CHAPTER 6 FINANCIAL CHARACTERISTICS OF DFIs IN SADC

Introduction

6.01 The general experience of DFIs in Africa (Chapter 2) has unfortunately led to their being seen as inherently flawed financial mechanisms, rather than as essential 'way-stations' in underdeveloped financial environments. The widespread financial distress of African DFIs has been caused by adverse macroeconomic environments and changing economic regimes. It is also attributable to African DFIs having had inappropriate institutional, organisational and financial structures, poor business processes and procedures, lack of qualified human resources or management capacity, and politically mandated functions. Governments in Africa have disabled their DFIs through incessant political intrusion in management decision-making, through directed credit, financial repression, and constrained portfolio choice. Implicitly they have compelled DFIs to finance projects and enterprises that relied for their success on protection, and on anti-competitive, anti-market industrial policies. Parastatals have dominated African DFI portfolios to the virtual exclusion of the private sector.

6.02 These and other built-in weaknesses have also left the portfolios and balance sheets of DFIs in SADC vulnerable to:

- Severe exchange risks that materialised with large devaluations under successive structural adjustment programmes;

- Collapse of demand in the stabilisation phase of adjustment as government budgets and imports were compressed, unemployment increased and real incomes fell;

- An acute shortage in the availability of foreign exchange for intermediate and spare parts imports which caused a large fall in effective capacity and capacity utilisation levels which were well below break-even points;

- A sudden contraction in liquidity from the banking system which eliminated access by enterprises to working capital; and

- Effective de-industrialisation with premature import tariff liberalisation which resulted in a flood of imports with which domestic industries were simply unable to compete as excessively high tariff barriers and non-tariff barriers (NTBs) were dismantled.

6.03 This chapter examines the financial functioning of national DFIs in SADC member states. It attempts to assess how productively the financial resources invested in national DFIs have been used and to inform judgements on what the chances are of a new DFI in SADC using such resources any better. Most national DFIs in SADC have experienced the same woes as their financially distressed counterparts in the rest of Africa. Yet as indicated in Chapters 1 and 2, the disappointing financial record of DFIs does not obviate the need for development finance and DFIs in SADC.

6.04 The level of financial development in most SADC countries suggests a role for development finance to meet long-term financial needs in environments with nascent or non-existent capital markets, and especially weak markets for debt securities (Table 6.A). In the particular case of South Africa, it is not the level of financial development, but egregious disparities in the socio-economic development of its different ethnic communities that justifies development finance interventions and the existence of DFIs.

Table 6.A Stock Exchanges in SADC[1], 1996

	Botswana	Malawi	Mauritius	Namibia	South Africa	Swaziland	Zambia	Zimbabwe
Year established / revitalised	1995 Botswana SE	1996	1988	1992	1887	1990	1994	1974 Zimbabwe SE
No. of listed companies	12	2	45	27	626	6 but 1 company under suspension	10	65
Market Capitali-sation (US$m)	326,00	14,57	1 658,00	508,00	241 829,00	471,00	0,229	3 920,00
Turnover Value (US$m)	97,50	0,056 since Jan '97	79,58	149,77	25 048,00	2,20	2,64	245,00
Turnover Volume (million)	42,811	259	90	68,6	8 993	3,3	-	537
No. of new issues	1	-	4	4	28	2	-	1
Value of new issues (US$ m)	-	-	-	48,9	203	25	-	11,5
Index - Main	352	106,75 Nov. 96 =100	353,46 Sept. '89 = 100	218,28	6 658	192,85	162,02 May '97	8786[3] 1084
Index change (%) - Main	6.02	6,75		-2.94	6,9	46,70	-	121[3] -18
No. of Broking Members	1	1	11	4	48	1	6	9

Source: 1997 African Stock Exchanges Handbook, Johannesburg: Profile Media

Notes:

1 *The Mozambican government is preparing to begin operations on the Maputo Stock Exchange early in 1998. In Tanzania, it is expected that the Dar-es-Salaam Stock Exchange will become operational by the end of 1997. Five broking companies have been licensed.*

2 *Market indicators as at 8 May 1997*

3 *Industrial and mining indices*

6.05 The sections that follow attempt to (i) situate SADC's various DFIs within their domestic financial markets; (ii) provide an overview of their financial performance; and (iii) conclude with an impressionistic view of their successes and failures. Analysis of the financial performance of DFIs in SADC has been hampered by a lack of complete information. There is some question about the institutions that might legitimately be classified as DFIs. For many of those that can, there is insufficient financial information available regarding, for example, their capital structures and financing, the quality of their portfolios and their overall effectiveness. From the information available this study has uncovered the existence of some 36 institutions that could be classified as DFIs of one sort or another in the twelve SADC countries studied. Of these, sufficiently detailed information to allow even rudimentary financial analysis was available for 24. Although development finance is sometimes provided through special funds administered by government departments, or by financial institutions such as building societies, these have not been regarded as DFIs for purposes of analysis in this chapter.

Financial Systems and DFIs in SADC

6.06 Apart from metropolitan South Africa, financial systems in SADC are predominantly at the primary or intermediate stages of financial intermediation (Chapter 1). This section describes briefly the financial systems of SADC countries, highlighting the role of DFIs within them (Box 6.A). Somewhat strangely, in the developing world, loans from long-term financing institutions is seen as making a greater contribution to economic development than credit from commercial banks. In the country-by-country analysis that follows, the role of DFIs is portrayed qualitatively mainly because data was not available to relate DFI assets to total financial assets, or to relate DFI market share as a percentage of total financing by the financial system for each segment absorbing credit. The analysis is presented in alphabetical order of country name.

6.07 Upon ***Angola's*** achieving independence in 1975, foreign banks were nationalised. A mono-banking system emerged which was extremely limited in terms of the services it provided. Since 1991 however, the Angolan government has been attempting to create a more efficient and diversified banking system as a key pillar of a market economy. On-going reforms are now resulting in the central bank, *Banco Nacional de Angola*, acting solely as a central bank with its commercial banking activities being separated out. Some foreign banks have established offices in the country. The first steps have also been taken toward establishing a competitive insurance market. There are now six commercial banks of which two are state-owned. There is also one small, state-owned, DFI, the *Agricultural and Fisheries Credit Fund (Caixa de Credito Agrico-Pecuario e de Pescas-CCAPP)* operating in Angola. This institution operated as a bank despite its weak resource base and serious loan portfolio problems. Little information is available on progress with restructuring CCAPP. In 1995 it was intended to discontinue the institution's commercial banking functions, limiting its financial transactions to long-term lending, which was to be funded from budgetary allocations. Angola has also four sector credit funds, attached to government departments. These funds are not lending institutions. They provide financial and fiscal incentives to stimulate entrepreneurial activities in various sectors. Credit for businesses remains inadequate and large parts of the country, especially small towns are 'under-banked'. Money and capital markets remain undeveloped with informal money markets filling the vacuum.

6.08 ***Botswana***'s financial system is dominated by its central bank (*Bank of Botswana*). It has four commercial banks carrying out normal retail and commercial banking activities, leasing, property finance and merchant banking. The capital market in Botswana is not broadly based, having a small equity market and no debt market. The stock market had 12 listed companies with a market capitalisation of US$326 million in 1996. The capital market is quite free. There is no capital-gains tax on the sale of publicly traded company shares, and dividends are not taxable. Foreign investors can trade freely in the stock market without bureaucratic controls. Botswana has two DFIs offering longer-term financing and specialised services targeted at specific sectors. These include:

- The **National Development Bank (NDB)** which was **e**stablished in 1963 by an Act of Parliament. Its mission is *'to satisfy the needs of target markets consistently with financial services and financial information on a quality and profit conscious basis.'* The NDB is commercially orientated but is under obligation to operate in a socially responsible manner. Financial services and loans are provided for commercially viable projects that contribute to national development, job creation and the generation of exports. NDB provides loans of varied tenure (1-12 years) for the purchase of land and premises, equipment finance, seasonal working capital and refinancing, and also provides industrial/commercial property on a rental basis. The NDB also acts as an agent for government in administering the Financial Assistance Policy Fund and in managing of the Small Borrowers Fund. It provides finance for the agricultural, commercial, manufacturing and industrial sectors.

- The **Botswana Development Corporation (BDC)** was established in 1971 under the Companies Act. Its mission is to assist in developing and establishing viable businesses in Botswana. It is required to be profitable and earn an acceptable return on investment. It is the largest provider of long-term loans and equity finance to businesses in all sectors in the country. BDC's other services include providing financial guarantees, financing feasibility studies, providing management and consulting services, investment advice, and finished factory premises.

6.09 In ***Lesotho*** the *Central Bank* is the principal banker to the government and to all other financial institutions. It co-ordinates Lesotho's monetary policy under the Multilateral Monetary Agreement (MMA) to which Lesotho subscribes, along with South Africa, Namibia and Swaziland. In addition it supervises all financial institutions and insurance companies and administers exchange controls under the MMA. The largest banks in Lesotho are the government-owned *Lesotho Bank* and the South African-owned *Stanbic* and *Nedbank*. All three banks cater to commercial and corporate markets. Lesotho also has three insurance companies and a number of insurance brokers. There is presently no active capital market in Lesotho, but it has open access to the South African capital market under the terms of MMA. Private investors in Lesotho have difficulty in securing bank credit due to stringent collateral requirements, exacerbated by the absence of private land ownership. Tight monetary policy is distorting the risk-return perceptions of banks in favour of holding risk-free deposits at the Central Bank rather than employing capital for lending purposes with all the portfolio risk consequences such lending implies. The financial capacity of Lesotho's commercial banks is augmented by those of two DFIs. They are:

- The **Lesotho National Development Company Ltd. (LNDC),** which was established under the LNDC Act (No. 20) of 1967. That Act was later amended under the Lesotho National Development Corporation Order (No. 13) of 1990, which became effective in June 1993. It opened up 40% of the corporation's shareholding to private investors with the government retaining 60%. In 1986 the German Investment Finance Corporation for Developing Countries (DEG) took up a small number of shares in LNDC. In 1994/95 the DEG stake was 10% of the total shareholding. LNDC was set up to promote export-orientated and labour-intensive projects to reduce chronic trade imbalances, create jobs and promote Lesotho as an attractive investment location for foreign and indigenous investors. Its main supporting functions are: financial assistance to investors; investment promotion; commercial and distribution services; provision of serviced industrial sites/factory buildings; industrial skills training; and promotion of agro-industries, distribution and commercial services, engineering and construction, and research and product development. LNDC is involved in agriculture, commerce, industry, mining, manufacturing and building and construction.

- The **Lesotho Agricultural Development Bank (LADB)** is another state-owned DFI established under the Lesotho Agricultural Development Bank Act (No. 5) of 1976. That Act was amended in 1988 to make LADB a fully-fledged universal bank, undertaking agricultural, development and commercial banking operations. Services provided by LADB include: taking savings deposits from the public; offering current (cheque) accounts; extending loans; transacting in foreign exchange; providing technical agricultural advisory services; and administering trust and revolving funds. Credit is geared to production, processing and distribution of agricultural products in Lesotho and falls into four loan categories: seasonal, short-term, medium-term, and long-term. LADB administers a Food Self-sufficiency Programme for the government, and a loan guarantee scheme for a global NGO, i.e. the Cooperative for American Relief Everywhere (CARE).

6.10 ***Malawi's*** government embarked on a programme to liberalise its financial system in 1995-96. It aimed to move to market-determined interest rates, no direct controls over credit, and unrestricted access to domestic financing facilities for local and foreign investors. The *Reserve Bank of Malawi* is independent in setting monetary policy and issuing local currency. It also administers the Exchange Control Act and operates the fledgling market in government stock. Malawi has six commercial banks, with the *National Bank of Malawi* and the *Commercial Bank of Malawi* operating countrywide. These banks offer all the conventional banking services including cheque accounts, registration of foreign capital with the Reserve Bank, short- and medium-term credit facilities, trade financing, export credit guarantees, foreign remittances and repatriation of capital. The capital market is in its infancy with 2 companies listed and only one stockbroker operating on the *Malawi Stock Exchange*. There are good prospects for further listings with the implementation of the privatisation programme. Malawi has six DFIs, far too many for the size of its economy. They include:

- The **Investment and Development Bank of Malawi (Indebank),** which started operations in 1972 and is regarded as among the more successful term-lending institutions in Africa. It has been consistently profitable with few portfolio quality problems. In addition to long-term finance, Indebank provides tailored short-term facilities through its wholly-owned subsidiary, Indefinance Ltd. Indebank is also the principal shareholder in the Leasing and Financing Company of Malawi. Sectoral involvement includes agriculture and agro-industry, industry, property development, hotels and tourism, commerce and services and mining.

- The **Malawi Development Corporation (MDC)** was established as a statutory body by an Act of Parliament in 1964 and is wholly-owned by the Malawi Government. Its objective is to develop the agricultural, commercial, industrial, mining and tourism sectors by providing loans and making equity investments in joint ventures.

- The **Mining Investment and Development Corporation (MIDCOR),** was established as a public company in 1985 for promoting investment in minerals.

- The **Small Enterprise Development Organisation of Malawi (SEDOM)**.

- The **Malawi Rural Finance Company (MFRC),** which was established in 1994/95 to provide financial services to rural areas with the aim of eventually becoming a fully-fledged rural development bank.

- The **Investment and Development Fund of Malawi (Indefund),** a private limited company, which was created in 1981. Its shareholders are Indebank (43.4%), MDC (38.4%) and the Nederlandse Financierings-Maatschappij for Ontwikkelingslanden N.V. (FMO) (18.2%). Indefund is supposed to promote enterprises owned and controlled by Malawian businessmen with preference for projects that earn or save foreign exchange. Financial assistance is provided to viable enterprises in all sectors and its services include loans for capital investment, working capital and starting-up costs; equity capital; leasing or hire purchase; and guarantees. It also acts as consultant and financial advisor to enterprises in which it has invested.

6.11 In ***Mauritius*** the central bank (*Bank of Mauritius - BoM*) began operations in August 1967. Its founding Act is being redrafted to provide the Bank with independence in the formulation and pursuit of monetary policy. BoM is the banker to the government and is responsible for the supervision of financial institutions. Next to South Africa, Mauritius has perhaps the most developed financial system in SADC. There are a number of public and private commercial banks, both domestic and offshore, that extend short- and long-term credit to the industrial

sector. Other financial institutions operating in Mauritius include insurance companies, mutual funds, pension funds, mortgage companies, leasing companies, investment companies and trusts, and the Stock Exchange of Mauritius. The money market involves inter-bank transactions and the trading of short-term Government/BoM bills. The capital market revolves around the securities exchange, which is the only organised market for shares and a limited number of bonds. The *Stock Exchange of Mauritius* came into operation in 1989. To obtain a listing on the official market, a company must be public, have a minimum capitalisation of Mauritian Rupees 20 million (about US$1 million), and must have been in operation for at least five years. The government also offers a series of tax incentives encouraging companies to be listed on the Stock Exchange and is encouraging the Mauritian capital market to develop a wider regional profile and role. Mauritius has two DFIs, namely:

- The **Development Bank of Mauritius (DBM)** is a publicly-owned, limited liability company. It finances projects involving the modernisation and diversification of agriculture, manufacturing, promotion of small/medium enterprises, dissemination of information technology and the promotion of a 'computer culture'. It makes equity investments in associated companies and provides various kinds of loan financing to clients. DBM lends mainly to small and medium-scale enterprises in industry, information technology, construction, transport, tourism, agriculture and agro-industry. It also makes loans to households from its special schemes to encourage: solar water heating; household computer use; and recovery from natural disasters.

- The **State Investment Corporation Ltd (SIC)** was established in August 1984 to take over the Mauritius Equity Financing Fund whose remit was too limited for a rapidly expanding and diversifying industrial sector in Mauritius. SIC finances existing and new ventures. It is empowered to enter into joint ventures with local or foreign investors to accelerate and diversify the country's industrial, tourism and agricultural base. It can act as a catalytic agent for curing sick enterprises in which public funds have been invested or whose debt obligations are guaranteed by Government. In that role it can make changes in management, restructure the capital base of a company, inject additional resources, and rationalise units in a particular industry. SIC is empowered to manage the investment portfolio of government in the private sector. It takes up equity in, and provides loan funding to subsidiary companies; clients; and local banks. SIC's portfolio is concentrated in: commerce and services; tourism; airlines; industry; and financial services. SIC finances medium and large projects and companies while DBM focuses at the smaller end of the scale.

6.12 The government of ***Mozambique*** and the World Bank have developed a financial sector adjustment and reform programme aimed at improving the efficiency of the banking sector, developing money and capital markets, and revising financial sector regulations. The *Central Bank* has increased its independence and expanded its oversight capabilities. Its commercial operations have been transferred to a separate bank. There are six commercial banks now operating in Mozambique. Some are offering their customers new products in line with market-oriented banking services. However, the informal money market that emerged in earlier mono-banking days is still being used extensively. Liberalisation of the insurance sector is proceeding, but as yet, there are no long-term insurers in the country. Money and capital markets are undeveloped in Mozambique, but active steps are being taken to deepen the financial system. An anticipated issue of Treasury Bills will be an important step in establishing a base market, while inter-bank lending will also develop as the number of banking institutions increase and as the result of greater liberalisation of lending regulations. The Mozambican government is in the process of establishing the Maputo Stock Exchange and is preparing for its operations to start early in 1998.

6.13 The (central) Bank of ***Namibia*** was established in 1990 to take over functions previously performed by the South African Reserve Bank. Namibia has six commercial banks, two building societies, five insurance companies and nine public financial institutions, including four DFIs. All banks provide comprehensive domestic and international banking services. Short-term insurance and life insurance broking, estate planning and factoring are some of the ancillary services provided by banks. The central bank, the Ministry of Finance and financial institutions are pursuing the development of new financial instruments and markets including parastatal bills, debentures and bonds, government treasury bills and negotiable certificates of deposit. The domestic money and forex markets are nascent but developing. Local inter-bank lending is limited due to the small size of the market with Namibian banks participating more in the South African inter-bank market. The *Namibia Stock Exchange* started operating in October 1992. By the end of 1996 it had 27 listed companies whose securities were being traded. The Stock Exchange is in the process of establishing an Unlisted Securities Market Authority, which will manage a separate trading system for shares of companies that do not meet the stringent requirements for a full board listing on the stock exchange. The four DFIs in Namibia are owned by the government and include:

- The **Agricultural Bank of Namibia (ABN)** which supports only the agricultural sector and lends mainly to individual farmers. After undergoing many changes since its inception in 1922, the Bank was last reconstituted on 23 December 1991 under the Agricultural Amendment Act No. 27. Its functions include lending to farmers, co-operative companies and control boards in support of the agricultural sector (short-, medium- and long-term loans). ABN also manages agricultural schemes (and emergency measures) on behalf of Government. It provides housing loans for farm workers and is engaged in fund management as well.

- The **Namibian Development Corporation (NDC)** is a DFI that lends to the non-agricultural SME sector. NDC was established under the Namibia Development Corporation Act of 1993, which transferred the public assets, rights, liabilities and obligations of the First National Development Corporation (FNDC) of South-West Africa to NDC. FNDC's private sector activities were transferred to Amalgamated Commercial Holdings (Amcom), a wholly-owned subsidiary of NDC, with the objective of commercialising and fully privatising such activities. The role of NDC is to promote, develop and support all economic sectors of the Namibian economy and to facilitate economic empowerment. NDC lends to enterprises; rents industrial and commercial buildings; makes equity investments; provides advice and aftercare; and entrepreneurial training. Its activities are concentrated in: agriculture and fisheries; commerce and industry; services; construction contractors; tourism; and mining.

- The **Development Fund of Namibia (DFN)** was established under the Development Fund of South-West Africa/Namibia Act, 1987, and originated from an amount of N$40 million donated in 1985/86 for purposes as mentioned in the Act. The Fund is managed by a Control Board that is accountable to the Namibian National Assembly through the Minister of Finance. DFN's objective is to *'contribute maximally to the promotion of the economic and socio-economic development of Namibia in its broadest sense by allocating its finance in accordance with economic rationale and principles with due attention to socio-economic needs especially in rural, communal farming and the small business and industrial sectors, and the need to increase productivity and thus raise the standard of life of the people in the less developed areas'.* Its functions are to: provide loan finance for projects and programmes; provide technical assistance; co-ordinate its activities with other institutions and the private sector; provide guarantees for outside parties; and manage a Job Creation Fund on behalf of Government. The Fund is mainly involved in the agricultural sector and rural and community development.

- The **National Housing Enterprise (NHE)** was constituted under Act 5 of 1993 and is engaged in the provision of housing for the low- to medium-income population of the country. The NHE reports to a Board of Directors, appointed by the Minister of Regional and Local Government and Housing. Its purpose is to enable communities and individuals to house themselves by giving people countrywide access to loans, investment opportunities, serviced land, and advice and support that they may need to acquire or erect a shelter of a standard and cost acceptable and affordable to them. The NHE administers new loans for housing.

6.14 The Reserve Bank of ***South Africa*** was established in 1920, and is now an independent institution. It is banker to the government, a custodian of foreign reserves, supervisor of banks and formulator of monetary and exchange rate policy. South Africa has a number of world-class commercial banks. These are regulated under the Banks Act of 1990, which stipulates prudential and regulatory requirements. At present there are 46 banks, including foreign banks operating in South Africa. Other financial institutions include finance companies, participation mortgage bonds, unit trusts and insurance companies. The *Johannesburg Stock Exchange* (JSE) is one of the larger stock exchanges in terms of market capitalisation. In 1996 it was ranked 16th in the world and is the largest exchange in the 'emerging markets' universe. It is governed externally by the Stock Exchanges Control Act of 1985, and internally by its own rules and regulations.

6.15 When a new political dispensation emerged in 1994, the constitutional and socio-economic transformation that occurred brought major changes in the roles and *modus operandi* of South Africa's DFIs. These were restructured on five sectoral lines:

- The **Development Bank of Southern Africa (DBSA),** created in 1983, has been transformed into an *infrastructure* financing institution under the Development Bank of Southern Africa Act, passed by Parliament in April 1997. In recognition of the development needs of its immediate neighbourhood, the Bank's mandate now formally extends beyond the borders of South Africa to include all SADC countries. The DBSA is wholly-owned by the South African government. It has its own Board of Directors and reports to Parliament through the Minister of Finance. The mission of the Bank is to *'facilitate the provision of infrastructural development finance in order to improve the quality of life of the people of South and Southern Africa. The Bank's development support complements the investment financing of the Government, the private sector and other development finance institutions by mitigating risk and through capacity building.'* The new mandate of the Bank covers: municipal and household infrastructure serving basic needs; economic infrastructure facilitating regional, national and sub-national linkages; institutional infrastructure; and social infrastructure (e.g.. health, education and recreation). The Bank's financial products include loan finance, equity investments, guarantees and refinancing commitments. While focusing on infrastructure, the DBSA does not finance large-scale projects in the power, communications and transport sectors where such projects are financed directly by Eskom, Telkom and Transnet respectively. However, the DBSA does finance large infrastructure projects outside SA in SADC e.g. the Lesotho Highlands Water Project and the Maputo corridor.

- The **Industrial Development Corporation (IDC)** is a self-financing, state-owned national development corporation established in 1940, and is a listed entity under the Reporting by Public Entities Act, No 93 of 1992. The IDC's Board of Directors is appointed by government. It is accountable to Parliament through the Minister of Trade and Industry. The IDC's mission is: *'to facilitate, promote, guide and assist in the financing of: new industries and industrial undertakings, and schemes for the expansion, better organisation*

and modernisation of existing industries and industrial undertakings, so that the economic requirements of South Africa may be met and industrial development may take place according to sound business principles.' Like the DBSA, the IDC can operate throughout SADC. Its current strategic focus is on: (i) financing small- and medium-sized undertakings that do not have ready access to the capital market; (ii) participating in large globally competitive industrial projects, especially where value is added to local raw materials; (iii) initiating projects that contribute to regional development; (iv) bringing new technologies into South Africa; (v) creating new employment opportunities; (vi) facilitating the participation of entrepreneurs from formerly disadvantaged communities in the formal business sector; and (vii) encouraging tourism.

- **Khula Enterprise Finance** is a financing institution created to support small and micro enterprises (SMME). It was established in 1996 under the Companies Act as a Department of Trade and Industry initiative. It is an independent, limited liability company with its own Board of Directors. It was set up with initial capital of US$6.1 million with a further allocation of US$11.6 million being expected as share capital for 1997/98, while further amounts of US$8.5 million and US$9.6 million are expected as Committed Grants for Institutional Support from Government (including donor contributions) for 1997/98. Khula aims to become a catalyst in the mobilisation of credit and equity to aspiring emerging small entrepreneurs (SMMEs) through viable and sustainable Retail Financing Institutions (RFIs). Its mission is to ensure enhanced availability of loan and equity capital to SMMEs by offering loans, guarantees and seed funds to RFIs in need of capital and capacity. In meeting its mission, Khula will target previously disadvantaged groups; in particular groups such as rural women, the disabled, and enterprises operating in the informal sectors. Khula's role is to: advance business loans to RFIs; furnish guarantees to approved applicants by using three products, namely industrial, institutional and portfolio guarantees; establish equity funds; and provide institutional support.

- The **Land and Agricultural Bank (LAB)** was established in 1912 and is governed by Act No. 13 of 1944. It is an autonomous statutory financing institution, which is accountable to Parliament through the Minister of Agriculture and Land Affairs. The Bank does not receive any financial support from the State and obtains its funds on the money and capital markets. The mission of the LAB is to provide *'the full spectrum of financing to the agricultural sector from the development stage up to and including the commercial level'*. The LAB supports development in the agriculture sector through retail and wholesale financing on sound business principles. Specifically it focuses on promoting food and fibre production; meeting the financing needs of farmers; and agricultural enterprises. Its facilities are available to individual agricultural producers by way of mortgage loans and charge loans, medium-term loans and seasonal loans to farmers, agricultural co-operatives and other agricultural institutions. It also finances special relief schemes.

- The **National Housing Finance Corporation (NHFC)** was established in 1996 as a Department of Housing initiative and is an independent, limited liability company with its own Board of Directors. The NHFC has two main funding programmes. The first involves funding specialised mortgage lenders that provide innovative housing finance to clients not sufficiently creditworthy for banks. The NHFC encourages such lenders to develop new lending products and methodologies to penetrate niche low-income housing markets on a cost-effective and sustainable basis. Its second programme involves funding housing institutions that are in the business of acquiring or developing residential accommodation and managing such accommodation under rental, rental for ownership, instalment sale or other tenure arrangements. Finance to supplement state subsidies for such institutions is presently not available from the private sector. In addition, the NHFC is mandated to use its capital base to share risk with conventional mortgage financiers on pilot schemes that

could assist in drawing them further down-market and expanding the impact of their lending in the housing market.

6.16 The Central Bank of ***Swaziland*** was established as the country's monetary authority in April 1974 and took on other central banking functions in 1979. The present mandate of the Bank includes: issuance, service and redemption of domestic debt; external debt management; administration of exchange control, and formulation/implementation of monetary policy. The Central Bank also operates three lending schemes, namely the Export Credit Guarantee Scheme, the Small Scale Enterprise Loan Guarantee Scheme and the Public Enterprise Loan Guarantee Fund. There are four commercial banks and a building society operating in Swaziland. Instruments used in the money market include: stocks and treasury bills, bank acceptances and negotiable certificates of deposits. Its stock market has been operating for more than seven years with five companies being listed at present. Swaziland has two DFIs: i.e. *the Swaziland Development and Savings Bank (SDSB)* and the *Swaziland Industrial Development Corporation (SIDC).* Two other institutions involved in development finance are the *Tibiyo Taka Ngwane*, a national trust, and the *Swaziland Business Growth Trust*, an NGO. Detailed information was available only for the SDSB and SIDC.

- **SDSB** was established in 1965. Its powers were widened under the Swaziland Development and Savings Bank Order of 1973 (amended in 1974). The Central Bank of Swaziland is SDSB's sole shareholder. The SDSB's raison d'être is to: promote Swaziland's economic development with maximum participation of the country's citizens; develop the commercial and industrial sectors; participate in the equity of other domestic financial institutions; mobilise domestic savings by accepting deposits under special savings schemes; promote agricultural and rural industries; train Swazi citizens; provide improved housing and health facilities within Swaziland; develop land and construct buildings; finance trade, business and industry;. Loan advances are made to the following sectors: agriculture; manufacturing; construction; commerce; and housing.

- The **SIDC Ltd**., a limited liability company, was formed as a joint venture between the government of Swaziland and major international finance institutions. The Government of Swaziland holds 34.9% of SIDC's shares, while CDC has 10.9%, DEG 22.1%, FMO 10.2%, the IFC 13.7%, Proparco 5%, Barclays Bank 1.6% and Standard Bank 1.6%, respectively. It is committed to supporting its customers by providing quality services and financing of projects through the provision of equity, loans and factory buildings for lease. The primary objective is the creation of wealth for the Swazi economy. The SIDC's financial services are provided to the manufacturing, mining, agro-industry, tourism, commercial, and other services sectors.

6.17 The Bank of ***Tanzania***, was established in 1966 with its objective being revamped in the new Bank of Tanzania Act of 1995 to maintain price stability with balanced, sustainable economic growth. In 1991, the financial sector was opened to private and foreign capital and forex and T-bill markets were liberalised. Interest rates are determined by the market guided by the central bank's discount rate. The latter rate is calculated and reset on the weighted average yield across all maturities of T-bills auctioned at regular intervals. Such auctions began in August 1993. Sixteen foreign banks and nine non-bank financial institutions have been licensed to do business in Tanzania. More than 80 *bureaux de change* are in operation. A Capital Market Authority was established in 1994 to regulate the Dar es Salaam Stock Exchange, which has become operational in 1998. For this purpose, five broking companies have been licensed in 1997. Four DFIs have been operating in Tanzania, namely, the *Tanzania Investment Bank*, the *Tanzania Development Finance Company*, the *National Development Corporation* and *Small Industries Development Organisation*. A fifth DFI, the

Tanzania Housing Bank has been liquidated. Detailed information was available for only two of the DFIs:

- The **Tanzania Investment Bank (TIB)** was established in 1970 under the TIB Act. In 1993, the Bank was transformed from a DFI into an investment bank, offering a wide range of services including deposit taking, financial advisory services, trust and fund administration and loan guarantees. The restructuring programme of the Bank was undertaken in three sequential stages. The first was *financial restructuring.* It involved reviewing TIB's portfolio, setting up loan loss reserves, transferring non-performing assets to the Loans and Advances Realisation Trust, re-stating the Bank's financial position and re-capitalising TIB to meet minimum capital requirements. The second was *organisational restructuring* to reflect TIB's new role in the economy and the revamping of its staff to enable TIB to address current activities and new challenges. The third involved *privatising* TIB by selling part of government-held shares and issuing new shares to private shareholders in order to increase paid-up capital and infuse fresh funds. As of June 1996, the Bank had completed stage one, most of stage two, and had started work on stage three. At that stage subscribers to the share capital of the Bank were the Government of Tanzania (99.098%), the National Bank of Commerce (0.676%) and the National Insurance Corporation of Tanzania Ltd. (0.226%). About 55% of the authorised share capital was paid up in 1996. TIB's portfolio embraces manufacturing, transport and storage, fish and fish processing, tourism and hotel development, mining, engineering, forestry and wood industry, and agriculture and agro-industry.

- The **Tanzania Development Finance Company Ltd. (TDFL)** was established in December 1962 under the joint sponsorship of the Tanganyika Government, Britain's Commonwealth Development Corporation (CDC) and the Federal Republic of Germany's DEG. TDFL's issued capital is now held by the TIB (32.11%), the CDC (26.35%), DEG (26.35%), FMO (4.52%) and the European Investment Bank (10.67%). Its mission is to play '*a leading role in financing commercially and economically productive business ventures and the development of financial markets in Tanzania.'* TDFL makes loans and equity investments (usually a combination of both) and provides financial and managerial advisory services. Its portfolio is concentrated in: agriculture; manufacturing; services (including hotels); and natural resources industries (fishing, mining, forestry).

6.18 Since independence, the Government of ***Zambia*** has played an active role in the banking sector. Under the pressures of structural adjustment Zambia was obliged to liberalise its economy and financial system. The Banking and Financial Services Act of 1994 was designed to provide an appropriate regulatory framework for the financial. Under that Act the *Bank of Zambia* continues to exercise supervisory authority over the banking system. Its main responsibility is to protect the value of the country's currency and reducing inflation to single digit levels. Monetary control is exercised through indirect instruments such as open market operations. Zambia has 19 commercial banks of which 14 are local and 5 international. Many of these banks also offer merchant and investment banking services. The Inter-market Discount House (IDHZ) of Zambia was established to help develop a local money market. IFC has made an equity investment of US$500 000 for a 20% stake in IDHZ. The number of building societies is also growing, catering for small depositors and concentrating on long-term mortgage loans. The emergence of a formal capital market in Zambia has had a positive impact on the economic and financial sectors. The Lusaka Stock Exchange (LuSE) began operations in February 1994. In the first year no companies were listed but unlisted stocks were traded until companies began to be listed in 1996. The number of such companies has increased to ten and the exchange now has six brokers as members.

6.19 In addition to these developments in the liberalised financial system, *Zambia Enterprise Financing (ZEF)* has been established to channel financial resources from the World Bank to the private sector through the domestic banking system. Finance Bank, Zambia the largest local private bank, has obtained a loan of US$6.5 million from the IFC for the same purpose. A venture capital fund has been set up with an initial capital base of US$15 million provided by a parastatal, the CDC and a number of European banks. Medium-term financing has been arranged by the Zambia Association of Manufacturers from the European Investment Bank (EIB) for its members; although the amount of such financing is relatively small and available on stiff terms. A limited amount of information was available on one DFI, namely the **Development Bank of Zambia (DBZ),** which was established under the Development Bank of Zambia Act in 1972, but which has been re-organised since. DBZ makes loans to enterprises, invests in joint ventures (equity and/or loans), administers special funds and manages a venture capital fund. It has financed enterprises involved in: manufacturing, mining, agriculture, including agro-industries and forestry, tourism, haulage/water transport and fishing.

6.20 In ***Zimbabwe***, the Reserve Bank (RZB) till very recently enjoyed a large measure of autonomy in setting monetary and exchange rate policy with the aim of maintaining the internal and external value of the currency. Discount houses are the only institutions that maintain a direct dealing relationship with the Reserve Bank. Commercial banks square their daily positions by calling/placing their funds with discount houses or by buying/selling RBZ securities from/to them. RZB accommodates money supply through purchasing/selling its securities to discount houses or making overnight advances. Zimbabwe's financial sector comprises seven commercial banks, ten merchant banks, six finance houses, five building societies and two accepting houses, the Post Office Savings Bank, insurance companies and pension funds, and seven registered representative offices of foreign banks. Most of the restrictions on the sector have been removed and banking regulations are being reviewed to make them more responsive to a market-led economy. The Zimbabwe Stock Exchange (ZSE) lists 65 companies and is included in the International Finance Corporation Global Index of emerging markets. The ZSE is open to foreign investors, within certain limitations. Since the opening of the ZSE to foreign participation in June 1993, foreign investors have traded in shares to a total value of US$350 million. The Zimbabwe Credit Insurance Corporation underwrites political and commercial risk. Zimbabwe has four DFIs that include:

- The **Zimbabwe Development Bank (ZDB)** which is a statutory corporation established under the Zimbabwe Development Bank Act of 1983. ZDB commenced operations in June 1984, with authorised share capital of Z$50 million of which the government of Zimbabwe held 51%. Following the amendment to the 1983 Act, ZDB is now a joint-stock company, with 11 shareholders, including its staff (as a group). Authorised share capital was increased to Z$100 million on 23 November 1994, of which Z$49 million has been issued and fully paid up. The government of Zimbabwe holds 33.27% of authorised shares, Zimbabwe Reinsurance Corporation 18.78%, the AfDB 8.16%, the RZB 7.14%, with the CDC, DEG, Finnish Fund for Industrial Development Co-operation, FMO and Proparco holding 6.12% each and the EIB 2.05%. The Board of Directors is selected by shareholders in proportion to their respective shareholding percentages. ZDB's role is to promote, develop and support all economic sectors of the Zimbabwian economy. Its statutes require that the Bank maintain a ratio of liquid assets to liabilities to the public of at least 10%, and that no less than 25% of ZDB's financing provided be targeted at small- and medium-scale enterprises. ZDB's mission is '*to secure and maintain a leadership position in chosen market segments through the provision of cost-effective resources to clients who seek to establish or expand viable operations in growth industries and to provide competitive rewards to high performing employees and to its shareholders.'* Its main functions are to provide: loans; equity finance; trade finance; lease finance; consulting services; technical assistance; resource mobilisation (through external lines of credit, ZDB bonds and foreign

currency bills); and other services, i.e. issuing of guarantees or sub-underwriting of share issues, participation in co-financing and syndications with other financial institutions. ZDB provides its services to all sectors of the economy, supporting only enterprises that are in the productive sectors or directly linked to productive activity where there is evidence of value added in their operations.

- The **Industrial Development Corporation of Zimbabwe (IDCZ)** was incorporated through its enabling Act (Chapter 286) in 1963, to invest in industry as a state agency. The Act was amended in 1984 to allow IDCZ to promote investment and economic co-operation across borders. It identifies and develops industrial project opportunities into commercially viable ventures in partnership with local, regional or international investors and technology partners. The Corporation is controlled by a Board of Directors and wholly owned by the Government of Zimbabwe with the Board reporting to the Minister of Industry and Commerce. IDCZ's mission is to meet the country's industrial development needs, through sustainable, accelerated manufacturing output, growth and employment creation by establishing new industries, funded by a combination of equity from investment income, proceeds from recycled mature investments, and low cost debt, run on sound business principles, that are competitive internationally. The objectives of the Corporation are: *'to establish and conduct industrial undertakings; to facilitate, promote, guide and assist in the financing of new industries and industrial undertakings, expansion schemes, better organisation and modernisation of existing industries; to undertake the development of management and technical expertise in the carrying out of operations in industry and industrial undertakings, including the development of expertise in project analysis, evaluation of investment opportunities and provision of consultancy services; and to take such measures as may be necessary or expedient to enable the Corporation to exercise control over enterprises in which it has made an investment.'*

- The **Small Business Enterprise Development Company (SEDCO),** is a state-owned financial institution, which became operational in 1984. It provides medium- and long-term loans and advisory and training services to formal and informal SMMEs.

- The **Agricultural Finance Corporation of Zimbabwe (AFC).**

6.21 ***Reprise:*** As the foregoing paragraphs suggest, the financial systems of most SADC countries remain underdeveloped, although they have all been going through a process of liberalisation, deregulation and strengthening since the early 1990s. The small number of companies listed on SADC stock exchanges, except for South Africa, shows the limited contribution which capital markets are making to investment and growth through the provision of long-term finance to indigenous companies. Bank credit remains the predominant source of funds to the private sector. It explains the existence of at least one multi-sectoral development bank or industrial development corporation in each of the 12 SADC Member States, except for Angola and Mozambique. Compensating for lacunae in domestic capital markets, these DFIs offer longer-term capital and other services (for the promotion of projects, enhancement of managerial skills, development of entrepreneurship and promotion of technological capabilities) to stimulate industrial development. In addition, some of the development banks and industrial development corporations are also providing trade finance and leasing facilities to fill such financial services gaps in their financial systems.

6.22 At least six countries have DFIs dedicated to the development of small, medium and micro enterprises (SMMEs), which often cannot meet the inhibiting collateral requirements of commercial banks. In order to extend financial services into rural areas, one of the seven DFIs focusing on agricultural and rural development, as well as one multi-sectoral development bank, also provides commercial banking services, indicating the limited geographic coverage

of the banking sector in some countries. Based on the development strategies and specific socio-economic conditions of a country, sector-specific DFIs (in addition to those for SMME and agricultural development) have been established in many countries. Examples are the two DFIs focused on housing finance for the lower-income market in South Africa and Namibia (although both countries have mortgage finance institutions and building societies) and the DBSA, focusing on mitigating perceived risks in essential infrastructural investment with a view to increasing commercial finance involvement in this area.

6.23 Economic and financial system liberalisation, which is now taking place in all SADC countries, is, *inter alia* associated with a broadening range of financial institutions, markets and instruments. But it seems to have had little influence on DFIs' roles, functions and financial products up to now. In response to changing policy frameworks, resulting in growing competition and financial pressures, most of the institutions have hardened the terms and conditions of their loans and improved their risk management practices. Only a few have embarked upon financial innovation (i.e. developing new products and services to facilitate their operations and the general conduct of financial intermediation) or moved into new niche markets. The TIB, which is broadening its functions and products towards merchant and investment banking, seems to be an exception rather than the rule. More interesting, from a SADC perspective, is the fact that three of the financially stronger DFIs, namely the DBSA, the SA-IDC and the IDCZ, have been permitted by their governments to operate outside the borders of their respective countries and have started doing so, although such forays are very recent.

6.24 A brief glimpse of the institutional structure of SADC's DFIs (Box 6.B), shows that the majority of the 36 DFIs reviewed are either wholly or majority state-owned. In countries with a low international credit rating and operating under severe fiscal pressures, public ownership of DFIs is putting a double squeeze on the financing of these institutions. On one hand, their access to lines of credit from international or private financial institutions has become severely restricted. On the other, they cannot necessarily rely any more on fiscal transfers for recapitalisation or loan funding. In the case of a few DFIs ownership is being broadened through 'privatisation' in line with general liberalisation policies, but also with the specific aim of mobilising larger amounts of funding for these institutions.

6.25 In most SADC countries, the statutory DFIs do not fall within the purview of their countries' banking acts, which would subject them to being regulated and supervised by the central bank. Furthermore, the enabling acts of most statutory DFIs in SADC do not specify prudential requirements such as, for example, under the Zimbabwe Development Bank Act, 1983, which requires a ratio of liquid assets to liabilities to the public of at least 10%. Other prudential requirements concerning capital adequacy, non-accrual policies, provisioning and the maintenance of statutory reserves are also conspicuous by their absence. This situation leaves the wholly/majority-owned public DFIs unduly vulnerable to pressures for achieving social, political or developmental objectives at the expense of their commercial viability as sound, self-sustaining financial institutions; particularly when their Boards of Directors and managements also reflect a significant influence by the governments concerned. This obviously creates a milieu where DFIs in SADC are susceptible to government interference in day-to-day operational decision making, resulting in a greater tolerance for non-recovery of debt and the associated risk of non-performing portfolios.

Box 6.B: Institutional Structure and Nature of DFIs in SADC

Country/institutions	Ownership and control structure			Nature of institution		
	Ownership	Statutory institution	Corporate Entity	Single sector/focus	Multi-sector/ focus	And Other financial service
Angola						
• Agricultural and Fisheries Credit Fund (CCAP)	Government	n/a	n/a	Agriculture and Fisheries		
Botswana						
• National Development Bank	Government	x			x	
• Botswana Development Corporation	Government		x		Industrial development	
Lesotho						
• LNDC	Government/DEG	x			Industrial development	
• Lesotho Agric Bank	Government	x		Agriculture		Commercial banking
Mozambique No DFIs						
Malawi						
• Indebank	Domestic private/foreign development institutions		x		x	Merchant banking
• Malawi Development Corporation	Government	x			x	
• MIDCOR	Government		x	Mining		
• SEDOM	Government	n/a	n/a	SMME		
• MRFC	Government	n/a	n/a	Rural development		
• Indefund	Domestic/foreign development institutions		x		Industrial development	

Country/institutions	Ownership and control structure			Nature of institution		
	Ownership	Statutory institution	Corporate Entity	Single sector/focus	Multi-sector/ focus	And Other financial service
Mauritius						
• Development Bank of Mauritius	Government		x		x	
• State Investment Corporation	Government		x		x	
Namibia						
• Namibian Development Coporation	Government	x		SMME		
• Development Fund of Namibia	Government	x		Rural development		
• National Housing Enterprise	Government	x		Housing		
• Agribank of Namibia	Government	x		Agricultural development		
South Africa						
• DBSA	Government	x		Infrastructure		
• Industrial Development Corporation	Government		x		Industrial development	Export financing
• Khula	Government		x	SMME		
• Land & Agric. Bank of SA	Government	x		Agriculture		
• NHFC	Government		x	Housing		
Swaziland						
• SIDC	Government/ Foreign financial institutions		x		Industrial development	
• SDSB	Government	x			x	Commercial banking
• Tibiyo Taka Ngwane	National Trust	n/a	n/a	n/a	n/a	n/a
• Swaziland Business Growth Trust	NGO	n/a	n/a	SMME		

Country/institutions	Ownership and control structure			Nature of institution		
	Ownership	Statutory institution	Corporate Entity	Single sector/focus	Multi-sector/ focus	And Other financial service
Tanzania • Tanzania Investment Bank • Tanzania Development Finance Company • National Development Corporation • Small Industries Development Organisation	Government /Private Sector TIB/Foreign financial institutions Government Government	 x n/a	x x n/a	 n/a SMME	x Industrial development n/a	Merchant/invest-ment banking n/a
Zambia • Development Bank of Zambia • Zambia Enterprise Fund	Government Private/ Inter-national financial institutions (IFC)	x	 x		x Industrial development	
Zimbabwe • Zimbabwe Development Bank • Industrial Development Corporation of Zimbabwe • SEDCO • AFC	Government Government Government Government	x n/a n/a	 x n/a n/a	 SMME Agriculture	x Industrial development	Trade and lease finance
TOTAL NO. OF DFIs = 36	**• 25 wholly-state owned** **• 1 national trust** **• 1 NGO** **• 9 mixed ownership**	**• 14** **• 8 Legal status n/a**	**14**	**• 7 Agricul-ture & rural** **• 1 Mining** **• 6 SMME** **• 1 Infrastruc-ture** **• 2 Housing** **• 2 unknown**	**• 8 Indus-trial develop-ment** **• 9 Multi-sectoral**	**• 6 DFIs render other financial services in addition to traditional DFI functions**

The Financial Performance of DFIs in SADC

6.26 The *raison d'être* for DFIs is to compensate for deficiencies in financial and capital market environments that are relatively undeveloped. Indirectly, if they do their jobs, they do contribute to the creation of employment, saving or earning of foreign exchange, distribution of income between individuals and geographic areas, diversification of industry, modernisation of the agricultural sector, development of entrepreneurial activity and development of capital markets (Murinde: 1996). However, a comprehensive evaluation of the overall development performance and impact of all the DFIs in SADC lies well beyond the scope of this report.

6.27 The previous section has described the legal status and operational focus of the various national DFIs in SADC. This section focuses on the financial performance of 24 of these institutions in terms of their capital adequacy, their asset and liability structures, their management of risk; earnings performance, management effectiveness and liquidity management (Mould: 1991 and Callier: 1991). Analysis beyond a conventional accounting approach has been constrained by the variance across DFIs in SADC in reporting standards and disclosure of financial and supplementary information. The conventional accounting approach has its limitations in assessing the financial and business performance of public DFIs. This is mainly because such an approach can not take into account the subsidies and concessional funds that such DFIs receive, thereby distorting their financial ratios. Nonetheless it provides some useful insights into the financial consequences of DFIs subordinating their commercial viability in attempting to emphasise social and developmental priorities. When that happens, the result usually is that both financial viability and developmental performance are compromised.

6.28 It should be underlined at the outset, that the financial performance of DFIs is not just a function of their institutional structure and management. It is widely acknowledged now that poor macroeconomic policies create and exacerbate stresses and strains in financial systems. Macroeconomic instability has a profoundly debilitating impact on financial institutions. Policies such as administered interest and exchange rates, directed credit allocation, and excessive protectionism contribute to building up severe financial weaknesses in productive and financial enterprises. Financial sector problems are compounded when such policies are suddenly and radically changed.

6.29 Adverse macroeconomic conditions in the pre-stabilisation and adjustment period in SADC (Box 6.C) and the speed, content and sequence of subsequent macroeconomic stabilisation and structural adjustments in the majority of SADC member states have contributed directly to exacerbating the financial distress of DFIs. They have without doubt resulted in eroding the 'real' capital base of some DFIs in SADC by significant amounts. Such erosion has been caused by large and spiralling currency devaluations as well as by financial losses and provisioning requirements. Indeed the real value of the capital of most SADC DFIs may be even lower than is recorded if all non-performing assets were fully provided for. Furthermore, due to the economic reforms, DFIs and/or their governments are remaining significantly exposed to exchange risk on their outstanding borrowings and future debt service payments, which have not been hedged.

6.30 Paucity of developmental finance is only one obstacle to development. The process of development is impeded by a series of other obstacles as well. For example, SMME development involves dealing with access to accurate information on market conditions and business opportunities, strengthening of managerial skills and technology transfer. Inadequate attention to such issues, no doubt limits the effectiveness of development finance and increases the credit risk for DFIs. The financial performance of DFIs, which are in the business of taking high risks, will undoubtedly be affected adversely in such circumstances. Other DFIs enjoying

more operational leeway and allowed greater discretion in making portfolio decisions might choose to serve lower-risk segments in an effort to protect their financial viability. Lack of access to finance for micro-enterprises in SA, in spite of a DFI focused on SMMEs before 1994, is an example of such risk aversion resulting in adverse selection. SEDCO in Zimbabwe is an example of what happens when risks are taken without any form of risk mitigation or management.

6.31 Table 6.B indicates the capital strength and financial stability of 24 SADC DFIs in terms of shareholders equity, resources employed or total assets, debt/equity ratio, equity ratio and interest cover ratio (see Tables 6.C to 6.Z for a financial analysis by institution). About 90% of the total capital employed or total assets of the DFIs in SADC is attributable to only six DFIs, namely, the Botswana Development Corporation, the Development Bank of Mauritius, DBSA, the SA-IDC and Land and Agricultural Bank, and IDCZ.

6.32 The ***equity ratio*** (the relation between equity and assets or capital employed) for the majority of DFIs, except for the LADB, MIDCOR, SDSB and DBZ, *seems* on the face of it to indicate that they are adequately capitalised to carry out their missions. However, closer scrutiny of this ratio over time, makes it clear that for many DFIs' in SADC initial share capital (authorised or issued and fully paid) has been inadequate in relation to total resources employed over the years. Under-capitalisation has resulted in financial distress having to be relieved through recapitalisation by their governments or by opening up their shareholding to other institutions. Examples of these include the BNDC in 1995, LADB in 1990, Indefund in 1996, Sedom in 1995, the Agricultural Bank of Namibia in 1992, SDSB in 1992, SIDC in 1994, the TIB in 1993, the IDCZ in 1994 and the DBZ in 1994. The last of these required recapitalisation through a government subvention of US$2.3 million.

6.33 Going beyond equity, the total net worth of DFIs is influenced by access to grant funding, (e.g. fiscal transfers), and the ability of institutions to strengthen their reserve positions. DFIs such as the LADB, Indefund, and the DBZ have seen their reserves being eroded considerably and even eliminated. NDC and TIB have seen their reserves consistently eroded in both US dollar and local currency terms since 1992, explaining to some extent their need for repeated recapitalisation. In contrast, DFIs in SA and Mauritius, as well as institutions such as BDC, LNDC, MDC and IDCZ have strengthened their reserve positions over the years. The financial strength of DBSA, which had a relatively low initial paid-up capital, was augmented through annual fiscal transfers from the time of its establishment up to the early 1990s.

6.34 Aggregate capital adequacy ratios such as the equity ratio do not convey a complete picture of capital adequacy in the absence of strict prudential and regulatory standards. Such standards would *inter alia* require DFIs to classify assets into different risk categories to provide for them and to relate them to capital or equity. Thus, the actual risk embedded in extant DFI loan and investment portfolios has to be taken into account to form a more accurate judgement on whether the DFIs in SADC are managing their balance sheets to achieve satisfactory earnings with acceptable risk. From the financial statements available it seems that only a minority of DFIs employ comprehensive risk management policies and procedures. With inadequate *ex ante* risk management practices, most, if not all DFIs, provide for loan losses on an *ex post* basis, even though such provisions might not represent a realistic estimate of potential portfolio losses.

BOX 6.C: THE SADC MACROECONOMIC ENVIRONMENT

Table 6.C.1 Trends in inflation and real interest rates, SADC economies, 1980–95

Country	*CPI Annual Average*			*Real Discount Rate*		
	1980–5	*1986–93*	*1994–5*	*1980–5*	*1986–93*	*1994–5*
Angola	..	3568.0(a)	2378.0	..	-813.0(a)	-2254.0
Botswana	11.4	11.5	10.2	..	1.0(a)	3.1
Lesotho	13.6	14.2	8.7	-1.6	-0.3	5.8
Malawi	13.4	18.7	59.0	-2.5	-4.3	-13.9
Mauritius	12.3	8.1	6.7	-1.9	3.6	5.9
Mozambique	35.0(b)	42.2	62.1	..	-4.8(a)	1.7
Namibia	12.5	13.2	10.4	..	4.1(a)	6.1
South Africa	13.8	14.4	8.9	..	3.3	5.1
Swaziland	14.8	11.2	13.6	-2.1	0.1	-0.1
Tanzania	29.8	25.3	31.5	-19.9	-14.1	27.3
Zambia	18.0	101.1	50.0	-6.1	-27.7	4.0
Zimbabwe	14.5	18.4	22.5	-4.4	-3.1	7.7
SSA	13.5	11.4				
Africa		16.3	30.7			

Sources: Fiscu (1997), World Bank (1995).
Notes: .. unavailable. (a) 1991–3. (b) 1985–7.

The FISCU **Macroeconomic Study: Convergence and Adjustment**[1] gives a detailed account of macroeconomic policies and policy-making at the national level within SADC. The trends in the rate of inflation and real interest rates, budget deficits as well as in exchange rates in tables 6.C.1 6.C.2 and 6.C.3 give and indication of the results of such policies and of the macroeconomic environments within which DFIs have had to function up till now.

Trends in the rate of inflation and the real interest rate are indicated here by the trends in the consumer price index (CPI) and the real discount rate (the nominal discount rate deflated by the consumer price index). By the mid-1990s half the SADC economies had inflation rates lower than in the early 1980s. However, only one country (Mauritius) experienced a consistent fall in its CPI, though five economies achieved lower inflation rates in the 1994-5 period than in the 1986-93 period. In the more recent period from 1995 to 1996, inflation rates have fallen further in all the SADC countries, except in Mauritius - and in many countries the falls have been very significant. Nonetheless, these trends need to be set against still high and unsustainable rates across a number of SADC economies. Angola has not yet succeeded in controlling either its inflation rate or monetary supply, while trends in and current levels of price increases in three other countries - Malawi, Tanzania and Zambia - have been extremely volatile and high, with inflation rates of 30% and considerably higher. In not one of these has the key objective of price stability been achieved. The trends in real interest rates are more consistent and less volatile than in inflation rates. Whereas in the mid-1980s only three countries (all CMA members) had positive real interest rates, by the mid-1990s only two countries clearly did not (Angola and Malawi). Major problems would appear to have been overcome in all but four countries (Angola, Malawi, Tanzania and Zambia) though the latter two, together with Mozambique, still experience marked volatility.

With regard to fiscal stability, table 6.C.2 indicates that the overall trend in the budget deficit across the SADC economies as a whole is positive: nine countries have experienced falling ratios of the deficit to GDP, while by 1994-6, the ratio was below 6% in eight countries. Moreover, recent years have witnessed far less volatility in this ratio. Angola, Tanzania and Zimbabwe provide the extreme cases of persistently high ratios and, except for Angola, of rising ratios in the 1990s. However, both Mauritius and South Africa have also experienced rising ratios in the 1990s; indeed, South Africa is the one country which has experienced a steady and consistent long-term rise in its budget deficit over the past 17 years.

[1] SADC Finance and Investment Sector, 1997. **Macroeconomic Study: Convergence and Adjustment** by RC Riddell, pp. 74-82. South Africa: Pretoria

Table 6.C.2 The budget deficit (excluding grants) as percentage of GDP, 1980-96

Country	*Annual Averages (%)* 1980–5	1986–93	1994–6
Angola	..	16.4	15.8
Botswana	-2.8	-10.9	-1.8
Lesotho	7.4	14.0	3.9
Malawi	12.4	8.7	3.4
Mauritius	8.8	0.9	4.0
Mozambique	..	25.5	6.1
Namibia	..	5.9	3.3
South Africa	4.0	5.2	5.4
Swaziland	3.5	1.3	5.1
Tanzania	10.0	5.6	8.0(a)
Zambia	14.3	8.9	2.8
Zimbabwe	9.2	8.7	11.6
SSA	6.5	6.9	

Sources: Fiscu (1997); World Bank (1995)

Notes: .. unavailable. - sign denotes surplus.

(a) 1994 and 1995.

Table 6.C.3 summarises trends in real and nominal exchange rates and also indicates the importance which the changes in exchange rates have had for the relative prices of traded goods. The tables shows (a) the volatility of exchange rate movements over period under consideration; (b) the massive devaluations which have occurred across all economies (except Mauritius which experienced a steady depreciation); and (c) the progressive devaluation of the rand (and its CMA-linked currencies), the 'hard' currency of the sub-region.

Table 6.C.3 Exchange rate movements 1990-7
Real/nominal rate against US$; Index 1990=100

Country	*Nominal* 1990	1995	1996	1997 (mid-July)	*Real Rate* 1995 1987=100
Angola	100	0.5	-	-	-
Botswana	100	66.0	51	52	70
Lesotho	100	70.0	60	56	66
Malawi	100	17.0	17	17	130
Mauritius	100	81.0	79	68	120
Mozambique	100	10.0	9	9	335
Namibia	100	70.0	60	56	73
South Africa	100	70.0	60	56	66
Swaziland	100	70.0	60	56	72
Tanzania	100	35.0	34	31	408
Zambia	100	4.0	3	3	68
Zimbabwe	100	28.0	24	23	124

Sources:ADB, 1997; Financial Times (London), own country statistics.

Table 6.B Financial strength of DFIs in SADC, US$ million

	Total shareholders equity				Borrowing	Capital employed / Total Assets	Debt/Equity ratio %	Equity Ratio %	Interest cover ratio %
	Share Cap.	Dev. Fund	Reserves	Total					
Botswana									
• BDC '96	56,3		60,2	116,5	76,5	201,5	65.7	57,8	167,2
• NDB '95				22,1	3,5	5,9	15,9	63,1	265,6
Lesotho									
• LADB '90				1,8	8,4	25,8	46,7	7,3	4,2
• LNDC '95	5,5		25,6	31,1	37,0	90,1	118,7	34,5	273,8
Malawi									
• MDC '95	1,3	0,08	48,4	49,8	10,0	78,6	20,2	63,4	268.4
• Indefund '96	0,4		0,3	0,7	4,1	4,9	604,7	13,9	252,7
• MIDCOR '93	0,2		(0,7)	(0,5)	0,5	1,2	(31,9)	(38,0)	(59,7)
• SEDOM '97	1,4			1,4	1,7	7,8	17,5	51,1	186,5
Mauritius									
• DBM '96	7,2		60,2	67,4	79,3	246,2	117,7	27,4	16,1
• SICOR '96	5,6		98,4	104,0		105,2		98,9	3 713,4
Nambia									
• Agr. Bank '96	35,4		46,3	81,7	0,3	95,5	0,0	86,0	356,0
• NDC '95	45,5	4,5	5,0	55,0	0,6	34,4	1,14	60,8	(82 120,0)
• NDF '95		11,0	17,4	28,4	8,4	28,4	29,0	100,0	1 149,0
• NHE '96	15,2		22,3	37,5	18,7	69,1	49,9	54,3	219,9
RSA									
• DBSA '97	46,6	882,7	209,3	1 138,6	7 701,8	1 850,3	61,6	61,5	31,2
• SA IDC '96	324,2		1587,8	1912,1	1 078,8	3 150,0	56,4	60,7	139,0
• LAB '96	46,8		400,8	447,6	504,6	1 022,0	112,75	43,8	12,7
Swaziland									
• SDSB '95	2,7	(26,5)	4,4	(19,4)	7,7	51,7	(39,5)	(37,5)	(10,1)
• SIDC '95	6,7		5,2	11,9	9,7	32,0	82,0	37,1	265,2
Tanzania									
• TIB '95	14,4	0,4		14,8	0,3	18,5	2,2	80,1	(1 650,8)
Zambia									
• DBZ '95	5,6		2,6	8,2	35,6	58,5	434,3	14,0	180,1
Zimbabwe									
• ZDB '96	15,8			15,8	42,0	69,6	291,1	22,7	161,3
• IDCZ '96	7,5		60,7	68,3	7,3	181,0	10,8	37,7	373,8
• SEDCO '95	13,8	0,2	1,3	15,3	4,7	22,3	30,6	68,5	67,7

6.35 It should again be emphasised that credit and portfolio management regarding customer risk, loan risk, sector risk and concentration (covariance) of risk, have for most DFIs been influenced by macroeconomic instability leading to sudden, drastic changes in their respective country's economic policies. Many of their loans to and investments in enterprises, sectors and geographic areas before the early 1990s were 'viable' only in the highly distorted macroeconomic, sectoral and political regimes that existed at the time. Belated, but sweeping, reforms resulted in devaluation of domestic currencies and rising inflation. In these conditions DFIs' real interest rates became negative, inducing entrepreneurs to take out additional loans to cover their debts to DFIs, the increased costs of imports, and to finance capital flight. Some DFIs (such as SEDCO) have not responded prudently to the comprehensive economic reform programmes being implemented. They continued to make loans (e.g. SEDCO's disbursements grew by 178.8% in 1992 and 66.2% in 1993 after economic reforms in 1991) that were becoming riskier by the day, thereby aggravating their financial exposure to high-risk clients and damaging their balance sheets.

6.36 With regard to credit and portfolio risk, the detailed (sub)sectoral composition of DFIs' financial involvement (Table 6.B) does not give much insight into the extent and volatility of these risks. But the information available on non-performing assets highlights what happens when such risks materialise. In cases where these have been significant, the size of non-performing assets, arrears and/or provision for doubtful debt are indicated below as well as mechanisms employed to deal with them.

- **Botswana:** 42% of NDB's total portfolio was exposed to the agricultural sector in 1995. Its objective is to reduce loans and advances to the agricultural sector due to the high risks involved and to increase long-term loans to other businesses. Loan loss provisions amounted to 49% (±US$ 17 million) of capital employed and 31% of the loan portfolio was in arrears. The latter improved from the previous year's 41% due to improvements in collateral cover and intensified arrears collection.

- **Lesotho:** LNDC had a net investment in companies in liquidation and /or dormant companies of about US$1 million (1% of its total capital employed) in 1995. In 1989, 25% of the LADB's loans were in arrears, amounting to US$1.1 million of the total US$4.5 million loans outstanding.

- **Malawi:** Indefund Ltd. had a recovery ratio of 10% from accounts in arrears while loan loss provisions amounted to 18% of the total loan and investment portfolio in 1996. MIDCOR's singular objective of promoting investment in Malawi minerals makes it extremely vulnerable to depletion of resources as witnessed by depletion of coal resources at the Kaziwiziwi coal mine in 1990. The operating losses posted by this DFI seemed to persist for the years under review (up till 1993), making it dependent on annual fiscal transfers for survival.

- **Namibia:** Loan arrears of ABN amounted to about 4% (US$3.3 million) of long- and medium-term loans to farmers and agricultural credit boards in 1994/95. For the same year, the recovery rate was 80.9% compared to 77.2% during the drought years of 1992/93. These figures vary considerably from year to year depending on climatic conditions. Loan arrears of NHE amounted to 3.6% (US$2.1 million) of the portfolio in 1995/96. Amounts collected versus required repayments amounted to 92.7% for 1995/96.

- **South Africa**: DBSA has been particularly affected by changes in SA's political dispensation. Former 'homeland' government debt to the DBSA, amounting to about US$722 million (1997), was restructured, resulting in a strengthening of its capital base.

The DBSA employs relatively sophisticated risk management policies and procedures. Loan loss provision takes place on a division of the total loan and investment portfolio into low-, medium- and high-risk categories. LAB had amounts in arrears of some US$39 million (3.7% of the total loan portfolio) in 1996

- **Swaziland:** SDSB saw a drastic deterioration in its financial position during the 1994/95 financial year when provision for doubtful debts of some US$24 million had to be made compared to less than US$1 million the previous year. According to the auditors' statement, the provision was made against poorly performing loans and advances where repayments of loans were often inadequate to reduce or prevent increases in accumulated arrears. At the same time, the auditors' main concern was that the condition and value of collateral, against which these loans were advanced, could not be determined. The SDSB's estimated sectoral breakdown of loans is: 20% in agriculture, 50% business and personal loans and overdrafts, and 30% housing and other loans. At the beginning of 1997 it was estimated that non-performing loans accounted for about 70% of the SDSB's portfolio. By February 1997, budgetary transfers to bail out the bank have exceeded 3% of GDP.

- **Tanzania:** Following drastic economic reforms from 1991 onwards, the asset base of TIB was eroded to the extent that the Bank had to be completely restructured. It suspended lending in 1994. Term loans granted and equity participation net of cancellations and redemptions amounted to US$9.5 million in June 1996, while the non-performing loans portfolio amounted to US$13.2 million, amounting to 139% of the performing loans and equity investments.

- **Zambia:** DBZ also saw its asset base eroded after introduction of macroeconomic reforms. By March 1994 non-performing assets rose to an estimated 85% (US$49 million) of total capital. In 1994, the DBZ's Board approved and adopted a Five-Year Corporate Plan which aimed at broadening the scope of DBZ's activities, consolidating and strengthening existing lines of business, and recapitalising the bank. In accordance with this plan, DBZ has embarked upon an internally managed financial restructuring exercise, aimed at cleaning and strengthening the balance sheet and improving its cash flow. The improved recent performance of the Bank is due to financing of better quality projects, improved supervision, the provision of trade financing as a new financial service, and recapitalisation by the Government.

- **Zimbabwe:** ZDB's provisions for bad debts amounted to 12% (US$6.9 million) of total loans and advances outstanding in 1996; nearly twice as much as in 1995. Over time, there has been a noticeable increase in the number of clients in difficulties for reasons of mismanagement and adverse economic developments. These factors have led to an increase in the required margin for higher risk borrowers and also to high levels of provisions. To contain these negative trends, ZDB is investing more resources in screening new applications and monitoring its existing portfolio through regional offices. The Bank has adopted a deliberate policy of consolidating rather than expanding its horticulture portfolio, which has grown rapidly over a short period of time. SEDCO has had a chronic problem of loan arrears. In 1992 arrears amounted to 11.4% (US$0.7 million) of total loans outstanding, while 40.5% of the portfolio was affected by arrears. SEDCO's arrears have been attributed to shortcomings in project appraisal, lack of qualified staff for appraisal, processing and monitoring of loans and loan books. The severe drought-induced recession in 1992 and rising interest rates further damaged its borrowers' already weak financial position, as did the absence of a comprehensive SMME policy addressing entrepreneurs' other constraints.

6.37 From the above outline, it is clear that DFIs in SADC that are experiencing problems with their portfolios are confined in their operations to one sector such as agriculture or mining or have a large portfolio exposure to one sector, obviously making them vulnerable to co-variant risks. Secondly, these DFIs have been casualties of drastic economic reforms in their respective countries, the severity of which has been influenced by their exchange risk exposure, lack of management autonomy and/or inadequate credit and portfolio risk management policies and practices. Furthermore, although the absolute amounts of adversely affected assets in relation to the total equity or resources employed by all DFIs in SADC do not seem extraordinarily high, a number of individual DFIs find themselves in financial distress. With few exceptions, portfolio infection across DFIs in all SADC member states could be much worse than reflected here because their generally inadequate risk management policies and procedures conceal the actual quality of assets which are doubtful and have been inadequately provided for.

6.38 Financial stability is also indicated by the ***debt/equity ratio*** of DFIs**.** The majority of the 24 DFIs analysed here display a relatively high degree of risky leverage; especially with high exposure to forex risk in their liability structures. (See Table 6.B). The full extent of the resulting instability can be appreciated by closer scrutiny of the sources and currency denomination of long-term borrowing by DFIs.

- **Botswana:** BDC's debt/equity ratio was 65.7% in 1996. It has been kept at roughly this level since 1987, except for 1992-1995 when the ratio increased to about 100%. In 1996, outstanding foreign borrowings amounted to 17.6% (US$13.5 million) of total long-term borrowing of US$76.5 million. In that year the government absorbed US$2.5 million of exchange losses on behalf of BDC. NDB has had a higher debt/equity ratio over the years except for 1995. Its foreign borrowing constitutes about 20% of total long-term borrowing, while these loans are to foreign agencies repayable over periods ranging from 15 to 30 years at interest rates varying from 1-11% per annum. Domestic borrowing constitutes loans from the government, repayable over 25 years and carrying interest rates varying from 6-9.5% per annum. In this case as well, the government carries a portion of exchange losses.

- **Lesotho:** LADB has had a relatively low debt/equity ratio up till 1985, after which it has doubled each year to amount to 447% in 1990, indicating a disconcerting build-up of unsustainably high leverage, resulting in an increasingly unstable capital structure. LNDC has had a relatively stable capital structure up till 1993 after which the debt/equity ratio increased to 138% in 1994 and fell to 119% in 1995. Foreign loans amounted to US$10.8 million or about 30% of total borrowing, on which an undisclosed portion of foreign exchange risk is carried by government.

- **Malawi:** For 1994 and 1995, the MDC had a relatively low debt/equity ratio, with about 60% (US$6 million) of its long-term debt exposing it or its government to exchange risks. Indefund has had a highly unstable capital structure over the years with a debt/equity ratio of more than 300% and reaching more than 600% in two of the 10 years under review. In 1996 about 10% (US$0.4 million) of long-term borrowing was from foreign sources. Huge losses eroded the capital base of MIDCOR in 1992 and 1993. Its business has had to be sustained by government grants and a relatively high volume of borrowings from domestic sources. SEDOM has had an unstable capital structure (as measured by its debt/equity) ratio over the entire period of review, although the growth in borrowings has generally been less than the growth in shareholders equity since 1989.

- **Mauritius:** The debt/equity ratio of DBM has been high but declining since 1991 due to growth in shareholders equity and a decline in borrowing. An increase in borrowing of US$6.2 million in 1996 contributed to total borrowings of US$79.2 million. Foreign

borrowing amounted to US$31.7 million of the total. In 1996 MDC negotiated with government indemnity for a forex loss of US$9.5 million on its borrowings.

- **Namibia:** All DFIs in Namibia have a relatively low debt/equity ratio and borrowings are all from domestic sources.

- **South Africa:** Between 1992-96 DBSA's debt/equity ratio indicated a stable financial structure. Growth in borrowing exceeded growth in shareholders equity to a significant extent only in 1997. Foreign borrowing amounted to 20% (US$138 million) of total borrowing (US$702 million). Foreign liabilities are fully covered forward or hedged by the SA government. The IDC also had a relatively stable capital structure and low debt/equity ratio. Long-term borrowings amounted to US$1 078 million in 1996 of which US$1 011 million (94%) was from foreign sources. The same government policy applies regarding forward cover and hedging to these foreign loans. LAB borrows only on the domestic capital market,and has had a much higher debt/equity ratio than the DBSA and IDC.

- **Swaziland:** SDSB had a relatively unstable capital structure with foreign borrowing amounting to 75% (US$5.7 million) of the total. Foreign borrowing is mainly by the Swaziland government, which on-lends to SDSB. SIDC had a relatively stable, if somewhat high, debt/equity ratio from 1989-1995 except for 1992 when this ratio was about 170%. Total long-term borrowing amounted to US$9.7 million in 1995, the sources of which remain undisclosed.

- **Tanzania:** TIB's debt/equity ratio declined dramatically since 1988 to a low of 2.24% in 1995, partly due to a steady repayment of loans and no new borrowing. In 1995 total long-term borrowing amounted to US$0.3 million of which foreign borrowing was US$0.19 million.

- **Zambia:** DBZ had a very unstable capital structure reflected by high and varying debt/equity ratios from 1985 to 1995. Total long-term borrowing amounted to US$48.6 million in 1993 of which foreign borrowing amounted to US$48.3 million. Taking into account the Kwacha's dramatic devaluation, it is clear that the DBZ exposed itself and/or its government to severe foreign exchange risks.

- **Zimbabwe:** ZDB had a high debt/equity ratio of 327% and 291% in 1995 and 1996 respectively. Total borrowing amounted to US$46 million in 1996, somewhat lower than the US$49.9 million borrowed in 1995. Amounts of foreign borrowing were not disclosed. Exchange risks were borne by the Bank. IDCZ had a low debt/equity ratio between 1992-1996. It declined further to 10.8% in 1996 due to a steady repayment of loans. Total borrowing amounted to US$7.3 million in 1996 of which US$2.9 million was in foreign currencies. A small portion of foreign loans has been guaranteed by the government and exchange losses are considered on the IDCZ's own account. SEDCO had a relatively low debt/equity ratio with total borrowings amounting to US$4.7 million in 1995 (from a World Bank loan).

6.39 Most DFIs in SADC have high debt/equity ratios contributing to instability of their capital structures. The situation is aggravated by foreign borrowings on which most of the institutions (except in SA and Mauritius) seem to carry some portion of the exchange risk. However, with a few exceptions, all foreign loans are guaranteed by the respective governments, which, in the event of default by the DFI, would ultimately have to bear the foreign exchange risks that actually materialised.

6.40 The composition of assets and liabilities - i.e. the balance sheet structure of DFIs - has a substantial impact on the level of earnings and their volatility, on liquidity and risk exposure. Unlike manufacturing or other production-oriented institutions, which use external products or commodities to produce yields from assets in their balance sheets, a DFI is almost entirely dependent on its balance sheet assets to generate earnings. Similarly its most significant costs arise from the liabilities in its balance sheet. DFIs have to generate adequate net financial returns with acceptable levels of interest rate risk and liquidity risk. For them to do so, gross returns and net yields on major classes of loans and investments (as well as the costs associated with each) must be known to enable planning of their broad borrowing and lending programmes. However, interest rate risk is not easily discernible from information contained in the DFIs' annual reports, although some do provide information on the maturity structure of borrowings. In order to give some indication of security of income, the interest cover ratio has been calculated. As shown in Table 6.B, a number of institutions have a very low interest cover ratio, and might thus be perceived as high risk borrowers by potential lenders. These include the LADB, MIDCOR, the Development Bank of Mauritius, the NDC, the DBSA, the LAB, the SDSB and the Development Bank of Zambia for which this ratio is highly unstable.

6.41 In mature capital markets, ***liquidity management*** by financial institutions involves allocating funds among various asset categories and carrying sufficient cash balances to ensure enough liquidity to meet maturing obligations while maximising income from liquid investments. In less mature capital markets with fewer and insufficiently liquid financial instruments for investing cash resources, incremental liquidity is often provided by government or special credit lines or by issuance of government guarantees to lenders to support liquidity. In any analysis of a DFI's financial performance, the current asset ratio indicates the ability of the institution to meet its current liabilities out of its current assets in the short term. That ratio is often used as a crude and partial proxy indicator of the effectiveness of liquidity management. When the quality of assets is lower than that reflected in DFIs' financial statements, this indicator signals a more favourable impression of liquidity management than might actually be the case. Against this ratio (see Tables 6.C to 6.Z), a number of DFIs seem to be particularly illiquid, namely the LNDC, MIDCOR, the Development Bank of Mauritius, the Namibia Agricultural Bank, the LAB, the SDSB, the Zambian Development Bank, and the IDCZ.

6.42 DFIs are not generally profit-maximising institutions. Nevertheless they need to generate sufficient **net earnings** to: (i) assure financial self-sustainability and growth; (ii) maintain capital adequacy by building up retained earnings; and (iii) assure steadily increasing access to markets for both debt and equity. Three ratios provide an indication of earnings performance, *viz*. return-on-equity, return-on-total assets and return-on-resources employed. DFIs in SADC for which all three these ratios seem to be particularly low include: the LADB, MIDCOR, the Development Bank of Mauritius, the NDC, the DBSA, the SDSB, the Development Bank of Zambia, and SEDCO.

6.43 Part of the explanation for relatively poor earnings performance lies in inadequate risk management. Earnings are also adversely affected by inflation and by government policies setting interest rate ceilings, requiring degrees of concessionality, directing lending and investment, labour and tax laws, etc. Concessional lending could explain the poor earnings performance of DBM and DBSA. But poor earnings are also the result of inadequate cost control and inefficiency. A crude indicator of efficiency is the operating expenditure to loan disbursements ratio. Using this ratio a number of DFIs show up as inefficient, including: the Botswana NDB (incurring a cost of 44 units for every 100 units disbursed), Indefund, MIDCOR, and the TIB. As far as the TIB is concerned, it should be kept in mind that it suspended its term financing operations in 1994. Nevertheless, it seems to have chosen to retain its staff complement and facilities in an effort to redirect its focus to other financial services.

Conclusions

6.44 Development finance and DFIs will remain an important part of the financial landscape in SADC for the foreseeable future because financial systems in most SADC countries remain underdeveloped. In such systems, DFIs are indispensable for offering a range of financial and other services to stimulate industrialisation. They are also important in ensuring that the needs of other sectors such as agriculture, housing and small and informal enterprises are addressed. The processes of economic and financial sector liberalisation taking place in all SADC countries have had a profound detrimental impact on the financial position and performance of extant DFIs in SADC. Yet, in the absence of capable capital markets in these countries, liberalisation programmes have been remiss in failing to emphasise the continued importance of DFIs and in indicating how their institutional structure, roles, functions, processes and financial products need to be revamped and adjusted to meet the challenges that structural reforms have created.

6.45 Most national DFIs in SADC have not escaped the difficulties associated with adverse macroeconomic environments and changing economic regimes. Nor have they corrected quickly enough their inappropriate structures, processes and procedures. They remain too dependent on financing from regional and global MDBs. They lack sufficient institutional capacity caused by a shortage of appropriate human resources and management capacity. They also suffer from being bound to politically mandated functions that do not have sufficient respect for commercial and financial viability. Subsidies on the cost of funds on-lent by DFIs, directed credit, and exchange risks, together with substantial losses on non-performing assets, have been straining some governments' budgets to keep national DFIs liquid and solvent. That, in turn, has compromised efforts to achieve monetary and fiscal control. In all these respects they are no different (except in a handful of countries) to their counterparts in the rest of Africa.

6.46 In order for DFIs in SADC to achieve financial self-reliance and limit future fiscal exposure, financial reparation in terms of re-capitalisation and providing for bad debts should be complemented by the introduction of proper financial management systems and the right operational priorities. This should include appropriate prudential regulations and their enforcement. That would go some way in restoring much-needed credibility in DFIs. Most importantly, DFIs in SADC need to become more market-oriented, market-sensitive and market-responsive in targeting and addressing those risks which private commercial sources of finance are unwilling to contemplate taking for the time being. They need to expand their shareholder base as well as their domestic and foreign sources for resource mobilisation with a view to transforming themselves in an orderly manner from being DFIs dependent on public largesse to becoming full service, investment or universal banks within a conscionable period of time.

Insert Box 6A here on an A3 fold out page and compare with original Excel format

Insert Tables 6C-6ZC (Xcel file) from here

BOX 6.A - A3 page