

IDC's support is flexible, designed in response to its clients' needs

- IDC value proposition is unique within South African context, structuring options include:
 - Joint development of projects with partners
 - Flexible term of the funding: Short, medium and long-term loans are available, matching clients' requirements to the product being offered (e.g. long term loans for capital-intensive projects, grace periods for start-up companies not generating cashflows during the construction period)
 - Grace periods for repayment : Repayments can be structured to suit cashflows and allow for periods where no payments need to be made on either capital or interest;
 - Flexible security requirements: In most instances, little security is required for small business applications
 - Due diligence process to ascertain sustainability of investment
- In addition, IDC activities in support of sector goals are designed to facilitate strategic industrial capacity development.

Terms for Accessing IDC Financing

- IDC requires that applicants for funding adhere to the appropriate laws and regulatory frameworks. These include but are not limited to:
 - The Financial Intelligence Centre Act, 38 of 2001 (FICA)
 - Taxation laws
 - Competition and Exchange Controls
 - Audited Financial Statements
 - Evidence of the Appointment of Auditors in compliance with the Companies Act, 2008
 - Environment, Health and Safety requirements
 - Proof of Insurance
- IDC's **equity** participation is tailored on a case by case basis and can take the form of direct equity (share acquisition) or indirect equity (preference shares, subordinated loans)
 - The terms are negotiated based on whether the company is a start-up company or a mature business.

Conditions Stipulated by IDC and Undertakings expected from Clients

- IDC uses conditions attached to funding to enhance the development impact of its investments and to contribute to the sustainability of the investment.
- There are several conditions and undertakings by clients that IDC requires to be met. They include but are not limited to:
 - Company to achieve a certain B-BBEE level;
 - Good practice in terms of corporate governance;
 - Limit job losses;
 - Regulating increases in management remuneration;
 - Regulating dividends being paid to shareholders;
 - Ensuring local availability of raw materials;
 - Implementation of HIV/AIDS policies and programmes.

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Constraints and Opportunities in the Provision of Industrial Finance

- The demand for industrial finance is dependent on the level of new investment in industry
- High levels of new investment in industry require:
 - Environment conducive for entrepreneurs to risk capital
 - Competitive inputs into industry
 - Access to markets for products to be sold

General constraints

- Low levels of economic growth locally
- Low levels of economic growth in traditional trading partners
- Low level of business confidence
- Banks rely on historical track record and security for investment decisions
- Low level of entrepreneurial activity

Particular issues related to start ups

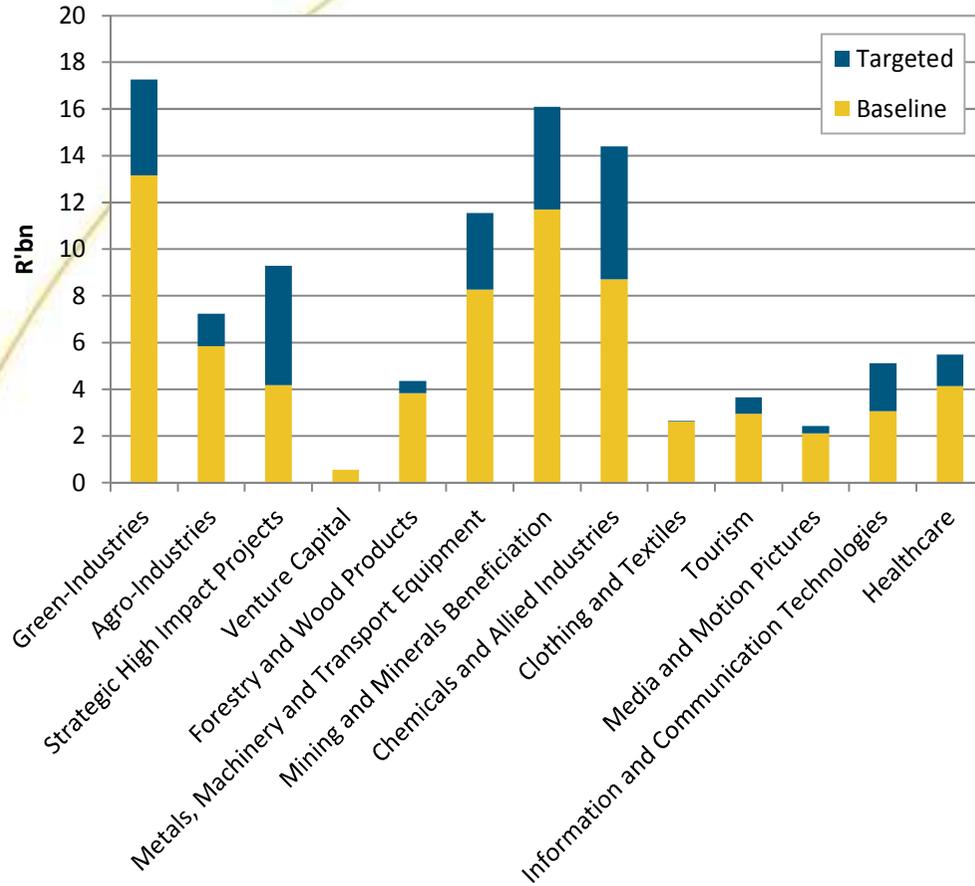
- **Access to Capital**
 - May not have had the opportunity to build up sufficient capital for sufficient equity contribution.
 - Lack of track record
 - Limited security
- **Access to Markets**
 - Do not have long-standing relationships in business that facilitate access to markets.
- **Capacity and Skills**
 - New businesses have a high rate of failure, often due to a lack of management experience and skills

Opportunities

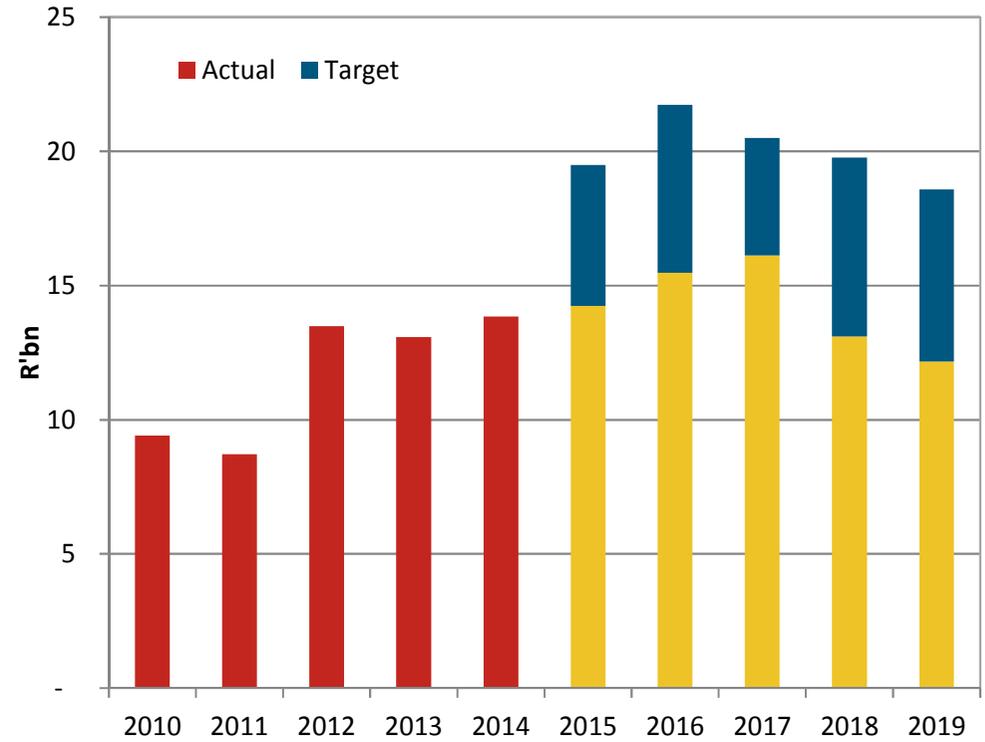
- Localisation opportunities through government procurement
- Access to growing markets in the rest of Africa

Investment Budgets aim to crowd investment in to productive sectors

Capital Allocation by SBU – 2014/15 to 2018/19



Historical Approvals and Capital Allocated



- IDC annual approvals, over the past three years, increased 37% compared to the previous three years.
- Targeting to maintain and grow investment into the economy to R100bn

Key Infrastructure Investments

Industrialisation Focus Areas

Geographic SIPs	<ul style="list-style-type: none"> ▪ Rail expansion and upgrades ▪ Port development and upgrades 	Heavy Engineering Industries	<ul style="list-style-type: none"> ▪ Rail and rolling stock ▪ Port equipment ▪ Refinery equipment ▪ Wind tower manufacturing ▪ Pumps and valves ▪ Heavy mining equipment ▪ Yellow metals ▪ Transport equipment ▪ Dish antennae ▪ Power generation equipment
Spatial SIPs	<ul style="list-style-type: none"> ▪ Municipal services, housing, water, sanitation ▪ Integrated public transport ▪ Agricultural logistics 		
Energy SIPs	<ul style="list-style-type: none"> ▪ Renewable energy generation and energy efficiency ▪ Conventional energy generation coal, gas and nuclear ▪ Transmission and distribution 		
Social Infrastructure SIPs	<ul style="list-style-type: none"> ▪ Public hospitals ▪ Schools ▪ FET colleges and universities 		
Knowledge SIPs	<ul style="list-style-type: none"> ▪ Broadband rollout ▪ Digital migration ▪ MeerKAT and Square Kilometre Array 		
Regional Integration SIPs	<ul style="list-style-type: none"> ▪ Electricity generation and transmission ▪ Transport infrastructure ▪ Ports and air linkages 		
Water and Sanitation SIPs	<ul style="list-style-type: none"> ▪ Bulk water supply ▪ Sanitation 		
		Light Manufacturing Industries	<ul style="list-style-type: none"> ▪ Building materials ▪ Off The Road ▪ Solar water heaters ▪ Solar panels ▪ Road Studs ▪ Piping ▪ Electric Cables ▪ Furniture ▪ Transformers ▪ Electrical equipment ▪ Medical consumables and equipment ▪ Computer hardware ▪ Printed circuit boards

IDC is actively identifying opportunities to develop manufacturing capacity associated with Strategic Integrated Projects (SIPs)

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- **Constraints, Opportunities and the Way Forward**
- **Conclusion**

- As a DFI, IDC is actively addressing financial constraints that productive sector investors face:
 - Through providing business support, not just finance;
 - Through structuring deals flexibly to meet client needs;
 - By enhancing the sustainability of the client;
 - By relying on due-diligence as the key input to an investment decision;
 - By supporting project development where opportunities are identified;
 - By taking equity risk to support promising businesses;
 - By co-investing with banks and other investors, with IDC often taking the higher risk finance.
- IDC's focus is increasingly on the manufacturing sector in pursuit of its objective of industrial capacity development
- IDC pursues developmental outcomes in support of transformation and inclusive growth

Thank you

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